Annual Report 2007

Green Energy

Hydro Québec

HYDRO-QUÉBEC generates, transmits and distributes electricity. Its sole shareholder is the Québec government. Using mainly renewable generating options, in particular hydroelectricity, it supports the development of wind energy through purchases from independent power producers. It also conducts research in energy-related fields such as energy efficiency.

The company comprises four divisions:

Hydro-Québec Production generates power for the Québec market and sells its surpluses on wholesale markets. It is also active in arbitraging and purchase/resale transactions.

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

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

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

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On the cover
Péribonka hydroelectric development

Photo opposite
Engineer Annie Rousseau inside a Francis turbine, Péribonka generating station

By developing Québec's hydropower potential, Hydro-Québec demonstrates its commitment to sustainability and helps ensure a secure energy future for all Quebecers. Hydropower is a green, renewable generating option that provides great operating flexibility. To conserve this valuable commodity, Hydro-Québec offers customers an attractive range of energy efficiency programs. And we are turning increasingly to wind power as a complementary source of energy. Our employees whole-heartedly embrace the principles of sustainable development and work tirelessly to protect the environment for today and for tomorrow.

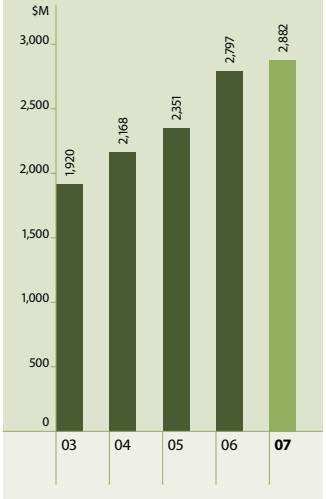
Green Energy

Hydro-Québec at a Glance

	2007	2006
Operations and Dividends ($M)		
Revenue	**12,330**	11,161
Operating income	**5,394**	5,009
Income from continuing operations	**2,882**	2,797
Income from discontinued operations	**25**	944
Net income	**2,907**	3,741
Dividends declared	**2,095**	2,342
Balance Sheets ($M)		
Total assets	**64,852**	63,254
Long-term debt, including current portion and perpetual debt	**34,534**	34,427
Equity	**20,892**	18,840
Cash Flows ($M)		
Operating activities	**5,159**	4,005
Investing activities	**(3,406)**	(4,275)
Financing activities	**(1,744)**	183
Cash flows from discontinued operations	**2**	52
Cash and cash equivalents	**54**	57
Ratios (%)		
Return on equity	**15.0**	20.6
Profit margin from continuing operations	**23.4**	25.1
Capitalization	**37.5**	36.1
Self-financing	**61.9**	86.5

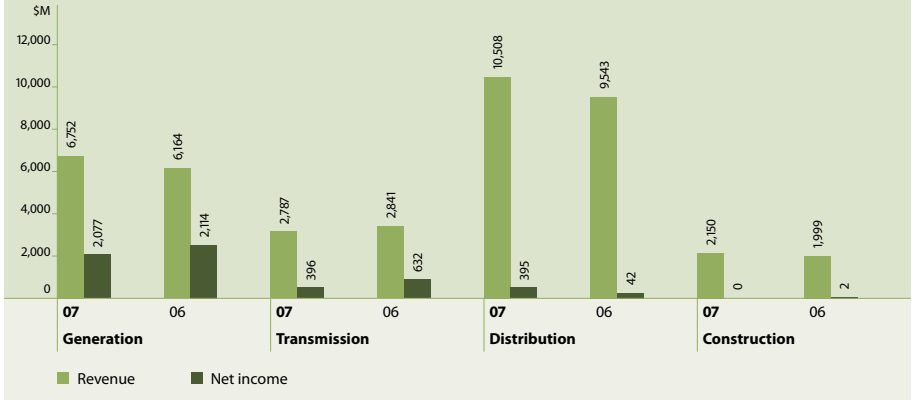
Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

Income from Continuing Operations

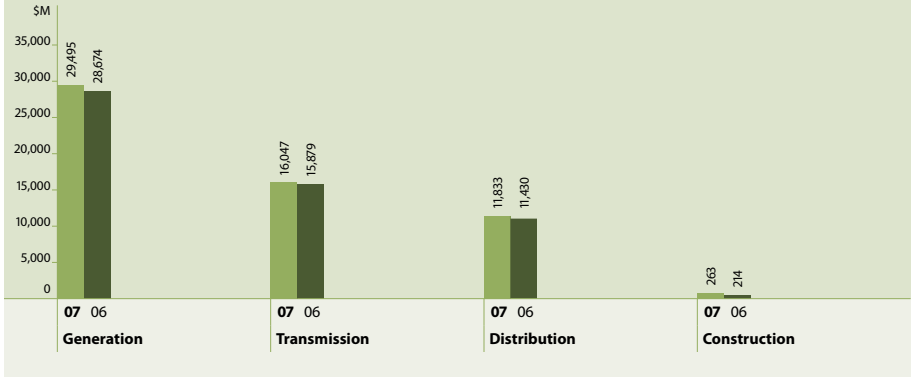


Income from continuing operations reached $2.9 billion, compared with $2.8 billion in 2006, when a non-recurring foreign exchange gain of $234 million was recognized. This growth is mainly due to a $290-million increase in net electricity exports.

Revenue and Net Income by Segment



Total Assets by Segment



Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

	2007	2006	2005	2004	2003
Customers and Sales					
Total customer accounts in Québec	**3,868,972**	3,815,126	3,752,510	3,701,275	3,644,463
Electricity sales in Québec (TWh)	**173.2**	167.3	169.2	165.9	167.1
Electricity sales outside Québec (TWh)	**19.6**	14.5	15.3	14.4	15.8
Number of Employees[a]					
Permanent as at December 31	**19,459**	19,116	19,009	18,835	18,317
Temporary (year's average)	**3,910**	3,799	3,577	3,567	3,596
Facilities					
Number of hydroelectric generating stations	**57**	55	54	53	52
Total installed capacity (MW)[b]	**35,647**	35,315	34,571	33,892	33,616
Peak power demand in Québec (MW)[c]	**35,352**	36,251	33,636	34,956	36,268
Lines (overhead and underground)					
Transmission (km)	**33,008**	32,826	32,544	32,487	32,434
Distribution (km)[d]	**109,618**	108,883	108,344	107,423	106,568
Number of transmission substations	**509**	508	505	506	506
Power Generation and Purchases					
Renewables (GWh)	**192,011**	182,368	183,399	175,704	180,556
All generating sources (GWh)	**206,012**	194,225	192,862	188,269	191,841
Proportion of renewables (%)	**93**	94	95	93	94

a) Excludes employees of subsidiaries and joint ventures.

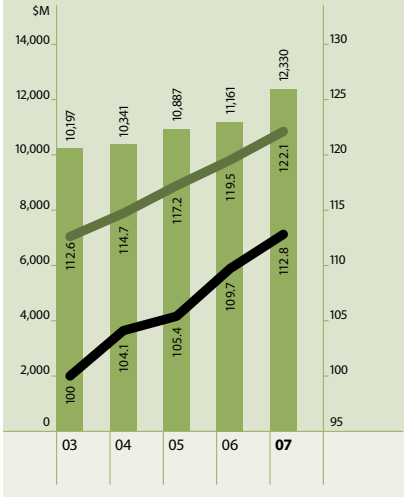
b) Hydro-Québec also has access to almost all the output from Churchill Falls (5,428 MW) and purchases all the output from seven privately owned wind farms with a total installed capacity of 420 MW. In addition, 1,222 MW are available under agreements with other independent suppliers.

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

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

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

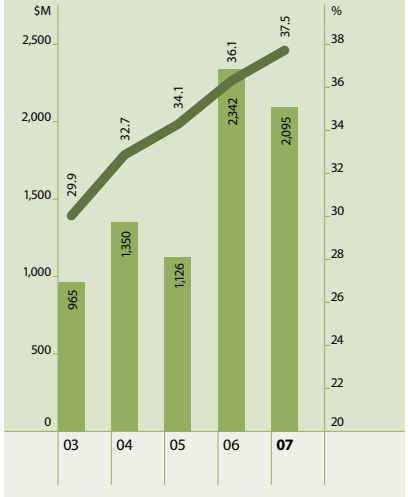
Revenue, Average Rate Increase Index and Consumer Price Index



- Revenue
- Average rate increase index (1998 = 100)
- Consumer Price Index (1998 = 100)

Revenue totaled $12.3 billion, up 11% over 2006 due to electricity sale increases of $966 million in Québec and $468 million outside Québec. Other revenue was down $265 million, mainly because of the recognition in 2006 of a non-recurring foreign exchange gain of $234 million on debts and swaps denominated in U.S. dollars.

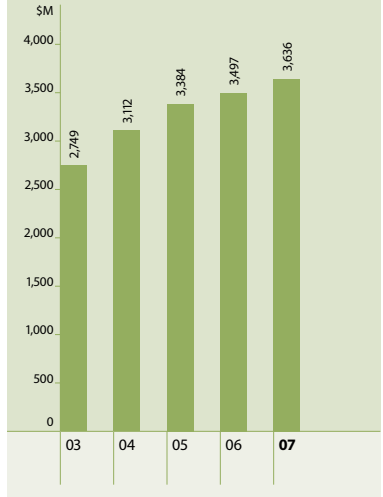
Dividends Declared and Capitalization



- Dividends declared
- Capitalization

Dividends declared from 2003 to 2007 total $7.9 billion.

Investments in Property, Plant and Equipment, Intangible Assets and the EEP[a]



Cash from operations amounted to $5.2 billion. This enabled us to pay the dividends of $2,342 million declared in 2006 and to finance a large portion of our investments ($3.6 billion).

a) EEP: Energy Efficiency Plan

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

Message from the Chairman of the Board

"Hydro-Québec's results are a testament to the quality of its management and the unconditional commitment of all its employees."

Michael L. Turcotte
Chairman of the Board

A Year of Major Achievements

Hydro-Québec's remarkable performance in 2007 is the fruit of rigorous management and the concerted effort and focus of all our employees on the company's business objectives. In light of the year's achievements and Thierry Vandal's leadership over the past few years, the Board of Directors recommended that he be reappointed to the position of President and Chief Executive Officer. Consequently, the Québec government renewed Mr. Vandal's mandate for five years.

In 2007, the Board greenlighted the startup of several major projects, including Eastmain-1-A/Sarcelle/Rupert, construction of Vaudreuil-Soulanges substation, and reinforcement of the future 1,250-MW interconnection with Ontario.

The Board continued to implement measures to satisfy the requirements of the *Act respecting the governance of state-owned enterprises,* which came into force in December 2006. In particular, it updated the rules of corporate governance for the conduct of the company's business, approved a financial disclosure policy and adopted expertise and experience profiles to be used in appointing Board members. As well, it updated some of its bylaws and undertook to assess its internal workings.

The Board of Directors also reorganized its committees and updated their mandates. As a result, it now has seven committees. In addition to the three committees required by law—Audit, Ethics and Corporate Governance, and Human Resources—we have the Executive Committee, Finance Committee, Environment and Public Affairs Committee, and Pension Plan Financial Management Committee. The members of each committee were appointed based on their experience and areas of expertise.

In 2007, four directors left the Board, namely Joseph Benarrosh, Andrée Corriveau, Norman E. Hébert Jr. and Paul Larocque. We gained five new members: Carl Cassista, Suzanne Gouin, Nathalie Le Prohon, Emmanuel Triassi and Gilles Vaillancourt. In addition to the Chairman and the President and Chief Executive Officer, the Board is made up of 15 members from a variety of backgrounds whose role is to advise and support the company in deciding on and working towards its strategic objectives. They all demonstrate exemplary dedication, and I thank them for their invaluable input.

Michael L. Turcotte
Chairman of the Board

Continuous Improvement

Hydro-Québec recorded $2,882 million in income from continuing operations in 2007, up $85 million from the previous year's $2,797 million. The increase in net electricity exports is responsible for most of this growth. Income from discontinued operations yielded $25 million, bringing net income to $2,907 million. These results will enable us to pay dividends of $2,095 million to our shareholder, the Québec government.

Our commitment to sustainable development

We apply the principles of sustainable development in all our activities—a paramount commitment that is demonstrated through our values, our policies and our practices. Ongoing development of Québec's hydropower potential and the integration of wind power into our system are just two examples of the clear position we have taken in favor of green, renewable energy sources.

Our expanding hydroelectric fleet

In the past year, we reached several major milestones in our mission to harness the province's hydropower potential. On January 11, we launched construction at Eastmain-1-A/Sarcelle/Rupert, in the James Bay region. This project of the decade will add 8.5 TWh to our annual hydroelectric output. In September, the fifth and final generating unit at Mercier, in the Outaouais region, went into operation. Then, in November, we started up the first unit at Péribonka, in the Saguenay–Lac-Saint-Jean region. Work also proceeded all year on the Chute-Allard and Rapides-des-Cœurs developments, on the St-Maurice River. Never before has Hydro-Québec simultaneously carried out so many projects on such a large scale and in so many different regions.

The complementary role of wind power

The contribution of wind power to the resource plan was enhanced in 2007 with the commissioning of the 100.5-MW L'Anse-à-Valleau facility in November. This is the second of eight wind farms slated for construction in the Gaspé region by the end of 2012 under agreements signed with private companies for the supply of 990 MW of wind power. In September, following the closing of the 2005 tender call for an additional 2,000 MW, we received 66 bids from 30 proponents for a total of 7,724 MW. The contracts, which are to be awarded in 2008, stipulate that a minimum of 60% of the total cost of each wind farm must be incurred in Québec, and at least 30% of the cost of the wind turbines must be spent in the regional county municipality of Matane or the administrative region composed of the Gaspé Peninsula and the Magdalen Islands. Hydro-Québec has also undertaken to promote projects that will contribute to the development of local and Aboriginal communities and will encourage their participation.

Our fast-growing transmission system

We stepped up work at Outaouais substation, a cornerstone of the new, 1,250-MW interconnection with Ontario that got off the ground in late 2006. We also brought three new generating stations onto the grid and finished upgrading the Matapédia regional grid in preparation for integrating the output of all the wind farms planned in the Gaspé region. Altogether, we invested $338 million in developing the transmission system in 2007. We spent an additional $440 million on projects designed to ensure system reliability and long-term operability.

"The strategies we have adopted are in keeping with the goal of sustainable development and will secure the energy future of Québec."

Thierry Vandal
President and Chief Executive Officer

Tangible results in energy efficiency

Our energy efficiency programs continue to win favor in all our customer categories. As a result, we surpassed our objectives for the fourth year in a row by posting energy savings of 866 GWh in 2007. This brings to 2.3 TWh the total annual savings achieved since the Energy Efficiency Plan was launched in 2003. We are therefore confident of reaching the 4.7-TWh target set for 2010. It bears repeating that every kilowatthour saved represents a gain both for the environment and for our customers.

Customer satisfaction: Our constant priority

According to a customer satisfaction study by J.D. Power and Associates targeting residential customers of Canadian electric utilities, Hydro-Québec ranked highest among large utilities in 2007. Our own surveys showed that the satisfaction indexes for all our customer categories were up. To increase our efficiency and keep on improving our performance in response to customer expectations, we rolled out the residential portion of the new Customer Information System in January 2008.

Ongoing activity

In 2007, Hydro-Québec Équipement and Société d'énergie de la Baie James launched, continued or completed approximately 250 projects or draft-design studies for building, rehabilitating or refitting generating stations. At the same time, Hydro-Québec Équipement worked on more than 700 projects involving the transmission system. In all, the volume of activity totaled $2,150 million. Outstandingly rigorous project management allowed several facilities to be commissioned ahead of schedule.

Spinoffs of technological innovation

The development and integration of new technologies are key to the performance of our facilities. That is why we place so much emphasis on innovation. In 2007, our research institute worked on a hundred or so innovation projects under mandates assigned to it by the divisions.

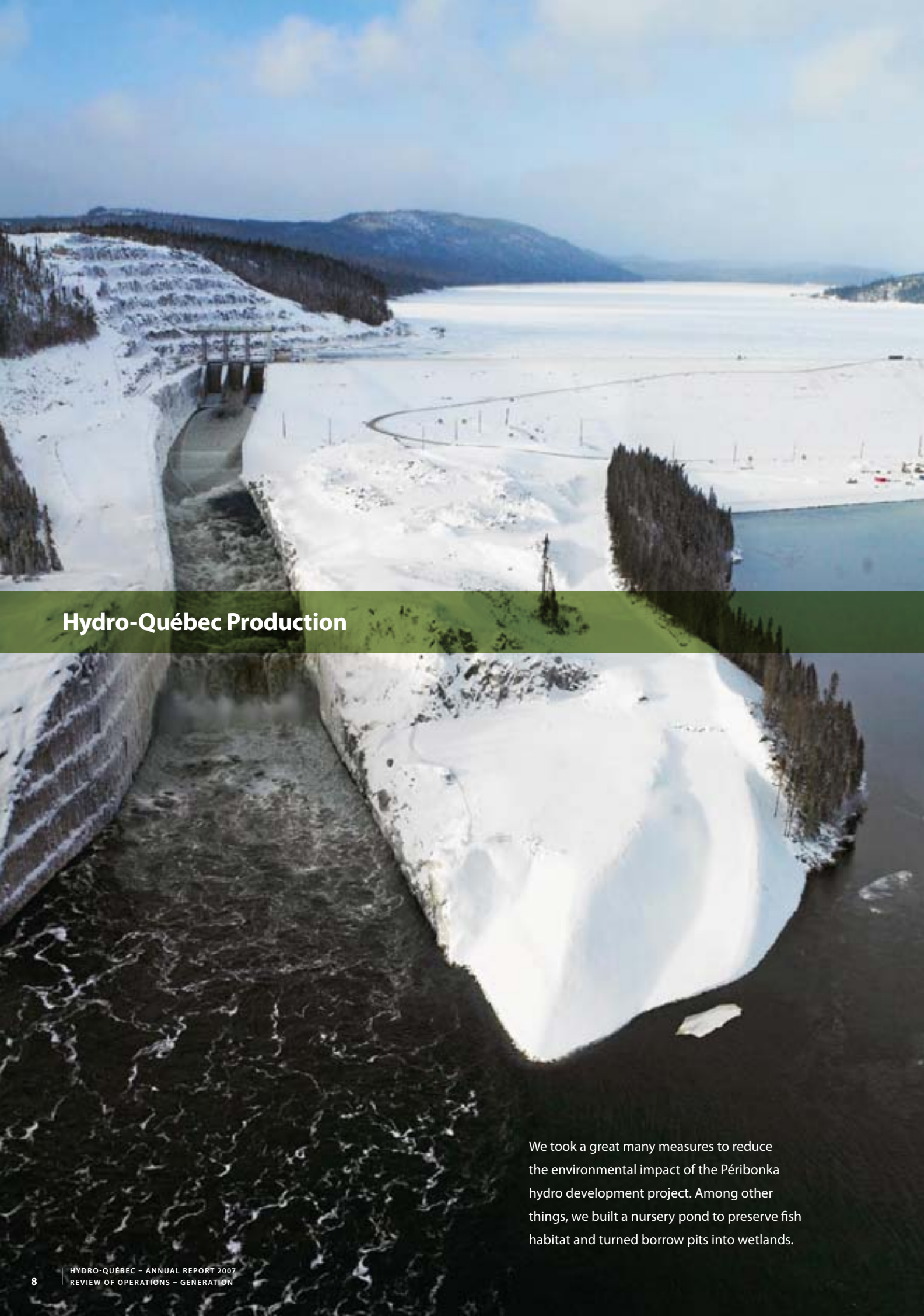
Shared success

Hydro-Québec, which plays a leading role in the Québec economy, bolstered its position in 2007 through the expansion of its generating fleet, the success of its energy efficiency programs, and considerable effort invested in developing, reinforcing and modernizing the transmission and distribution systems. Above all, however, our outstanding performance is due to the remarkable efforts of our employees. Thanks to continued healthy and constructive labor relations and to a highly motivated workforce, we have progressed steadily toward the achievement of our objectives. We owe a debt of gratitude to these energetic men and women who, day after day, put their skills to work serving our customers.

We also wish thank the members of the Board of Directors for their crucial contribution to our success.

Thierry Vandal
President and Chief Executive Officer

Hydro-Québec Production



We took a great many measures to reduce the environmental impact of the Péribonka hydro development project. Among other things, we built a nursery pond to preserve fish habitat and turned borrow pits into wetlands.

Hydropower: The Key to Our Development

Hydro-Québec Production's performance in 2007 was remarkable in many ways. Through the tireless exertions of our employees and partners, we reached some major milestones in the development of the province's hydropower potential. Among the highlights, we broke ground at Eastmain-1-A/Sarcelle/Rupert—Québec's hydroelectric project of the decade—commissioned Mercier generating station and started up the first unit at Péribonka. In addition, four years of determined efforts by a large team of specialists culminated in the completion of the environmental impact assessment for the Romaine complex.

At the same time, we proceeded with a number of rehabilitation projects and kept up our programs of rigorous periodic maintenance designed to optimize our output. Careful management of energy reserves enabled us to increase our net electricity exports. We also paid the Québec government $263 million in water-power royalties and posted net income of $2,077 million.

OUR MISSION Hydro-Québec Production generates electricity to supply the domestic market and sells its excess output on wholesale markets. We also offer balancing and firming capacity services to Hydro-Québec Distribution to offset fluctuations in wind farm output and thereby facilitate the integration of this energy source.

OUR FACILITIES Our generating fleet comprises 56 hydroelectric generating stations, 1 nuclear generating station, 4 conventional thermal generating stations and 1 wind farm, representing assets worth $24.7 billion and total installed capacity of 35.5 GW. We also have 26 large reservoirs with a storage capacity of 175 TWh, and more than 565 dams and control structures.

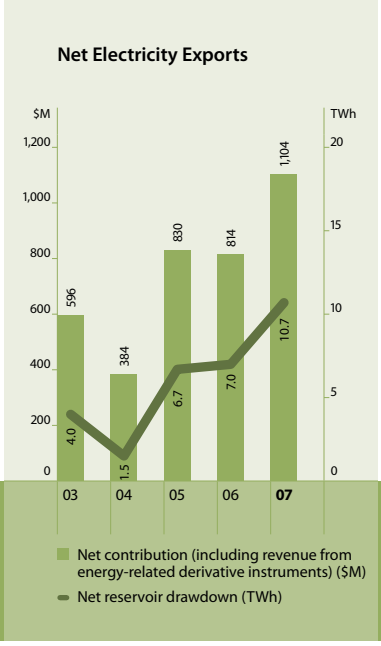
OUR ACTIVITIES We supply Hydro-Québec Distribution with a heritage pool of 165 TWh of electricity per year at 2.79¢/kWh. Above this volume, we sell our output on the free market inside and outside Québec, in response to calls for tender or short-term needs.

2007 IN FIGURES

Revenue	$6.8 billion
Net income	$2.1 billion
Customers (% of revenue from electricity sales)	
Hydro-Québec Distribution	77%
Other	23%
Sales volume	
Hydro-Québec Distribution	171.5 TWh
Other	17.5 TWh
Property, plant and equipment as at December 31 (including work in progress)	$28.6 billion
Investments (property, plant and equipment, and intangible assets)	$1.8 billion

"Our employees' competence makes us ever more efficient."

Richard Cacchione
President, Hydro-Québec Production



Mercier generating station, in the Outaouais region.

Making the most of our energy

We constantly strive to optimize our generating facilities' output. Any surplus over the heritage pool set aside for the domestic market is therefore sold on the open market at the best possible terms. The flexibility afforded by our fleet of hydroelectric generating stations also allows us to import electricity when prices on external markets are low and export it when prices are high.

▸ Hydro-Québec Production recorded net income of $2,077 million in 2007, down from $2,114 million in 2006. Had it not been for the 2006 recognition of a $234-million non-recurring foreign exchange gain on debts and swaps denominated in U.S. dollars, net income for 2007 would have risen on the strength of higher net electricity exports. However, this increase was partially offset by the payment of water-power royalties.

In 2007, net exports by Hydro-Québec Production represented only 5.6% of sales volume, but generated 25% of the company's income from continuing operations.

▸ The volume of electricity sales to Hydro-Québec Distribution totaled 171.5 TWh, versus 165.1 TWh in 2006. Net income arising from the 165-TWh heritage pool was $1,181 million, while income from deliveries of baseload and cycling capacity (4.1 TWh) starting March 1, 2007, amounted to $122 million. Net results from spot transactions with Hydro-Québec Distribution and other trading totaled $41 million.

▸ Sales outside Québec generated $1,483 million for 17.5 TWh, up from $1,149 million for 14.5 TWh in 2006. Net electricity exports and the related financial transactions yielded $1,104 million for net reservoir drawdown of 10.7 TWh—a unit contribution of 10.3¢/kWh—compared with $814 million and drawdown of 7.0 TWh in 2006. The increase in revenue is mainly attributable to the higher volume of sales and, to a lesser extent, favorable market conditions. Net electricity exports and related transactions, less generating, procurement and transmission costs, yielded net income of $733 million, up from $564 million in 2006.

▸ As at December 31, 2007, our energy reserves corresponded to 116.6 TWh, compared with 114.3 TWh in 2006. After managing our reserves carefully for the first eight months of the year, we were able to increase net exports by year end thanks to heavy precipitation in the James Bay region in September.

▸ We operate our facilities in such a way as to maintain a sufficient energy reserve at all times to offset a potential runoff deficit equivalent to 64 TWh over two consecutive years and 98 TWh over four consecutive years. To comply with the industry's current reliability criteria, we also keep a capacity reserve approximately 9% higher than our contract commitments.

▸ Under the terms of an agreement for integrating the wind power that Hydro-Québec Distribution purchases from independent suppliers, we offer the division

- a balancing service to mitigate the impact of hourly variations in the quantity of wind power carried on the Hydro-Québec TransÉnergie system, and
- firming capacity equal to 35% of the contractual capacity of the wind farms in commercial operation.

The average cost of a kilowatthour in 2007 was 2.1¢. This corresponds to the sum of our generating and procurement costs divided by the net sales volume.

Thierry Vandal, President and Chief Executive Officer, and Jean Charest, Premier of Québec, at the inauguration of Péribonka generating station. In the background, Claude Béchard, Québec Minister of Natural Resources and Wildlife.

The Rapides-des-Cœurs development, under construction in the upper Mauricie region.

Continuing to expand our generating fleet

Following the completion of Sainte-Marguerite-3 and Rocher-de-Grand-Mère generating stations in 2004, Toulnustouc in 2005 and Eastmain-1 in 2006, this past year saw the commissioning of the Mercier facility and the first generating unit at Péribonka.

To meet Québec's electricity needs, we are continuing to develop hydropower, a green, renewable energy.

- The commissioning of the $176-million Mercier generating station in the Outaouais region added 51 MW to our installed capacity and 0.3 TWh to our annual output.
- The first generating unit at Péribonka, in the Saguenay–Lac-Saint-Jean region, came on stream in November. Once all three units are in operation, the plant will have installed capacity of 385 MW and annual output of 2.2 TWh. The total cost of the project is $1.4 billion.
- The Chute-Allard and Rapides-des-Cœurs developments on the Saint-Maurice River are close to completion. Commissioning will begin in spring 2008 and will continue over the next year. The two generating stations will have a combined capacity of 139 MW and annual output of 0.9 TWh, for a total cost of $960 million.
- After securing the necessary government approvals, we launched construction of the Eastmain-1-A/Sarcelle/Rupert project in the James Bay region. The cost of work is estimated at $5.0 billion, making it Québec's hydroelectric project of the decade. It consists in building two generating stations and diverting some of the water from the Rupert River into Eastmain 1 reservoir and from there to the lower Grande Rivière, where the output of three existing powerhouses will be increased by the additional flow. Once completed, it will add 893 MW to our fleet and will have an annual output of 8.5 TWh. The various project components will go into operation in stages from the end of 2009 to winter 2012.

We use water to generate 97% of our output.

- On the North Shore, Sainte-Marguerite-3 generating station has been operating at its full 884-MW capacity since fall 2007. Following work carried out by the manufacturer, Unit No. 2 was available for the 2007–2008 winter peak.
- The environmental impact assessment for the Romaine hydropower complex was tabled with the competent authorities in January 2008. Hundreds of engineers, scientists and local stakeholders, including Innu community members who shared their traditional knowledge, labored for four years to produce this 2,500-page study, complemented by 50 background reports. The estimated $6.5-billion project calls for four generating stations with a total installed capacity of 1,550 MW and annual

The Rupert spillway being built in the James Bay region.

Rehabilitation at Rivière-des-Prairies generating station in Montréal.

output of 8.0 TWh to be developed on the Romaine River in the Mingan area. If construction gets under way in summer 2009, commissioning of the facilities should begin in late 2014 and be completed by the end of 2020.

- We continued preliminary studies with a view to building a 1,550-MW complex on the Petit Mécatina River, about 300 km east of the Romaine River. This initial phase, scheduled to end in spring 2008, will allow us to determine the development's configuration and cost.

- All our hydroelectric projects comply with three fundamental criteria: they must be profitable, environmentally acceptable and favorably received by the communities concerned.

Ensuring long-term operability

In 2007, we invested $403 million in rehabilitating our facilities to ensure their long-term operability and, in some cases, to increase their generating capacity. To optimize our fleet, we need to know its condition and its uprating potential. Our employees' expertise and commitment play a crucial role in this regard.

- Refitting of Outardes-4 generating station in the Manicouagan region made steady progress. This operation has yielded additional capacity of 42 MW to date.

- Ongoing rehabilitation at Beauharnois in the Montérégie region will add approximately 200 GWh in annual output once the work is completed in 2016.

- In the Mauricie region, phase II of the La Tuque rehabilitation continued with the commissioning of a first generating unit that added 21 MW to the station's peak capacity.

- Refurbishing at Rivière-des-Prairies generating station in Montréal moved ahead, while major work is nearly finished at Rapide-2, Rapide-7 and Rapides-des-Quinze in the Témiscamingue region.

- Rehabilitation also progressed at Mercier dam (Outaouais region), Coteau-1, Coteau-3 and Île-Juillet dams (Montérégie), and Melville dam in the Shawinigan complex (Mauricie).

- After we obtained the necessary approvals from the Canadian Nuclear Safety Commission and the Québec government, phase I of the modification of the solid radioactive waste storage facilities at Gentilly-2 generating station commenced in July 2007. Draft-design studies on refurbishing the plant are under way, and we will decide in 2008 whether to proceed with the project.

Hydro-Québec Production operates a fleet of 62 generating stations with a total installed capacity of 35.5 GW.

Rehabilitation of Melville dam in the Shawinigan complex, Mauricie region.

Dominic Rivard (right) of Gentilly-2 receiving the Jean-Jacques-Archambault Award of the Institute of Electrical and Electronics Engineers Canada. He is accompanied by Robert A. Hanna, then president of IEEE Canada.

Improving generation through innovation

The work we carried out with our research institute in 2007 is part of a portfolio of 25 projects worth a total of almost $18 million.

▸ Some of our efforts focused on hydroelectric generating station alternators. For example, the MIDA diagnostic tool, which rates alternators on the basis of their degree of wear, has now reached the technology transfer phase. The goal of another project, known as AUPALE, is to model thermal and mechanical behavior in order to determine when alternator capacity needs to be increased.

▸ In preparation for the possible refurbishment of Gentilly-2, we developed a set of tools and a model for mechanizing the dismantling of the plant's reactor feed pipes. The model is intended to facilitate and speed up refurbishment and increase worker safety.

▸ Several innovation projects got off the ground in 2007. One of them concerns a method for locating water infiltrations in dams, and another involves evaluating ice pressure on hydraulic structures.

Technological innovation helps us optimize our generating facilities.

Hydro-Québec TransÉnergie

Montréal telecontrol centre. All our telecontrol centres are now equipped with GEN-4 SCADA (supervisory control and data acquisition), which offers greater flexibility in managing the transmission system.

A Reliable, Fast-Growing System

In 2007, we focused considerable resources on developing the transmission system in order to integrate the output of new facilities and increase energy interchanges with Ontario. At the same time, we embarked on major initiatives to optimize system reliability and ensure the long-term operability of our assets. We were able to reach our objectives thanks to the unqualified support of our employees.

In August, the Régie de l'énergie designated our Direction du contrôle des mouvements d'énergie (System Control) as Reliability Coordinator for Québec, thereby confirming the upcoming implementation of a new regime of mandatory reliability standards in the province.

To meet the many challenges facing us in the coming years, we are intensifying our efforts to ensure that our employees' specialized, multidisciplinary knowledge is not lost. We will achieve this goal by facilitating the transmission of knowledge and relying on targeted recruitment, training and coaching strategies.

OUR MISSION Hydro-Québec TransÉnergie operates the most extensive transmission system in North America. It markets system capacity and manages power flows throughout Québec while fulfilling its primary obligation, namely to ensure system reliability. Since August 2007, our Direction du contrôle des mouvements d'énergie (System Control) has been the designated Reliability Coordinator for Québec.

OUR FACILITIES Our system comprises 33,008 km of lines and 509 substations, as well as numerous interconnections with the systems in Ontario, New Brunswick and the U.S. Northeast.

OUR ACTIVITIES In compliance with North American regulatory provisions, we ensure non-discriminatory treatment of wholesalers who want to gain access to our system.

2007 IN FIGURES

Revenue	$2.8 billion
Net income	$396 million
Customers (% of revenue)	
Hydro-Québec Distribution (native load transmission service)	91%
North American wholesalers (point-to-point transmission services)	7%
Other	2%
Property, plant and equipment as at December 31 (including work in progress)	$15.2 billion
Investments (property, plant and equipment, and intangible assets)	$778 million
Regulatory regime	Cost-based

"Our employees' expertise allows us to meet a twofold challenge: to develop the system and ensure its long-term operability."

Isabelle Courville
President, Hydro-Québec TransÉnergie

A 161-kV line connects Péribonka generating station to a substation 128 km away.

Mercier generating station is linked to the grid by a substation and a 69-kV line.

Expanding our system to meet demand

In 2007, we invested $338 million in expanding the transmission system. We connected Péribonka, Chute-Allard and Rapides-des-Cœurs generating stations to the grid and continued work to integrate the output of other hydroelectric or wind power facilities. To further increase transmission capacity, we installed additional transformers at several substations, mainly in the St. Lawrence Valley. In addition, the project to build a new, 1,250-MW interconnection with Ontario, launched in late 2006, proceeded at a rapid pace.

In 2007, we added more than 385 MW of capacity to the transmission system.

- We brought the output of Mercier generating station, in the Outaouais region, onto the grid at a total cost of $17 million.
- In the Saguenay region, we commissioned Péribonka and Simard substations, as well as the 128-km, 161-kV line that links them and connects Péribonka generating station to the grid—in all, a $171-million project.
- On the upper St-Maurice River, we completed a $105-million project for the construction of a 61-km, 230-kV line connecting Chute-Allard and Rapides-des-Cœurs generating stations to Rapide-Blanc substation.
- Construction of the 315/230-kV Outaouais substation—part of the upcoming interconnection with Ontario—made steady progress and should be completed in 2009. In January 2008, we received the final approvals required to extend a 230-kV line to Ontario; commissioning is slated for fall 2008. The substation and line will cost an estimated $440 million.
- To increase system capacity, we added transformers at Monseigneur-Émard, Sainte-Thérèse-Ouest, Baie-d'Urfé and Templeton substations, at a total cost of $46 million.
- We launched a $48-million project to build the 120/25-kV Saint-Lin substation, in the Laurentians, and the 25-km, 120-kV Paquin–Saint-Lin line.
- Near the Cree village of Wemindji, in the James Bay region, we broke ground on a 120/25-kV substation to replace the current 25-kV switching substation. This $27-million project will also add equipment at La Grande-1 substation and raise the capacity of the La Grande-1–Wemindji line.
- In the Montérégie region, we built a 6-km, 120-kV underground line between Marie-Victorin and Saint-Maxime substations, at a cost of $14 million.

Construction of Chute-Allard substation, in the upper Mauricie region.

Outaouais substation under construction near the Ontario border.

Maintaining system reliability

Alongside our initiatives to develop the transmission grid, we devote considerable resources to ensuring system reliability and long-term operability. We invested $440 million in 2007 to maintain and upgrade facilities, roll out state-of-the-art technologies and comply with the regulatory requirements of operating a transmission system.

- The average number of hours of service interruption per customer fell from 0.54 in 2006 to 0.49 in 2007—significantly better than our target of 0.60 hours per year.
- We had no difficulty handling the 2007–2008 winter peak load of 35,352 MW, which occurred on January 21, 2008, at 8 a.m.
- The 20-km, 120-kV Kingsey–Arthabaska line went into operation. Built at a cost of $16 million, this double-circuit line on steel towers replaces two single-circuit lines carried on wooden H-frames.

Preserving the service quality and reliability we are known for is a constant concern.

- At Lévis substation, we began tests prior to commissioning de-icing equipment that will improve system reliability in winter. We also finished reinforcing 567 km of strategic lines that supply the Québec City, Chaudière-Appalaches, North Shore, Lower St. Lawrence and Eastern Townships regions.
- The $52-million refurbishment of Sorel substation got under way.
- At Hauterive substation, work commenced on a $79-million project to increase transformer capacity, ensure long-term operability, modify the configuration and add a 315-kV supply line.
- Reconstruction of the 6-km, 161-kV Chicoutimi-Nord–Dubuc line started in the fall. This project, which will loop the 161-kV grid serving the city of Saguenay, is part of the operation to integrate the output of Péribonka generating station.

Work is under way to increase transformer capacity at Templeton substation in the Outaouais region.

Construction of the underground Marie-Victorin–Saint-Maxime line in the Montérégie region.

Reconstruction of the Kingsey–Arthabaska line in central Québec.

A regulated activity

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

- In July 2007, the Régie gave the green light to increase transformer capacity at Saint-Maxime substation, in the Montérégie region, and to rebuild its 25-kV section, at a total cost of $42 million.

In 2007, we submitted seven major transmission projects to the Régie de l'énergie for approval.

- In October, the Régie authorized a $30-million project to build the 120/25-kV Vaudreuil-Soulanges substation and loop the current Dorion–Rigaud line in order to connect the substation to the grid.
- On February 15, 2008, the Régie handed down two decisions:
  - The first is a preliminary decision on the 2007 application to modify the conditions of transmission service for 2008. It sets the revenue needed to provide transmission services at $2,733 million ($2,529 million for native load and $204 million for short- and long-term point-to-point service). The decision thus authorizes an adjustment of transmission rates retroactive to January 1, 2008. A final decision on this matter was handed down on February 29, 2008. This first decision also authorizes Hydro-Québec TransÉnergie to acquire the telecommunications assets of the Technology Group associated with transmission operations and to incorporate them into the rate base retroactive to January 1, 2008. In addition, it sets the conditions governing the variance account for point-to-point transmission service revenue.
  - The second decision authorizes investments of $717 million in 2008 for projects valued at less than $25 million. This amount includes $75 million for investments in telecommunications facilities.

Improving transmission service through innovation

Advanced technologies play an increasingly important role in transmission systems. In 2007, we devoted more than $18 million to developing or adapting innovations in order to improve system performance and ensure long-term operability. These innovation efforts have led to numerous projects carried out with Hydro-Québec's research institute.

- Our transmission system telecontrol centres are now equipped with GEN-4 SCADA (supervisory control and data acquisition), which offers greater flexibility in managing our facilities.

We innovate to conserve our leadership in transmission.

- We developed new diagnostic methods to assess the condition of tower foundations. We also designed a tool to determine the condition of insulators on direct-current lines.
- We are working on the APOC project, which is intended to reduce system losses and improve voltage regulation through better use of system control tools.

A truck equipped with a boiler and a remote-controlled mast is used to de-ice equipment.

Improved interphase spacers designed to counter galloping on transmission lines.

Engineers Christian Roy and Ray Awad presented the best paper at the 2007 Jicable conference. Their presentation was on a dry-insulated cable technology.

- We tested a steam de-icing technique that uses a truck equipped with a boiler and a remote-controlled mast, allowing a jet of pressurized steam to be sprayed on live equipment (up to 345 kV). With this technique, the blades of a disconnect switch can be de-iced in less than a minute.

- Highly efficient interphase spacers developed by our research institute have been installed on the system. These devices enable us to counteract galloping on transmission lines and prevent any contact between conductors, particularly under heavy ice loading.

- Hydro-Québec renewed its $1-million financial support for the NSERC/Hydro-Québec/UQAC industrial research chair on atmospheric icing of power system equipment (CIGELE), which was inaugurated in 1997 in partnership with the Natural Sciences and Engineering Research Council of Canada and the Université du Québec à Chicoutimi. Other partners, including Hydro One and the French companies Electricité de France and Réseau de Transport d'Electricité, are now also associated with the chair, which was granted a third five-year term.

- We play an active role in the search for ways to bring wind power into major grids. For example, we are working on models simulating the behavior of a set of wind turbines so that the optimal connection and operating conditions can be established.

Hydro-Québec Distribution

Our first hybrid bucket truck, which we are testing as part of our involvement in the Hybrid Truck Users Forum, runs on electricity and diesel. It should yield fuel savings of 40% to 60%, and a corresponding reduction in greenhouse gas emissions.

Continuously Improving Our Practices

In 2007, we kept up our efforts to ensure a reliable power supply and quality service.

Our employees' constant drive for efficiency allowed us to complete the third and final stage of the rollout of the Customer Information System in January 2008. We took comprehensive action to ensure that the introduction of this portion, which covers residential customers, went smoothly. We also stepped up maintenance efforts to improve facility performance and system reliability.

As part of our commitment to sustainable development, we sought the cooperation of local and regional organizations to urge as many people as possible to join in the effort to reduce electricity consumption. Customer participation in our various energy efficiency programs generated savings of 866 GWh in 2007. Savings since these programs were launched in 2003 now total 2.3 TWh—solid progress toward our 4.7-TWh target for 2010.

OUR MISSION Hydro-Québec Distribution provides Québec customers with a reliable power supply and quality services, while demonstrating a concern for efficiency and sustainable development.

OUR FACILITIES The division operates 109,618 km of lines, a customer relations centre set up in nine locations and offering online services, and five distribution control centres.

OUR ACTIVITIES To serve the domestic market, we rely primarily on the heritage pool of 165 TWh which we purchase from Hydro-Québec Production at a fixed price of 2.79¢/kWh. To meet demand beyond that volume, we purchase electricity under market conditions. We ensure that the distribution system operates efficiently at all times. We offer customers products and services tailored to their needs, and a wide range of energy efficiency programs.

2007 IN FIGURES

Revenue	$10.5 billion
Net income	$395 million
Customers (% of revenue)	
Residential customers	51%
Commercial and business customers	19%
Large-power customers	30%
Property, plant and equipment as at December 31 (including work in progress)	$8.3 billion
Investments (property, plant and equipment, and intangible assets)	$721 million
Regulatory regime	Cost-based

"We do our utmost to offer our customers the best possible service at least cost."

André Boulanger
President, Hydro-Québec Distribution

Bruno Gingras, Vice President, Customer Services, and André Boulanger, President, Hydro-Québec Distribution, with the J.D. Power and Associates award.

New wind power supply contracts will be awarded in 2008.

PHOTO: GUILLAUME HUET / CARTIER WIND ENERGY

Managing supplies with care

In 2007, we managed our procurement activities so as to offer customers reliable electricity service at least cost.

- On November 1, we filed the Electricity Supply Plan 2008–2017 with the Régie de l'énergie. In it, we present our supply strategies based on the domestic demand forecasts for the next decade. Key points include the integration of 3,500 MW of wind power by 2017.

We must maintain a constant balance between supply and demand.

- To ensure balanced management of supply and demand, we sold our surplus electricity on short-term markets, in accordance with a decision by the Régie de l'énergie. The Régie also approved the suspension of deliveries of power generated by the TransCanada Energy plant in Bécancour for 2008.

- Deliveries of forest biomass power generated by Kruger began in July, adding to the power Bowater Canadian Forest Products has been delivering since 2006. The total capacity of their generating facilities is 39 MW.

- The 100.5-MW L'Anse-à-Valleau wind farm went into operation in November. This is the second of eight such facilities slated for construction in the Gaspé region by the end of 2012 under the call for tender we launched in 2003.

- In response to our 2005 call for 2,000 MW of wind power, we received 66 bids from 30 proponents for a total of 7,724 MW. The bid analysis is based on a twofold objective: to secure a supply of power at the lowest price and to maximize economic spinoffs in Québec. The contracts are to be awarded in 2008.

- In keeping with the commitments set out in the 2008–2017 electricity supply plan for off-grid systems, we continue to favor the use of renewables as a way to reduce the proportion of thermal energy in electricity delivered to customers who are not served from the main grid. The northern communities of Akulivik and Kangiqsualujjuaq, which have expressed an interest in a combined wind/diesel project, have authorized us to set up anemometric towers on their land to carry out wind measurements for this purpose. In the Magdalen Islands, we launched the Energy Efficiency Advisor Home Visit program to diagnose customers' consumption and propose energy efficiency measures. We plan to meet 3,750 customers in this region by 2010. We are also implementing an energy conservation project at Cap-aux-Meules thermal generating station designed to reduce station consumption by more than 1 GWh.

- In February 2007, the Régie de l'énergie approved a 1.9% across-the-board rate adjustment that came into effect on April 1, 2007. In February 2008, further to an application filed in August 2007, it approved a 2.9% across-the-board rate adjustment, effective April 1, 2008.

ENERGY STAR award for our 2007 promotional campaign. Cassie Doyle, Deputy Minister, Natural Resources Canada, and Mark Saucier, Hydro-Québec's Director, Energy Efficiency.

Under the guidance of their trainers, employees get ready for the rollout of the residential portion of the Customer Information System, which covers 2.8 million customers.

Our goal: Customer satisfaction

One of our main priorities in 2007 was to prepare for the January 2008 launch of the residential portion of the Customer Information System (CIS), the final stage in this extensive upgrade project. Integrating our information systems will improve our efficiency in serving customers.

On the energy efficiency front, we surpassed our objectives for the fourth year in a row. Our programs generated new energy savings of 866 GWh in 2007, for a cumulative total of 2.3 TWh since the Energy Efficiency Plan was launched in 2003.

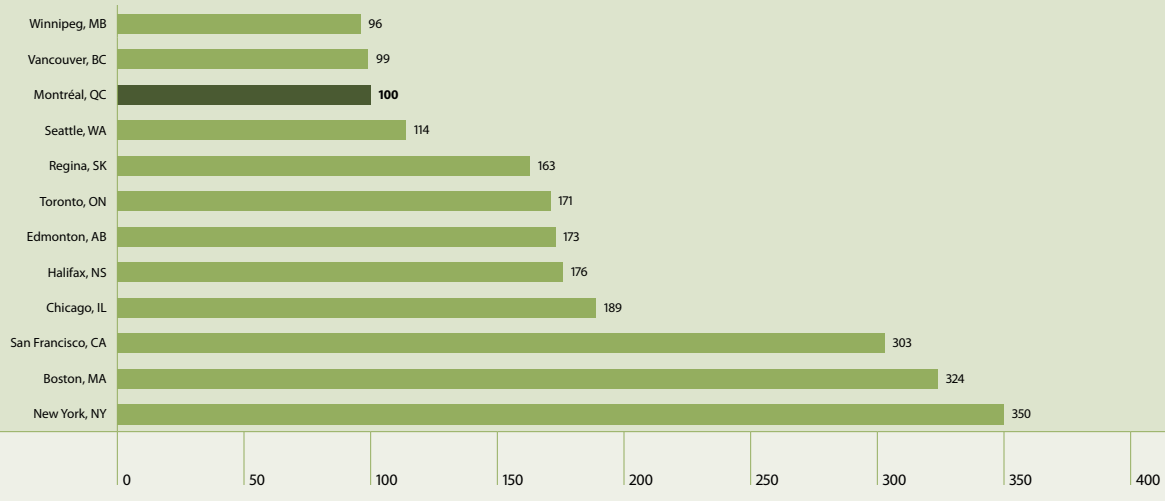
RESIDENTIAL CUSTOMERS

- According to our surveys, the residential customer satisfaction index rose to 7.5 on a scale of 10, compared with 7.3 in 2006. In a study of Canadian electrical utility customers by J.D. Power and Associates, Hydro-Québec ranked highest among large utilities.

Hydro-Québec has been cited as a model for residential customer satisfaction.

- Bolstered by the experience we acquired in rolling out the commercial and business portion of the CIS in 2006, we worked hard throughout 2007 to limit the impacts of this transition on our 2.8 million residential customers.

Comparative Index of Electricity Prices at April 1, 2007
Residential Customers[a]



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

Items in the 00Watt Classroom Toolkit, a new energy conservation teaching aid for elementary school students.

Our Traffic Light Optimization Program is a huge success.

The farm equipment component of the Efficient Products program delivers both energy savings and quality improvements.

▸ In keeping with the principles of sustainable development, we promoted our online services, in particular Online Billing and the submission of meter readings by phone or Internet. As a result, 56,249 customers signed up for Online Billing in 2007, a 78% increase over 2006. With a total of more than 236,000 electronic invoices produced each billing cycle, this means that we avoid printing more than 1.5 million bills per year.

▸ In partnership with the Association des industries de produits de vitrerie et de fenestration du Québec and the provincial Agence de l'efficacité énergétique, we launched a program encouraging the purchase of ENERGY STAR® qualified windows and patio doors.

▸ We enlisted the help of local and regional governments to promote the ENERGY WISE Home Diagnostic. Under this initiative, we will provide them with financial support for the community project of their choice, in any of the following areas: culture, sports and recreation, environment or community activities.

▸ Last fall, in partnership with the Montréal Science Centre, we launched the 00Watt Classroom Toolkit. This new teaching aid is designed to make grade five and six students aware of how much energy we consume and teach them ways to avoid wasting energy.

▸ In October, we were given two awards by the Canadian government for our commitment to energy efficiency, recognizing our efforts in 2006 and 2007 to promote ENERGY STAR certification under the ENERGY WISE programs.

▸ Since 2001, we have offered special payment arrangements to low-income customers who are having trouble paying their electricity bills. In 2007, we entered into 23,000 such arrangements, for arrears of $30 million. As well, after forming a work team with representatives of community groups, we submitted some 20 proposals to the Régie de l'énergie that will enable us to improve all of our interactions with these customers.

COMMERCIAL AND BUSINESS CUSTOMERS

▸ Satisfaction indexes rose for commercial and business customers in 2007, reaching 7.6 and 7.2, respectively, up from 7.3 and 7.1 at the end of the previous year. The strongest increases related to telephone service, billing and request processing.

▸ Under the Empower Programs for Building Optimization and for Industrial Systems, we contributed financial assistance to more than 600 energy efficiency projects, which represent total energy savings of 162 GWh. In addition, we streamlined the project submission and processing procedures, making it easier for customers to participate in these programs starting in 2008.

▸ In 2007, the provincial Department of Transport and some 30 municipalities took advantage of the Traffic Light Optimization Program to replace 43,562 incandescent bulbs with light-emitting diodes (LEDs), for annual energy savings of 13.7 GWh. Accordingly, Hydro-Québec has decided to extend the program until the end of 2010.

® ENERGY STAR is an official trademark, used under licence.

Beaulieu Canada's Acton Vale plant. This major carpet manufacturer is an active participant in our energy efficiency programs and a member of the Energy Savers' Circle.

The Kénogami division of Abitibi-Bowater has now joined the Energy Savers' Circle. Gérald St-Pierre, Director of Strategic Project Investments and Energy (right), is shown with André Boulanger, President, Hydro-Québec Distribution.

▸ The Efficient Products program offers rebates on the purchase of energy-efficient lighting products, motors and farm equipment. The farm equipment component, which covers heat pads, high-efficiency fans and plate heat exchangers, was developed in cooperation with the UPA (the Québec agricultural producers' union) and other associations active in this field. Customers have been eager to sign up for the program, since the equipment covered helps improve product quality and can yield sizable productivity gains. Farm rebates granted in 2007 generated recurring savings of 2 GWh, bettering the target of 1.2 GWh.

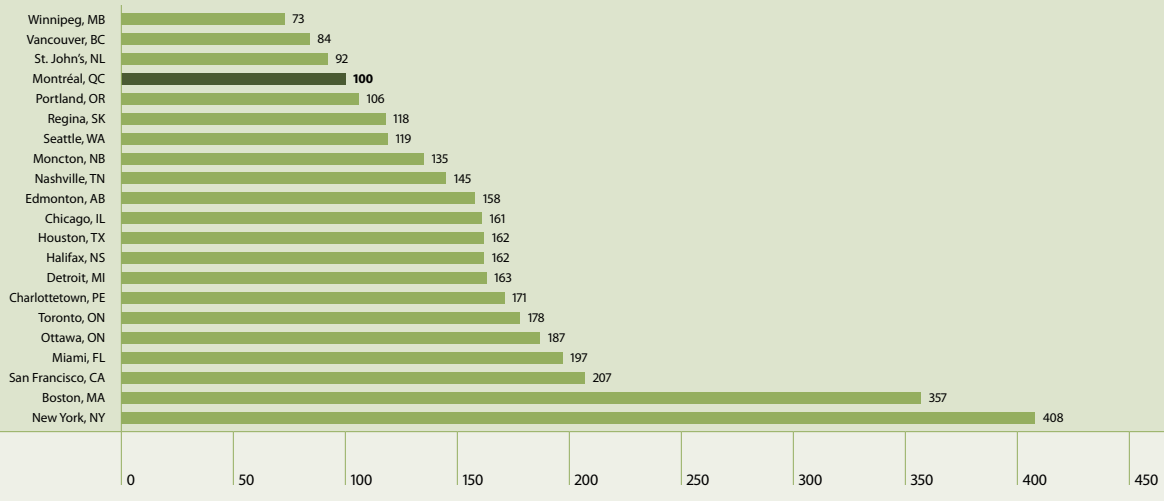
LARGE-POWER CUSTOMERS

Industrial, commercial and institutional customers with a power demand of 5 MW or more consume 42% of the electricity distributed in Québec. In 2007, they achieved more than one-third of the energy savings recorded under our efficiency programs.

▸ The satisfaction index for large-power customers rose to 9.2 out of 10, versus 9.1 in 2006.

▸ The 152 projects initiated in 2007 under energy efficiency programs designed for this customer category will yield annual energy savings of 345 GWh. To date, 76% of large-power customers have participated in one or more of our programs.

Comparative Index of Electricity Prices at April 1, 2007
Large-Power Customers[a]



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

Serge Y. Piotte, Vice President, Distribution System, at the launch of the new guide to integrating service entrances for residential buildings.

A rotary kiln that uses a plasma torch to dry biological sludge was developed by our energy technologies laboratory and installed at the municipal treatment plant in Valleyfield.

- A partnership set up in 2006 with the Centre de recherche industrielle du Québec gave rise to a pulp-refiner energy optimization project for thermomechanical pulp mills.

- Established in 2005, the Energy Savers' Circle recognizes major customers that are particularly proactive in their energy conservation efforts. In 2007, it welcomed six new members who took steps to cut their plants' electricity consumption by at least 5% or to save at least 50 GWh per year. The Circle now boasts 15 members.

- In the fall, a plasma-assisted wet oxidation (PAWO) system was installed at the municipal water treatment plant in Valleyfield. Developed by Hydro-Québec's energy technologies laboratory and marketed by Fabgroups Technologies, this process uses a rotary kiln equipped with a plasma torch to trigger a reaction that destroys the organic matter in biological sludge. The new system will enable the municipality of Valleyfield to cut its annual CO_2 emissions by 3,000 tonnes.

Maintaining reliable distribution

Every year, we work to improve the overall performance of our system. In 2007, we continued modernizing our facilities and updating our practices to improve service continuity and quality. We also carried out major operations to keep our facilities in good working order and ensure their long-term operability. Steady growth in requests for hookups also accounted for much of our efforts.

- The normalized system average interruption duration index was 127 minutes per customer.

We are intensifying our efforts to improve service continuity.

- We continued the system automation program launched in 2006. This program, which will run until 2012, involves installing remote-controlled equipment at strategic points on the system to detect outages remotely and speed up service restoration. Ultimately, this new technology will mean a 15-minute reduction in the average length of service interruptions, thereby benefiting all customers.

- We completed more than 50,000 new hookups on schedule.

- All affected customers received advance notice of scheduled outages, and the work was carried out on time in 87% of cases. To improve our performance, we also established follow-up mechanisms.

- In July 2007, the Régie de l'énergie approved the principles applicable to system extensions and alterations, and asked us to add them to our Conditions for Electrical Service.

- Our work-related accident frequency was the lowest in 10 years. To build on this success, we introduced a program to encourage all our employees to think prevention. This program should come into effect in 2008.

Thermographic inspection of the underground grid. Seated in a truck, a technician takes part in the inspection by using partial discharge tests to run diagnostics.

Our overhead distribution system includes 99,125 km of lines.

- Amending the standard for thermographic inspections of the underground grid allowed us to optimize preventive maintenance operations while ensuring public and worker safety. We were consequently able to increase system availability, eliminate needless replacements of components and achieve substantial efficiency gains in detecting and diagnosing anomalies.

- Under an initiative promoting the use of green technologies in our operating activities, since fall 2007 we have been testing Canada's first hybrid bucket truck. This vehicle runs on electricity and diesel, adopting electric mode first both for driving the truck and for operating the bucket. The project arises out of Hydro-Québec's participation in the Hybrid Truck Users Forum, an association of North American organizations established to encourage the commercialization of hybrid specialized trucks. The new bucket truck should yield fuel savings of 40% to 60%, with a corresponding reduction in greenhouse gas emissions.

- On April 16, 2007, after working for several years with nine partners involved in residential construction and renovation, we launched a handbook on optimizing the visual integration of service entrances for residential buildings. The solutions proposed in this book promote respect for the architectural character and other distinctive features of buildings.

- An agreement that is a model of cooperation in urban vegetation control was signed between the city of Montréal and Hydro-Québec. The two organizations developed a shared vision of vegetation control, adopted standards, and will offer joint training programs for their employees and subcontractors.

- In April, ISO 14001 certification was renewed for the second time for all Hydro-Québec Distribution units.

Improving distribution service and energy efficiency through innovation

Innovation is the key to ensuring the long-term operability of our equipment, enhancing system performance and improving the energy efficiency of the company's and customers' facilities. In 2007, we invested close to $21 million in 45 projects assigned to Hydro-Québec's research institute.

- As part of an R&D project carried out with the institute, we developed a method for locating faults on the underground grid that creates very little disturbance for the equipment. On the strength of the 2007 results, we started up a pilot project that should lead to faster fault location and a reduction in incidents caused by these operations.

- The energy technologies laboratory and an industrial partner tested a new type of three-element hot water heater that draws less power than conventional models.

Hydro-Québec Équipement and SEBJ

At the Eastmain-1-A/Sarcelle/Rupert jobsite, engineering is working for the environment, as well. To mitigate the impact of the partial diversion of the Rupert River on the natural environment and land users, we are building a series of hydraulic structures to preserve the flow facies over most of the river's length.

High-Value-Added Services

Hydro-Québec Équipement and Société d'énergie de la Baie James (SEBJ) faced new and complex challenges in 2007. As always, the initiative and commitment demonstrated by all our teams enabled us to fulfill our mandates.

Several projects for Hydro-Québec Production reached major milestones. In the Saguenay–Lac-Saint-Jean region, the first generating unit at Péribonka went into operation. At James Bay, work began on the Eastmain-1-A/Sarcelle/Rupert project. In the Outaouais region, Mercier generating station came on stream. And in January 2008, the environmental impact statement for the planned Romaine hydroelectric complex, in the Mingan area, was tabled with the competent authorities.

On behalf of Hydro-Québec TransÉnergie, we worked to extend and reinforce the transmission system. We connected Péribonka, Chute-Allard and Rapides-des-Cœurs generating stations to the system, upgraded the Matapédia regional grid and stepped up work on Outaouais substation as part of the new Ontario interconnection project.

OUR MISSION Hydro-Québec Équipement and Société d'énergie de la Baie James carry out engineering and construction work related to generating and transmission facilities for Hydro-Québec Production and Hydro-Québec TransÉnergie. Our projects meet stringent criteria in terms of profitability, respect for the environment and social acceptability.

OUR ACTIVITIES Our services cover all project stages and aspects, from planning through to completion: study of the biophysical and human environment, engineering, construction, project management and handoff to the operator. We are continually seeking new ways to reduce costs and construction time while maximizing facility performance. We work actively with partners in the industry and in the communities concerned.

2007 IN FIGURES

Volume of activity	$2.2 billion
Main customers (% of volume)	
Hydro-Québec Production	70%
Hydro-Québec TransÉnergie	28%
Other	2%

"Our innovative work methods are one of the keys to our success."

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

The underground powerhouse being built at Péribonka.

Excavation of overburden on the site of the future Eastmain-1-A powerhouse.

Meeting every challenge

The projects we carry out for Hydro-Québec Production and Hydro-Québec TransÉnergie have major financial impacts and involve a multitude of constraints. In response to these challenges, we aim ever higher. Here is an overview of our main achievements in 2007.

- The 32-km^2 reservoir for the 385-MW Péribonka generating station was impounded in the fall, and the first unit was started up three months early. Another highlight was the flawless performance of the plastic-concrete cutoff wall we installed in 2006 beneath the foundation of the dam, to a record depth of 115 m. As well, we moved up the commissioning dates of Péribonka and Simard substations as well as the 128-km, 161-kV line that links the two and connects the generating station to the grid. The jobs created by the Péribonka project corresponded to 835 person-years in 2007, and regional spinoffs amounted to $106.7 million, bringing the total for the project to $503.6 million.

We have action plans at all our jobsites to keep both our own personnel and contractors' employees safe.

- All units at the 51-MW Mercier generating station have been in operation since September.

- Sainte-Marguerite-3 reached its full 884-MW capacity following the recommissioning of its second unit.

- Work is nearly complete on phase I of the rehabilitation of Rapide-2 and Rapide-7, each of which has four units. As a result, unit capacity has risen from 12 MW to 15 MW.

- We tabled the environmental impact statement for the Romaine hydropower complex, in the Mingan area, in January 2008. This project, scheduled to run from 2009 to 2020, calls for the construction of four hydroelectric developments with a total installed capacity of 1,550 MW. The annual output would be 8.0 TWh.

- We completed construction of the 6-km, 120-kV underground Marie-Victorin–Saint-Maxime line and reconstruction of the 20-km Kingsey–Arthabaska line.

Expanding and optimizing the generating fleet

We are currently involved in building five hydroelectric generating stations, two of them for Eastmain-1-A/Sarcelle/Rupert, Québec's project of the decade. At another 250 jobsites across the province, we are hard at work on rehabilitation or refitting projects designed to increase the capacity of the generating fleet or ensure its long-term operability. These projects generated a total volume of activity of $1,501 million in 2007.

Construction of the transfer tunnel, a key component of the Rupert diversion.

Rupert spillway under construction.

▸ Construction of the Eastmain-1-A/Sarcelle/Rupert project got off the ground in January 2007. Once it is completed, this project will add 893 MW to Hydro-Québec Production's fleet, or 8.5 TWh a year—enough energy to supply about 425,000 residential customers. The various components will be commissioned in stages from 2009 to 2012.

- On the site of the 768-MW Eastmain-1-A powerhouse, we finished excavating overburden and started excavating rock.
- We completed the technical studies for the construction of Sarcelle substation and the 103-km, 315-kV Sarcelle–Eastmain-1 line needed to connect the 125-MW Sarcelle powerhouse to the grid.
- We commenced drilling on the transfer tunnel between the Rupert forebay and tailbay, and began concreting the Rupert spillway.

One year after we broke ground at Eastmain-1-A/Sarcelle/Rupert, approximately $194 million had been spent on the acquisition of goods and services in the host and neighboring regions: $62 million in Nord-du-Québec, $55 million in Abitibi-Témiscamingue and $77 million in Saguenay–Lac-Saint-Jean.

In all, the Eastmain-1-A/Sarcelle/Rupert project created 16,689 person-years of employment; 15% of the workforce came from Cree communities in the region, while other James Bay residents accounted for 6%.

▸ Construction is 80% complete at Chute-Allard and 70% complete at Rapides-des-Cœurs. The combined capacity of these two generating stations will be 139 MW. To prepare to bring them onto the grid, we erected a 61-km, 230-kV line and added series compensators at Des Hêtres substation. We also began work to build a switchyard at each powerhouse and to upgrade Rapide-Blanc substation. In 2007, jobs generated by this project totaled 976 person-years—with 59% of the workforce coming from the region, particularly the Attikamek community of Wemotaci—and regional spinoffs amounted to $98.5 million.

▸ Rehabilitation proceeded as planned at Beauharnois and Rivière-des-Prairies generating stations, as well as at Rapides-des-Quinze, where the bulk of the work should be finished in 2008.

▸ Rehabilitation continued at Melville dam in the Shawinigan complex and at Mercier dam.

▸ Good progress was made on the refitting of Outardes-4 and on the second phase of the rehabilitation of La Tuque generating station. So far, this effort has increased their capacities by 42 MW and 21 MW, respectively.

▸ Work was launched on the expansion of the solid radioactive waste storage facilities at Gentilly-2 nuclear generating station. With a view to the possible refurbishment of the plant, we also carried out studies examining the emergency shutdown system, reactor cooling system and control system replacement.

▸ In Nunavik, studies are also under way on rebuilding Kuujjuaq thermal generating station. Off-grid systems such as the one in Kuujjuaq are operated by Hydro-Québec Distribution.

Erection of the walls and structure for the converter section of Outaouais substation.

Refurbishment at Hauterive substation on the North Shore.

Developing the transmission system

Province-wide, we have more than 700 projects under way for Hydro-Québec TransÉnergie. These projects are intended either to increase system capacity—allowing greater energy interchanges with Ontario, for example—or to ensure the reliability and long-term operability of the transmission assets. In 2007, these operations generated a volume of activity of $599 million.

- Work on the 1,250-MW interconnection with Ontario moved ahead as scheduled. Construction of the 315/230-kV Outaouais substation is well under way, and in January 2008 we received the final approvals required to extend the 230-kV line to Ontario. In addition, to reinforce the interconnection, we are studying the 114-km, 315-kV Chénier–Outaouais line to be built in an existing right-of-way.

- For the Péribonka project, we are rebuilding the 6-km, 161-kV Chicoutimi-Nord–Dubuc overhead line that crosses the Saguenay River.

- To increase system capacity, we added transformers at Monseigneur-Émard, Sainte-Thérèse-Ouest, Baie-d'Urfé and Templeton substations.

- In the James Bay region, we broke ground on a 120/25-kV transformer substation near the Cree village of Wemindji to replace the existing 25-kV switching substation. This project also entails upgrading the La Grande-1–Wemindji line from 25 kV to 120 kV and making alterations to La Grande-1 substation. Commissioning of the new facilities is slated for fall 2008.

- Refurbishing is under way at Sorel substation. We also began work at Hauterive substation to increase transformer capacity, ensure long-term operability, modify its configuration and add a 315-kV supply line.

- We conducted detailed engineering studies and started building a 120/25-kV substation in the municipality of Saint-Lin–Laurentides, as well as a 120-kV line approximately 25 km long connecting it to Paquin substation. The facilities should come on stream in late 2008.

- Projects under study include:
  - construction of Anne-Hébert substation and a 315-kV line (Québec City region);
  - construction of Mont-Tremblant substation and two 120-kV lines (Laurentians);
  - construction of Watson substation in Mistissini and a 161-kV line (northern Québec);
  - reconstruction of Carleton substation in the regional county municipality of La Matapédia, and refurbishing of Rapide-2, Rapide-7 and Abitibi substations in Abitibi-Témiscamingue, and Albanel and Nemiscau substations in northern Québec;
  - replacement of the control system for the back-to-back converters at Châteauguay substation.

- We refurbished a synchronous condenser at Lévis substation to increase transmission capacity.

- We finished mechanical reinforcement on 567 km of strategic lines in the Québec City, Chaudière-Appalaches, North Shore, Lower St. Lawrence and Eastern Townships regions.

We worked on more than 1,000 projects in 2007.

- We carried out $100 million in work on various Hydro-Québec buildings. This amount includes renovation of the administrative building on Jarry Street in Montréal and construction of an administrative building near Radisson substation in the James Bay region.

Concreting the new Saint-Lin substation in the Laurentians.

A cofferdam is set in place at the La Tuque site.

Innovation: A cornerstone of our success

We owe our accomplishments mainly to the initiative shown by our employees and partners, and to their extensive know-how in engineering, environment and project management. Committed and determined, our employees have developed innovative capabilities that help make our projects a success, whatever the obstacles encountered.

Innovative practices and concepts are behind the success and profitability of our projects.

- In 2007, we continued to deploy version 5 of CATIA (Computer Aided Three-dimensional Interactive Application) and used it to model several new and existing facilities. This software allows many different project variants to be analyzed in order to find the best solutions.
- We are relying on a number of innovations to save time and money on the Eastmain-1-A/Sarcelle/Rupert project:
  - Using prefabricated components for the superstructure of Eastmain-1-A powerhouse will reduce the need to pour concrete, which is difficult in winter.
  - At Sarcelle powerhouse, we will install bulb-type units. This model, in which the turbine and alternator are housed inside a watertight metal casing, is particularly well suited to facilities with a low head (about 10 metres in the case of Sarcelle) and heavy flow conditions.
  - We are constructing a bituminous-concrete watertight core for Nemiscau-1 dam, even though there is plenty of till in the region. In this way, we will become familiar with a technique we could use at the Romaine complex in the Mingan area, where till is less abundant.
- Tests on a digital model to assess the structural behavior of Beauharnois generating station in case of an earthquake allowed us to considerably scale back the reinforcement work on the plant. This tool will also enable us to implement preventive measures when refurbishing other facilities.
- La Tuque generating station was the scene of several technology firsts. For instance, we reprofiled a draft tube between two actively working units and introduced a fast, innovative construction method using hoists mounted on cranes to install cofferdams 24 m high.
- Rather than build a transformer substation at Simard switching substation, we added a transformer block, a solution with a smaller footprint.
- The GenSpec software designed by our engineers for use in drawing up technical specifications is a French-language tool that has been welcomed by universities and engineering firms alike. It makes it easier to define and check the specifications of various products and services. For this innovation, which complies with international standards, the team won the award of merit in the Software Application – Large Organization category, presented by the Office québécois de la langue française.
- We developed a dry-insulated cable technology in cooperation with Hydro-Québec TransÉnergie. Cables insulated in this way are more reliable than those insulated with paper and oil. They also have no environmental impact and require no maintenance.
- In partnership with various project management associations, we are involved in a research chair set up by the Université du Québec à Montréal in late 2007 to establish best practices in project management.

Modeling water flow for a study on the behavior of hydraulic equipment, at the scientific computation centre of Hydro-Québec's research institute. The centre's immense processing capacities help Hydro-Québec to explore new research avenues and to go much further in its quest for innovative solutions.

A Leader in Technological Innovation

Putting innovation to work

We rely on constant innovation to maintain our technological leadership in the power industry. Our telecommunications and information technology experts and research scientists work in synergy to develop solutions for the future. They help the company meet the challenges it faces in achieving its short- and long-term business objectives as well as in ensuring the security, long-term operability and technological advancement of the power system.

In 2007, our innovation efforts focused on integrating wind power into Hydro-Québec's grid, optimizing our facilities and improving their reliability, and further automating the power system. We also implemented an integrated architecture for our telecommunications network and continue to roll out information systems in a way that promotes technological convergence.

Our high-performance computation centre

Hydro-Québec's research institute now has a high-performance computation centre to carry out simulations, modeling and other tasks requiring extensive data processing and exchange capabilities. The centre is equipped with a supercomputer made up of 1,000 networked computing cores. In 2007, it was used in several innovation projects, particularly in pursuit of the following objectives:

- Improving the natural inflow forecasting system to enhance water resource management
- Improving the output and efficiency of hydraulic turbines
- Increasing transmission capacity
- Assessing temperature rise and maximum load in certain types of equipment (alternators, transformers, cables, etc.) to estimate their impact on service life

Using MATH technology to improve turbine performance at Bersimis-2 generating station.

An experimental solar water heater being tested at our energy technologies laboratory.

Integrating wind power

Hydro-Québec intends to become a model for the world in bringing wind power onto a major grid. In 2007, the company's research institute oversaw several innovation projects in this area.

- In cooperation with Environment Canada, we conducted studies to forecast and characterize wind power generation in order to maximize output from this form of energy without jeopardizing the reliability of the transmission grid.

- We worked to develop management tools to balance hydro and wind power and to develop and improve models simulating the behavior of wind turbines and wind farms connected to the Hydro-Québec grid.

- We participated in the creation of the Canadian Wind Energy Strategic Network (WESNet), a pan-Canadian network of wind power experts from the private sector, universities and the power industry. The objective of the network is to seek solutions for the climatic and geographical challenges faced in developing wind power in Canada and Québec.

- We will be contributing $1 million over eight years to the Université du Québec à Rimouski, mainly to support research on the social acceptability of wind farms and the role they play in regional socioeconomic development. Part of the grant will be in the form of scholarships.

Improving energy efficiency

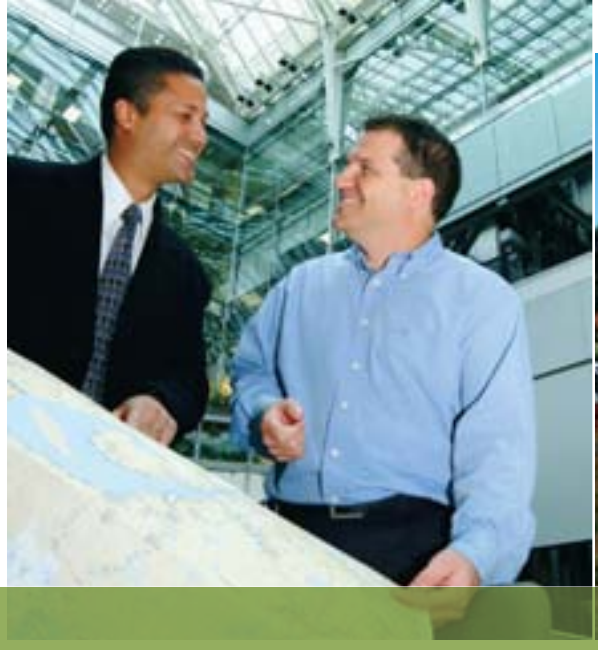
Hydro-Québec's research institute develops technologies to improve the energy efficiency of the company's generation, transmission and distribution facilities.

- In 2007, we modified the runner on one of the turbines at Bersimis-2 generating station using MATH technology (MATH is short for *Modèles d'analyse des turbines hydrauliques,* or hydraulic turbine analysis models). The result was a 1% increase in the unit's peak output.

- We continued to work on software allowing us to better control the system voltage profile in order to reduce transmission losses.

- Through an electroforming process, we produced magnetic materials for an amorphous steel alloy to be used in the cores of distribution transformers. This could decrease transformer losses by more than 40%.

- To help Hydro-Québec customers reduce their electricity consumption, the institute also carried out research in advanced refrigeration technology, heat waste recovery, the reduction of industrial energy intensity, solar buildings and integrated energy systems.



Our engineers are working to implement an integrated architecture for Hydro-Québec's telecommunications network.

The Cleanova III Plus placed first in the mass-produced electric-drive vehicle category at the first Laurentian alternative energy rally.

An increasingly automated system

In 2007, we began implementing an integrated architecture for Hydro-Québec's telecommunications network in order to optimize planning, technology evolution and security. We also defined technical, technological and business approaches to expand the remote management of our facilities.

Ground transportation technologies

Through TM4, our joint venture with Groupe Industriel Marcel Dassault, we are involved in developing electric drivetrains for major vehicle manufacturers.

- Nearly 40 Cleanova vehicles with TM4 engines are currently being tested in Europe and Canada; Hydro-Quebec has five in its fleet.
- Hydro-Québec was one of 16 participants in the first Laurentian alternative energy rally, held in October 2007. Its Cleanova III Plus placed first in the mass-produced electric-drive vehicle category, with average fuel consumption of 3.5 l/100 km for the 450-km route.

In 2007, Hydro-Québec signed licence agreements with Merck and IoLiTec (Germany), Solvionic (France) and Valeo Management L.P. (Canada) for the use of new types of molten salts to be used in lithium ion batteries for electric vehicles. These materials have a number of advantages in terms of safety, performance and environmental protection. Hydro-Québec also signed a licence agreement with Industrial Minerals for the purification of natural graphite from a mine in Ontario, to be used for the anodes in lithium ion batteries.

Conducting research on new lumber drying technologies.

Hydro-Québec's research institute carries out research on molten salts to be used in manufacturing lithium ion batteries for electric cars.

Strength in partnerships

To maximize the value and scope of its innovation projects, Hydro-Québec partners with universities, government agencies, companies and research centres in Québec and elsewhere.

- In 2007, Hydro-Québec contributed $5.2 million to Québec universities for research contracts and 17 research chairs.
- We formed new alliances, including ones with the Gruppo De Nora (Italy) and Siemens (Germany), to develop low-loss distribution transformers.
- Since 2001, we have participated in research conducted by the Ouranos consortium on regional climatology and climate change adaptation. In 2007, this work focused on assessing how climate change will impact Québec's energy needs and Hydro-Québec's generating potential to the year 2050.
- We continued to collaborate with Forintek Canada, Canada's wood products research institute, on the second phase of the ÉlectroBois program, which involves the development of new lumber drying technologies.
- Lonza Canada, which uses CeTECH (cerium oxidation) technology developed by Hydro-Québec's energy technologies laboratory, opened a plant in Shawinigan in 2007. CeTECH is a generic process that can be used to synthesize a wide range of high-value-added fine chemicals, including Vitamin K_3, and is much less harmful to the environment than standard processes.
- In 2007, Hydro-Québec participated in the creation of the Consortium on Hydraulic Machines made up of Alstom Hydro (Canada), VA TECH HYDRO (Switzerland), Voith Siemens Hydro (United States), Université Laval, Natural Resources Canada and the Natural Sciences and Engineering Research Council of Canada (NSERC). The consortium has a twofold objective: to improve the performance of hydraulic equipment such as turbines and to train experts in this field.

For a Clean and Sustainable Future

In 2007, the Fondation Hydro-Québec pour l'environnement provided financial support to the conservation organization Appalachian Corridor (ACA) for stewardship of a protected area of the Sutton Mountains in the Eastern Townships, part of which will become the Green Mountains Nature Reserve.

Hydropower, our strong suit

Through its energy choices, Hydro-Québec promotes sustainable development while ensuring a secure electricity supply for Québec. We rely on large hydro, a green, renewable energy source that is very low in greenhouse gas (GHG) emissions. This makes us an active participant in the fight against climate change in Québec. In addition, the energy we export to meet demand in neighboring states and provinces often replaces power from coal- and gas-fired plants, thus helping to reduce GHG emissions throughout northeastern North America. Finally, Hydro-Québec supports the development of other green energies such as wind power and encourages all its customers to save energy.

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

Type of emission	**2007**	2006
Carbon dioxide (CO_2)	**245,832**	215,243
Sulphur dioxide (SO_2)	**1,150**	979
Nitrogen oxides (NO_x)	**6,205**	5,917

a) Most of our emissions are from thermal generating stations supplying off-grid systems. According to 2005 data, power generation is responsible for only 1.7% of GHG emissions in Québec, compared with 39.0% for transportation and 36.3% for industry.

A study on greenhouse gas emissions is under way at Eastmain 1 reservoir.

At Péribonka reservoir, lake trout populations will be monitored over several years.

Our environmental practices

Every year, we invest significant amounts in environmental protection to limit our ecological footprint. Built into our development projects are mitigation measures to reduce environmental impacts, as well as follow-up programs to assess the effectiveness of these measures. In our ongoing operations, we strive to improve our performance by adopting responsible practices and using less polluting technologies. ISO 14001–certified environmental management systems govern most of our activities affecting the environment; these systems require that we periodically measure our performance so we can keep improving how we do things.

- For the Eastmain-1-A/Sarcelle/Rupert development project, measures on an unprecedented scale—costing a total of $120 million—were included in the project right from the design stage to mitigate the impacts of the partial diversion of the Rupert River. For example, the construction of hydraulic structures will help to preserve fish populations and their habitats, traditional hunting, fishing and trapping activities, and the recreational and scenic interest of the river.

- Since 2006, we have participated in the EM-1 Project, a major study to measure GHG emissions from hydroelectric reservoirs. The study consists in quantifying GHG emissions before, during and after impoundment of Eastmain 1 reservoir, and comparing them with emissions from natural ecosystems. The project will include the development of a predictive model for GHG emissions from Eastmain 1 reservoir over a hundred-year time span.

- At the Péribonka jobsite, former borrow pits were made into wetlands and a nursery was created to preserve fish habitat. Most of the construction work on the line to the power plant was done in winter, and reduced-footprint towers were used to spare the region's blueberry fields as much as possible.

- In 2007, we replaced 210 of our light-duty vehicles (49% of vehicles replaced during the year) with more energy-efficient models. The result is a 71,000-litre reduction in annual fuel consumption and a 166-tonne reduction in CO_2 emissions from these vehicles. We are also currently testing our first hybrid (electric/diesel) bucket truck. It should consume 40%–60% less fuel than standard models, for a corresponding reduction in GHG emissions.

In Montréal, employees use self-service bicycles to get around at work.

Thousands of trees have been saved since we switched to environmentally friendly paper for printing and photocopying.

- Since 2006, Hydro-Québec has participated in the *allégo* project, an initiative by Montréal's Agence métropolitaine de transport to promote the use of modes of transportation other than single-occupancy vehicles for the daily commute. We provide self-service bicycles for employees' use and offer incentives for employees to take mass transit, use carpooling or walk or cycle to work.

- In 2007, Hydro-Québec personnel used environmentally friendly paper for their printing and photocopying needs, which saved roughly 14,000 trees and 19 million litres of water over the year.

- We recycled 1,030 tonnes of paper and cardboard and 8,309 tonnes of metal in 2007. In addition, as part of a campaign encouraging employees to recycle, we set up 300 multi-material recycling stations in 86 buildings. As a result, nearly 19,000 employees are now able to recycle.

- We systematically decontaminate and recycle insulating oil used in our facilities. In 2007, our reuse rate was 91%, comparable to previous years.

- To date, 16 of our buildings have been certified under BOMA Québec's *Go Green* program, which sets standards for environmental excellence such as reduced energy and water consumption and residual hazardous materials management. These practices have been adopted in all buildings owned by Hydro-Québec.

A better quality of life

We strive to preserve the quality of life of citizens living near our facilities, as well as the landscapes they enjoy. In addition, we fund many local initiatives benefiting the environment and local communities.

- In 2007, the Fondation Hydro-Québec pour l'environnement allocated close to $1.5 million to 15 projects in eight administrative regions of the province. For example, it will provide $524,200 over two years to the Appalachian Corridor (ACA) project for stewardship of a huge protected area in the Sutton Mountains. Nearly 5,000 hectares of this will be set aside for the creation of the Green Mountains Nature Reserve, which will

Installation of an energy-efficient ventilation system at our Jarry Street administrative building in Montréal.

Unveiling of a panel announcing the designation of the Manicouagan-Uapishka region as a biosphere reserve, attended by Line Beauchamp, Québec Minister of Sustainable Development, the Environment and Parks.

The absence of overhead lines on Île des Sœurs in Montréal beautifies the landscape.

increase public access to this conservation area while preserving its ecological integrity. The goal is to protect the environment and encourage stewardship by the community.

- The Manicouagan-Uapishka region, where we operate 11 hydroelectric facilities, has been designated a biosphere reserve under UNESCO's Man and the Biosphere program. This is the result of a long effort by many organizations, including Hydro-Québec.

- The municipality of Sainte-Cécile-de-Milton was able to open a new municipal park and restore and enhance elements of the town's religious heritage, thanks to a grant of over $500,000 under Hydro-Québec's Integrated Enhancement Program.

- To improve the visual integration of our facilities, 13,800 residential customer connections were made to the underground distribution system in 2007.

Helping to Shape Society

The future at Hydro-Québec: in a field as challenging as electricity, employee expertise is essential. This is why we are working on several fronts to ensure successful integration of tomorrow's workforce.

We take our human resources to heart

Since Hydro-Québec relies on all its people to achieve its objectives, it has implemented a wide range of communication and training tools so they can understand the issues facing the company and improve their skills. In 2007, job satisfaction rates at Hydro-Québec reached record highs, demonstrating our employees' sense of belonging. Nonetheless, our workforce is aging and the number of retirements is growing each year. To deal with this situation, we have a corporate succession plan that includes such measures as promotional campaigns, recruitment strategies, training activities and knowledge transfer mechanisms. We have also instituted programs to welcome new employees, facilitate their integration and measure their job satisfaction.

- According to our annual employee survey, completed by 13,890 respondents, overall job satisfaction went from 8.42 out of 10 in 2006 to 8.46 out of 10, the highest level ever recorded; overall employee motivation was rated 6.92 out of 10, comparable to the level in 2006.
- To ensure pay equity, we instituted new compensation plans for non-unionized employees and for members of the Hydro-Québec professionals' and specialists' union.
- Out of the 2,860 employees eligible for retirement in 2007, 758 left the company.
- According to our annual survey, the satisfaction rate among new personnel in the areas of employee induction and integration was 8.3 out of 10 in 2007. Of the 1,551 new employees hired in 2007, 67% were under 35 years of age.
- Hydro-Québec is a partner in the Institute of Electrical Power Engineering, whose mission is to facilitate the sharing of university resources in electrical engineering and get industry involved in training the next generation of engineers. In 2007, we awarded 15 general scholarships and 27 traveling scholarships to 37 students of the Institute, for a total contribution of $83,650. In addition, 17 new graduates of the Institute joined the company's ranks in 2007; in total, Hydro-Québec has hired 78 graduates since the Institute was created.
- We offered internships to 170 students from university graduate and undergraduate programs. We also took in 16 college-level students from work-study programs in such disciplines as industrial electronics and civil engineering.

Highest job satisfaction rate ever recorded!

In 2007, the company spent $115 million on training activities.

- The frequency of work-related accidents improved in 2007, at 3.24 per 200,000 hours worked, compared with 3.33 in 2006. In addition, we continued the due-diligence audit procedures begun in 2006 to meet our obligations in occupational health and safety and ensure the implementation of measures to prevent accidents.

- In 2007, we dedicated 4.2% of the payroll to training programs, and 16,453 employees took part in at least one training activity.

- In our project for managing diversity at Hydro-Québec, we drew up a profile of target groups (women, Aboriginal people, members of ethnic and visible minorities and the disabled) and compared our results with labor market availability rates established by Québec's Commission des droits de la personne et des droits de la jeunesse for various job categories such as clerical, trades, technicians, engineers and scientists. We are completing an action plan with a timeline of 2015 to harmonize the profile of our human resources with the labor market.

- As part of our emergency biohazard response plan, we conducted simulations of emergency situations that demonstrated our ability to ensure service continuity in the event of a pandemic.

A mainspring of the Québec economy

Hydro-Québec is a driver of the provincial economy. Its day-to-day operations and its construction, refurbishing and innovation projects generate billions of dollars in spinoffs and support thousands of jobs throughout Québec.

- Procurement of goods and services inside and outside Québec totaled $2,586 million[a] in 2007, compared with $2,673 million the previous year. It can be broken down as follows:
  - $1,057 million for the purchase of goods
  - $33 million for rentals
  - $1,101 million for specialized services and other work
  - $395 million for professional services

- In 2007, goods and services procured from companies in Québec totaled $2,436 million, or 94% of all procurement.[a]

- The number of jobs in Québec supported by our overall procurement of goods and services is estimated at 19,000, including 13,000 direct jobs.[a]

- To guarantee security of supply and competitive prices, we are continuing to diversify our sources, particularly for strategic goods and services required to fulfill our core mission.

- We worked to expand our toolbox for evaluating the performance of suppliers to promote continuous improvement in the quality of goods and services purchased.

- We reinforced our criteria for adherence to sustainable development principles:
  - We developed tools to make suppliers aware of our environmental requirements.
  - We formulated a declaration of environmental compliance for the suppliers of certain types of goods and services.
  - We negotiated agreements for the recovery and reclamation of materials and equipment such as refrigerators, computers, glass, plastic and metal.

- In 2007, our capital spending on various hydroelectric projects generated 4,606 construction jobs for outside suppliers.

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

Exhibition of photos from our archives in the lobby of our head office. Hydro-Québec lends archival material to exhibitions highlighting Québec's industrial heritage.

Our Shared Services Centre coordinates the transportation of workers to remote regions.

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

Administrative region of Québec	Procurement of services[c]	Procurement of goods[d]	**Total**
Abitibi-Témiscamingue (08)	20,589	15,898	36,487
Bas-Saint-Laurent (01)	7,041	2,584	9,625
Capitale-Nationale (03)	185,255	31,370	216,625
Centre-du-Québec (17)	82,877	29,807	112,684
Chaudière-Appalaches (12)	55,664	26,496	82,160
Côte-Nord (09)	45,370	9,553	54,923
Estrie (05)	6,552	8,532	15,084
Gaspésie–Îles-de-la-Madeleine (11)[e]	4,304	1,397	5,701
Lanaudière (14)	27,930	17,960	45,890
Laurentides (15)	79,969	20,497	100,466
Laval (13)	120,798	28,315	149,113
Mauricie (04)	124,703	40,148	164,851
Montérégie (16)	114,592	258,450	373,042
Montréal (06)	377,348	433,776	811,124
Nord-du-Québec (10)	9,045	6,123	15,168
Outaouais (07)	6,974	21,665	28,639
Saguenay–Lac-Saint-Jean (02)	184,079	30,307	214,386
Total	**1,453,090**	**982,878**	**2,435,968**

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

b) Excluding procurement by Société d'énergie de la Baie James.

c) Specialized services, professional services and other work.

d) Purchases and rentals.

e) In the regional county municipality of Matane and the Gaspésie–Îles-de-la-Madeleine region, contracts awarded to independent wind power producers as a result of the first Hydro-Québec Distribution call for this type of energy generated spinoffs estimated at roughly $185 million in 2007.

Recycling metal at our Saint-Hyacinthe residual hazardous materials recycling centre.

Québec Premier Jean Charest awards a Grand Prix québécois de la qualité 2007 to Maurice Charlebois, Executive Vice President, Human Resources and Shared Services.

PHOTO: © MOUVEMENT QUÉBÉCOIS DE LA QUALITÉ

Hydro-Québec's Shared Services Centre won one of the Québec government's grand prizes for quality in 2007. These awards recognize efforts to achieve excellence in both the private and public sectors. With their rigorous selection criteria, they can be compared to such prestigious international prizes as the Deming Prize (Japan), Malcolm Baldrige National Quality Award (United States) and the European Quality Prize.

Hydro-Québec's Contribution to the Québec Economy

	2007	2006
Dividends declared ($M)	**2,095**	2,342
Capital tax ($M)	**278**	261
Public utilities tax ($M)	**240**	230
Water-power royalties ($M)	**263**	–
Municipal and school taxes ($M)	**35**	36
Loan guarantee fees paid to the shareholder ($M)	**169**	158
Percentage of goods and services procured from Québec companies	**94**	92
Direct jobs supported by procurement, including procurement outside Québec (person-years)	**13,000**	14,000
Integrated Enhancement Program grants ($M)[a]	**0.4**	1.1

a) Under the company's Integrated Enhancement Program, communities affected by major transmission projects receive grants equivalent to 1% of the capitalized cost of the facilities.

Close community ties

To help ensure project acceptance by local communities and maximize the economic spinoffs of its activities, Hydro-Québec partners with local authorities, socioeconomic organizations and citizens' groups. It also contributes to the development of regions where it is active and participates in various ways in training the next generation of workers.

- In May 2007, Hydro-Québec and the Union des municipalités du Québec signed a partnering agreement on energy efficiency. The two-year agreement contains provisions for the establishment of one-stop service to provide support to municipal officials in planning and carrying out energy efficiency initiatives. A similar agreement was reached with the Fédération Québécoise des Municipalités in September.

- In order to maximize spinoffs from the Romaine hydropower project, Hydro-Québec and the regional county municipality of Minganie signed a partnering agreement in January 2008 to fund various economic, environmental, social and cultural projects. Funding under the agreement extends to 2070.

- To incorporate traditional knowledge into the environmental impact assessment for the Romaine hydropower complex, a survey was conducted of some 20 Innus from the communities of Ekuanitshit, Nutashkuan and Unaman-shipu. The purpose of the survey was to document traditional knowledge of the study area and perceptions of the relations between the various components of the biophysical environment and the effects of these elements on the traditional life of Innu communities.

- Hydro-Québec and the Comité de maximisation des retombées économiques du Nord-du-Québec (ComaxNord) signed a new agreement to maximize jobs created and contracts awarded in the region for the Eastmain-1-A/Sarcelle/Rupert project. Hydro-Québec and ComaxNord also renewed their existing financial partnership.

High-school students spent a day at Hydro-Québec as part of the Student Business Project.

Rehabilitation of a weir at Gaillard power station in Haiti.

- Hydro-Québec participated in career and science fairs organized by Cree communities. This gave community residents a chance to find out about the company's activities and job opportunities.
- As part of the Student Business Project, we welcomed a number of high-school students for day-long visits.

International influence

On the world scene, Hydro-Québec participates actively in international organizations such as the World Energy Council, the International Council on Large Electric Systems (CIGRE), the Institut de l'énergie et de l'environnement de la Francophonie, and the e8. We also share our expertise with developing nations under international cooperation projects.

- In May 2007, the International Hydropower Association (IHA) held the first world congress on sustainable hydropower development. As a precursor to this event in Antalya, Turkey, which attracted participants from 42 countries, Hydro-Québec helped design and run a training course on hydropower sustainability and auditing hydropower projects for compliance with IHA guidelines.
- The chairmanship of the e8 passed to Hydro-Québec for the 2007–2008 cycle and, as a result, the organization's annual summit in June 2008 will be chaired by Thierry Vandal.
- We have renewed our commitment to the Fonds Hydro-Québec pour la Francophonie for five years. During the last year, this fund was active in the following areas:
  - Renewal of funding for an assistance program to help Électricité d'Haïti get the power industry in Haiti back on its feet
  - Funding of training courses in Benin, Switzerland and Togo, in cooperation with the Secrétariat international francophone pour l'évaluation environnementale and the Institut de l'énergie et de l'environnement de la Francophonie
- Hydro-Québec participated in the 20th World Energy Congress, held from November 11 to 15 in Rome. The conference brought together roughly 4,000 decision makers from all sectors—business, government, international agencies, universities, etc.—and all parts of the globe. The 21st World Energy Congress will be held in Montréal in 2010.

Contributing to the Community

Hydro-Québec supports activities and events of every kind across Québec, of which the Festival de Lanaudière is one. The company invests in health, education, humanitarian aid and cultural development, as well as encouraging its employees to get involved in their communities.

PHOTO: GUY HAMELIN / FESTIVAL DE LANAUDIÈRE

A longstanding commitment to society

Hydro-Québec is proud of its longstanding commitment to Québec society. In 2007, it contributed $24.7 million—or almost 1% of its net income—in donations and sponsorships to a large number of organizations and activities in all regions of the province. Areas funded included culture, health and humanitarian aid, education and youth, social and economic development, sports and the environment. Continuing its annual tradition, it donated $6.1 million—nearly half of which came from its employees, pensioners and directors—to United Way/Centraide, which supports a multitude of community projects and organizations across Québec.

Culture

- Hydro-Québec helps a number of major cultural institutions to thrive, including the Grands Ballets Canadiens de Montréal, Opéra de Montréal, Théâtre du Nouveau Monde, Pointe-à-Callière Montréal Museum of Archeology and History, Musée national des beaux-arts du Québec, Musée de la civilisation, Opéra de Québec, Domaine Forget in the Charlevoix region and the Orford Arts Centre.

- Hydro-Québec sponsors all the symphony orchestras in Québec. It has been a title sponsor of the Orchestre symphonique de Montréal since 1999 and season sponsor of the Orchestre symphonique de Québec every year since 2005, and is also a partner of the Orchestre Métropolitain du Grand Montréal.

- In 2007, we funded a number of theatre companies such as the Théâtre du Rideau Vert, Centaur Theatre Company and Théâtre La Licorne in Montréal; Théâtre du Trident in Québec City; Théâtre de l'Arbre-muse in Trois-Rivières; Théâtre Les gens d'en bas in Bic; and Théâtre La Rubrique in Saguenay.

- We provided funding for a number of major cultural events in 2007, including the Québec City Summer Festival, Festival des traditions du monde in Sherbrooke, Mondial des cultures in Drummondville, Festival du cinéma international en Abitibi-Témiscamingue, Festival de Lanaudière, Musiqu'en Nous in the Outaouais region, Festival classique des Hautes-Laurentides, Symposium international d'art contemporain de Baie-Saint-Paul, the blueberry festival in Dolbeau-Mistassini and Festiv'Art de Frelighsburg. In addition, we support annual or biennial events such as the Québec Winter Carnival, Festi-vent sur glace in Saint-Placide and the Puvirnituq Snow Festival. We are also supporting the celebrations marking the 400th anniversary of Québec City.

Thierry Vandal co-chaired the United Way/ Centraide campaign of greater Montréal. Hydro-Québec's contribution: $6.1 million.

Romeo and Juliet performed by Les Grands Ballets Canadiens de Montréal.

PHOTO: SERGUEI ENDINIAN

Poster for the Théâtre du Rideau Vert's production of *Marie Stuart*.

PHOTO: ANGELO BARSETTI

Health and humanitarian aid

In 2007, we contributed $2.3 million to the fundraising campaigns of roughly 60 hospitals in all regions of Québec. Major institutions in and around Montréal and Québec City benefiting from our support include the Montréal Heart Institute, Centre hospitalier universitaire Sainte-Justine and the Corporation de l'Institut de cardiologie de Québec. Other beneficiaries include the Centre hospitalier régional de Rimouski, Hôtel-Dieu d'Alma, the Chicoutimi Health and Social Services Centre's Fondation de ma vie, Centre hospitalier Pierre-Janet (in the Outaouais region), Centre de santé et de services sociaux du Sud de Lanaudière, Hôpital Charles LeMoyne in the Montérégie region and the Hôpital de Memphrémagog in the Eastern Townships. The Fondation les petits trésors of the Rivière-des-Prairies Hospital, which works in the field of children's mental health in the Montréal region, also received our assistance.

We also supported 150 other organizations active in helping drug addicts, working with the underprivileged, or facilitating the social integration of troubled youth, including the Fondation des Auberges du cœur, Le Boulot vers… and the Réseau québécois des CFER (Centres de formation en entreprise et récupération), a network of centres that provide training in business and recycling.

Education and youth

For a number of years, we have provided financial support to Québec universities for development activities and scholarships rewarding academic excellence. In 2007, our donations to universities totaled $3.4 million, including new commitments to the Université du Québec à Rimouski, Concordia University and McGill University. This amount does not include funding for research chairs ($1.6 million) and research contracts.

We provided assistance to the Québec Youth Foundation, Regroupement des maisons de jeunes du Québec and the Fondation Père Sablon.

To get young people interested in science and technology and inspire the next generation of scientists, we again supported the project *Les filles et les sciences: un duo électrisant!,* a day of activities encouraging girls 13 to 15 years old to discover science and technology.

Operating room at the Institut de cardiologie de Québec.

PHOTO: © CORPORATION DE L'INSTITUT DE CARDIOLOGIE DE QUÉBEC

Les filles et les sciences: un duo électrisant! workshop run by some of our engineers.

Hydro-Québec presented the scientific program for the centennial of the Centre hospitalier universitaire Sainte-Justine.

PHOTO: NANCY LESSARD © AGENCE BOS

Socioeconomic development

▸ Hydro-Québec's social and economic involvement is a natural extension of its numerous operations, prompting it to partner with socioeconomic and business groups in various sectors. For example, we support a number of chambers of commerce as well as the Association des directeurs municipaux du Québec and the Fédération des agricultrices du Québec. Events such as the Congrès CFP (cardboard, fibre and paper convention) also receive our support.

Sports

▸ Hydro-Québec has strengthened its partnership with the Québec Foundation for Athletic Excellence by creating new grants for emerging young national- and international-level athletes. They supplement the annual grants the organization offers to outstanding young athletes.

▸ We have been sponsoring the Québec Games for more than 20 years.

▸ The Lake Saint-Jean International Swimming Marathon and the Tour de Beauce also benefited from our support again this year.

▸ Hydro-Québec supports the Défi sportif challenge for athletes with disabilities and the Special Olympics Québec to encourage disabled youth to participate in sports.

Environment

▸ Hydro-Québec sponsored various environmental initiatives in 2007, such as the second National Environmental Exhibition and the accompanying grand parade of alternative-fuel vehicles, the third Business and Sustainable Development Conference organized by the Unisféra International Centre and a seminar on biodiversity organized by the Center for the Development of International Research on the Environment (CEDRIE).

▸ Both the International Forum on Applied Sustainable Development organized by the Université de Sherbrooke and the Climate 2050 Conference in Montréal benefited from funding and the active participation of Hydro-Québec management.

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

Hydro-Québec would like to point out that this analysis, and especially the Outlook section, contains statements based on estimates and assumptions concerning future results and the course of events. Given the risks and uncertainties inherent in any forward-looking statements, Hydro-Québec's actual future results could differ materially from those anticipated. It should also be noted that certain financial and operating data for previous years have been reclassified to respect the presentation adopted for the current year. Finally, the information contained herein takes into account any significant event that occurred on or before March 14, 2008.

Management's Discussion and Analysis

Overview

Income from continuing operations amounted to $2,882 million, compared to $2,797 million last year, when a $234-million non-recurring foreign exchange gain was recognized. This result is primarily attributable to a $290-million increase in net electricity exports.

Income from discontinued operations amounted to $25 million in 2007, mainly as a result of a gain on the sale of our interest in DirectLink, in Australia. This transaction, which was concluded on February 28, 2007, marked the completion of our plan to dispose of our foreign holdings.

Net income declined by $834 million from 2006 to total $2,907 million, mainly as a result of gains of $917 million on the sale of assets in 2006, including $813 million for the sale of our interest in Transelec, in Chile.

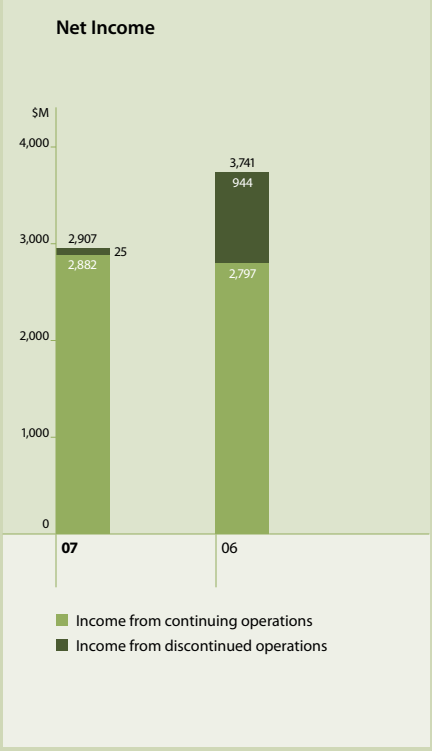
Revenue totaled $12,330 million, up $1,169 million (11%) from 2006. Revenue from electricity sales reached $11,985 million, compared to $10,551 million in 2006, an increase of $1,434 million attributable to higher electricity sales in Québec ($966 million) and outside Québec ($468 million). Other revenue decreased by $265 million, primarily due to the recognition in the second quarter of 2006 of a non-recurring foreign exchange gain in the amount of $234 million on debts and swaps denominated in U.S. dollars.

Total expenditure reached $6,936 million, up $784 million from 2006. This was mainly due to a $240-million increase in electricity and fuel purchases and the payment of water-power royalties to the Québec government since January 2007 for $263 million.

Return on equity amounted to 15.0%, compared to 20.6% in 2006. This indicator is evidence of our healthy financial performance. The exceptional return on equity in 2006 included gains of $917 million on the sale of foreign interests.

Cash from operations amounted to $5.2 billion, up $1.2 billion from 2006. Among other things, this cash made it possible to pay the dividends of $2,342 million declared in 2006 and to finance a large part of our investments. The size of our capital program, which reached $3.6 billion in 2007, compared to $3.5 billion in 2006, reflects our continued involvement in major projects in the Generation and Transmission sectors, such as the Eastmain-1-A/Sarcelle/Rupert development, which got under way in the first quarter, and a new interconnection with Ontario.

Dividends declared from 2003 to 2007 total $7.9 billion.



Consolidated Results

Income from continuing operations reached $2,882 million, compared to $2,797 million last year, when a non-recurring foreign exchange gain in the amount of $234 million was recognized. This result is primarily attributable to a $290-million increase in Hydro-Québec Production's net electricity exports due especially to a higher sales volume and favorable market conditions.

Revenue was up by $1,169 million (11%) to total $12,330 million in 2007. Revenue from electricity sales increased by $1,434 million and reached $11,985 million. Sales in Québec accounted for $10,368 million, an increase of $966 million, for a volume increase of 5.8 TWh over 2006. On markets outside Québec, revenue totaled $1,617 million, up $468 million. Other revenue decreased by $265 million, mainly due to the recognition as at June 30, 2006, of a $234-million non-recurring foreign exchange gain on debts and swaps denominated in U.S. dollars.

The $966-million increase in revenue from electricity sales in Québec essentially results from colder temperatures in 2007, higher revenue from special contracts with large industrial customers, for which the risks are assumed by Hydro-Québec Production, and rate adjustments that came into effect on April 1, 2006 and 2007.

The $468-million increase in revenue from electricity sales outside Québec results from a higher export volume for Hydro-Québec Production and, to a lesser extent, Hydro-Québec Distribution's resale transactions.

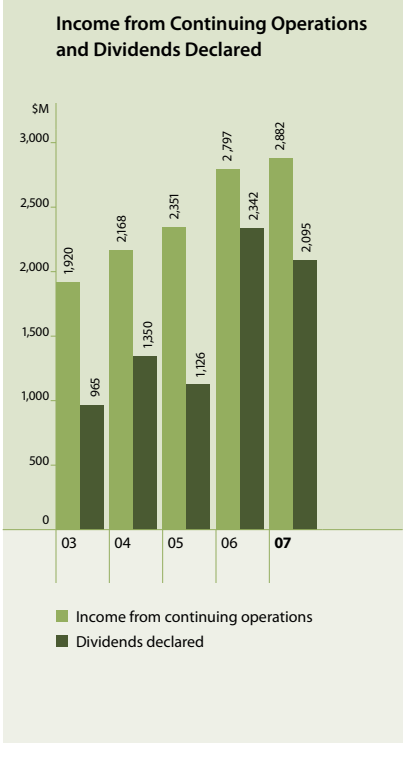
Total expenditure amounted to $6,936 million, which is $784 million more than in 2006.

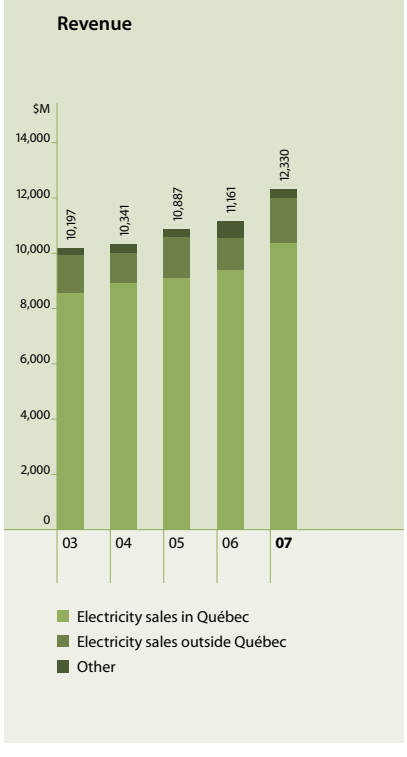
Operating expenses rose from $2,394 million in 2006 to $2,545 million in 2007. This $151-million increase is attributable to inflation and a higher volume of activity. Underlying factors were the commissioning of Eastmain-1 and Mercier generating stations by Hydro-Québec Production, stepped-up system maintenance and vegetation control activities by Hydro-Québec Distribution and the additional costs incurred by Hydro-Québec Distribution for the third and final phase in the deployment of the Customer Information System. Higher pension costs also contributed to the increase in operating expenses.

Electricity and fuel purchases amounted to $1,555 million in 2007, as against $1,315 million in 2006. This $240-million variance is mainly attributable to a $247-million increase in electricity purchases in excess of the heritage pool by Hydro-Québec Distribution.

Depreciation and amortization expense totaled $1,991 million, versus $2,007 million in 2006. Depreciation of property, plant and equipment increased by $93 million due to the commissioning of several facilities. However, there was a net decrease of $120 million resulting from the amortization of regulatory assets and liabilities according to the conditions stipulated by the Régie de l'énergie. Of the $262 million in regulatory liabilities recognized in 2006 for cost variances in electricity purchases in excess of the heritage pool, $251 million was amortized in 2007, which reduced the depreciation and amortization expense by an equivalent amount. Conversely, the partial amortization of the regulatory asset related to native load transmission service costs recognized in 2006 following a Régie decision increased this expense by $70 million. It should be noted that amortization of these two items was taken into account in setting the rates that came into force in April 2007.

Taxes were $816 million, up $287 million over 2006, including $263 million due to the January 2007 introduction of water-power royalties payable to the Québec government by Hydro-Québec Production.





Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

Regulatory deferrals in 2007 led to the recognition of a $57-million regulatory asset and regulatory liabilities of $86 million.

Two factors underlying these deferrals relate to revenue from transmission services. First of all, the Régie de l'énergie handed down a decision in March 2007 regarding transmission rates to be charged by Hydro-Québec TransÉnergie effective January 1, 2007. This decision translated into an increase of $57 million in native load transmission revenue, reflecting the cost of the infrastructure needed to meet demand growth in Québec. Since distribution rates for 2007 had already been set, the $57-million increase resulted in the recognition of a regulatory asset in the same amount.

Secondly, the Régie established a new variance account in 2007 corresponding to the difference between revenue forecasts for point-to-point transmission services recognized by the Régie for the purpose of setting transmission rates and actual revenue from point-to-point transmission services. This mechanism makes it possible to attribute positive or negative revenue variances to customers of native load transmission services and long-term point-to-point transmission services. Since actual revenue for 2007 exceeded forecasts, an amount of $50 million was recorded as a regulatory liability.

In addition, the actual cost of supplying electricity in excess of the heritage pool was lower than the cost forecasted for the purpose of rate-setting by the Régie de l'énergie. A $36-million regulatory liability was therefore recorded, bringing the total regulatory liabilities recognized in 2007 to $86 million.

It should be remembered that in 2006 a regulatory asset totaling $340 million had been recognized for transmission service costs for 2005 and 2006. In addition, a regulatory liability in the amount of $262 million had been recorded in 2006 to take into account the fact that the actual cost of supply in excess of the heritage pool was lower than the costs forecasted for rate-setting purposes.

Financial expenses totaled $2,512 million, versus $2,212 million in 2006, for an increase of $300 million. The difference is attributable in part to higher interest rates on capital markets. In addition, the adoption of new accounting standards for financial instruments, which abolished the transitional rules implemented in 2004, gave rise to an upward adjustment of retained earnings as at January 1, 2007, and terminated the amortization of a deferred gain. Other factors contributing to the increase in financial expenses were lower capitalized financial expenses, which in turn stemmed from a decrease in the average value of property, plant and equipment under construction (due in particular to the commissioning of Eastmain-1 powerhouse in the second half of 2006), as well as higher guarantee fees and the fact that no interest was allocated to discontinued operations in 2007.

Income from discontinued operations was $25 million in 2007, compared to $944 million in 2006. The 2007 income essentially resulted from an $18-million gain on the sale of our interest in DirectLink (Australia). It should be recalled that 2006 income included disposal gains totaling $917 million, including $813 million from the sale of our interest in Transelec, in Chile.

Net income amounted to $2,907 million, versus $3,741 million in 2006. This $834-million decrease is attributable to gains of $917 million on the sale of assets in 2006 and the recognition of a non-recurring foreign exchange gain in the amount of $234 million during the same year. The difference was mitigated, however, by a $290-million increase in net electricity exports in 2007.

	2007	2006
OPERATIONS AND DIVIDENDS ($M)		
Revenue	**12,330**	11,161
Operating income	**5,394**	5,009
Income from continuing operations	**2,882**	2,797
Income from discontinued operations	**25**	944
Net income	**2,907**	3,741
Dividends declared	**2,095**	2,342
BALANCE SHEETS ($M)		
Total assets	**64,852**	63,254
Property, plant and equipment	**53,228**	51,854
Long-term debt, including current portion and perpetual debt	**34,534**	34,427
Equity	**20,892**	18,840
RATIOS		
Return on equity (%)	**15.0**	20.6
Capitalization (%)	**37.5**	36.1
Self-financing (%)	**61.9**	86.5
Interest coverage	**2.13**	2.06

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

Financial Position

Operating activities

Cash from operating activities totaled $5,159 million in 2007, versus $4,005 million in 2006. These funds were used to finance a large part of our investments and to pay the dividends declared for 2006.

Investing activities

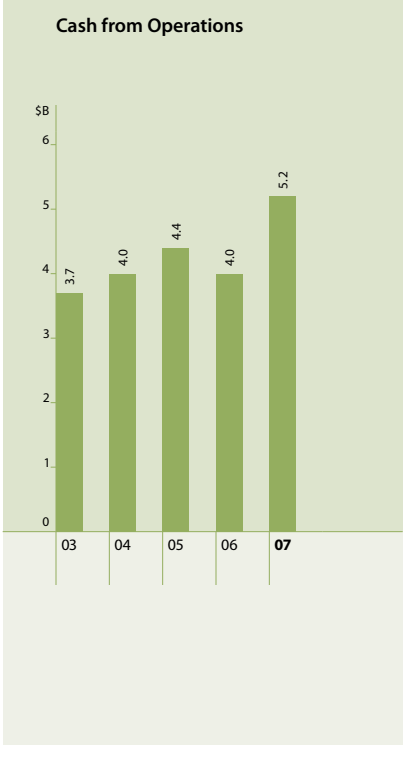
In 2007, Hydro-Québec invested $3.6 billion in property, plant and equipment, intangible assets and the Energy Efficiency Plan, versus $3.5 billion in 2006. Of this total, $2.0 billion was devoted to development projects and $1.4 billion to maintaining or improving the quality of assets, while $0.2 billion went to the Energy Efficiency Plan.

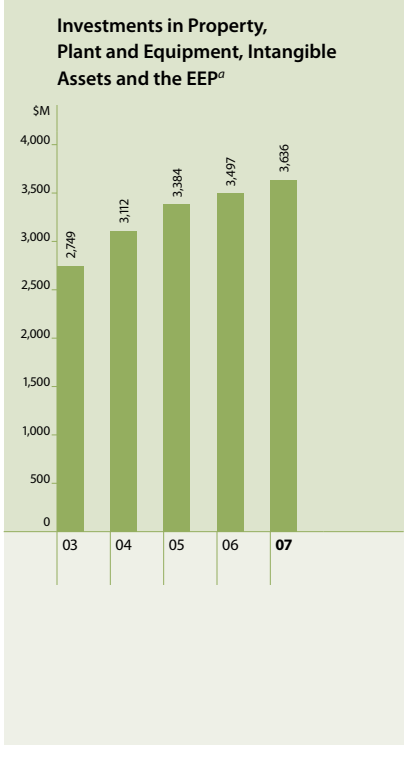
Hydro-Québec Production invested a total of $1,807 million in 2007, compared to $1,615 million in 2006. As expected, a large portion of this amount, $1,404 million, was devoted to development projects, such as Eastmain-1-A/Sarcelle/Rupert, Péribonka (where the first of the three generating units was commissioned in the last quarter of 2007), Chute-Allard and Rapides-des-Cœurs hydroelectric developments and Mercier generating station. The amounts allocated to fleet maintenance and improvement totaled $403 million. The division also continued the rehabilitation and refitting of several facilities, including Beauharnois, La Tuque and Outardes-4, as well as draft-design studies for the refurbishment of Gentilly-2 nuclear generating station.

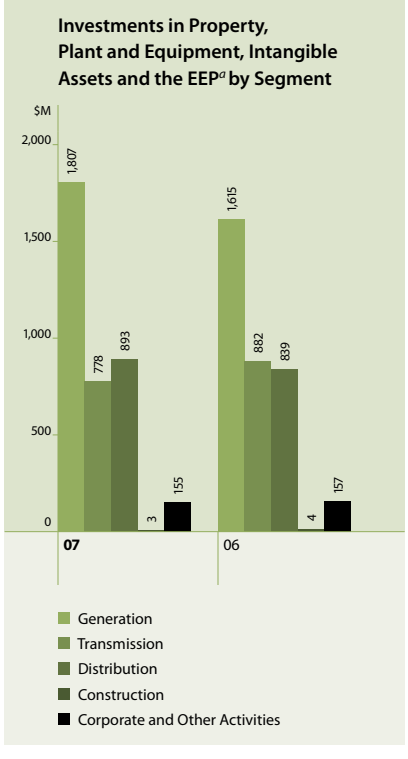
Capital spending at Hydro-Québec TransÉnergie totaled $778 million, approximately 40% of it to meet demand growth in Québec. This included connecting Péribonka, Chute-Allard and Rapides-des-Cœurs generating stations to the grid, as well as building a new, 1,250-MW interconnection with Ontario, to be commissioned in phases until 2010. The remainder was devoted to long-term transmission system operability and the improvement of service quality.

Hydro-Québec Distribution invested $721 million in capital projects to meet demand growth, ensure the long-term operability of the distribution system and enhance service quality. An additional $172 million went to the Energy Efficiency Plan.

Note that Hydro-Québec Équipement and Société d'énergie de la Baie James carry out engineering and construction projects for Hydro-Québec Production and Hydro-Québec TransÉnergie.







a) EEP: Energy Efficiency Plan

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

Financing activities

Net issues of long-term debt in 2007 totaled $550 million.

Hydro-Québec's gross borrowings, including net disbursements in the amount of $481 million relating to credit risk management, totaled $1,543 million, versus $3,955 million in 2006.

The borrowing program included the reopening, on January 19, August 8, October 5, and December 10, 2007, of a bond issue maturing in February 2045. These operations raised $2,028 million at an average rate of 4.9%, exclusively on the Canadian market.

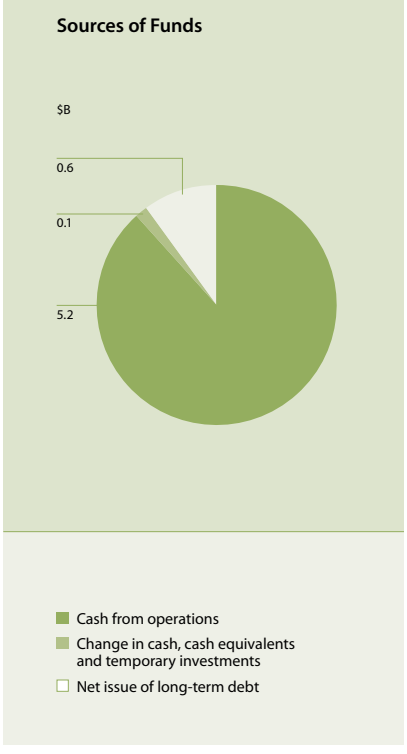
The proceeds of all these activities financed some of our investments and were also used to refinance debt maturing in 2007.

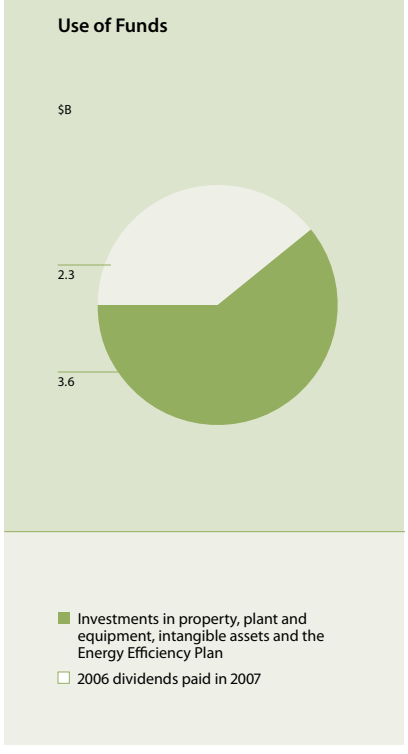
The Corporation has access to the following preauthorized funding sources:

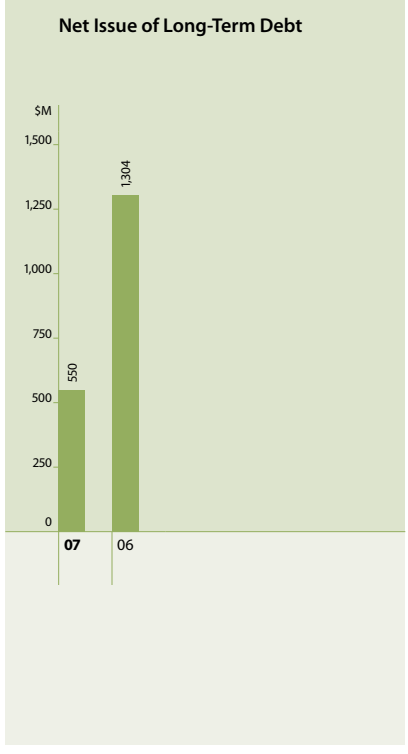
PREAUTHORIZED FUNDING SOURCES

Type of financing	Authorized volume	Market	Outstanding as at December 31, 2007
Credit lines	US$350 million or C$350 million		–
	C$40 million		–
	US$110 million		–
Standby credit[a]	US$2,000 million		–
Commercial paper[a]	US$2,250 million or equivalent in C$	United States or Canada	C$29 million
Medium-term notes[a]	US$3,000 million or equivalent in other currency	United States	US$440 million
	C$16,000 million or equivalent in US$	Canada	C$12,166 million

a) Guaranteed by the Québec government.







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

CREDIT RATINGS

	2007		2006	
	Commercial paper	Long-term	Commercial paper	Long-term
U.S. agencies				
Moody's	**P-1**	**Aa2 stable**	P-1	Aa2 stable
Fitch Ratings	**F1+**	**AA- stable**	F1+	AA- stable
Standard & Poor's	**A-1+**	**A+**	A-1+	A+
Canadian agency				
DBRS	**R-1 (middle)**	**A (high) stable**	R-1 (middle)	A (high) stable

Dividends and capitalization rate

Since the Corporation has met all the requisite conditions, with a capitalization rate of 39.8% at year end, dividends totaling $2,095 million were declared for 2007. When these dividends are factored in, the capitalization rate stands at 37.5%.

Dividends declared from 2003 to 2007 total $7.9 billion.

Segmented Information

As in 2006, Hydro-Québec had four operating segments, namely Generation, Transmission, Distribution and Construction, as well as activities grouped under Corporate and Other Activities. The main change made to the organizational structure in 2007 relates to the transfer of information technology activities from the Human Resources and Shared Services Group to the Technology Group. These groups' results are presented under Corporate and Other Activities.

Moreover, in connection with Hydro-Québec TransÉnergie's 2008 rate application, the Régie de l'énergie approved, on February 15, 2008, the inclusion of telecommunications assets related to transmission activities in the rate base. These assets, which were transferred from the Technology Group to Hydro-Québec TransÉnergie, as well as the related investment projects, have therefore been regulated since January 1, 2008. However, management of telecommunications activities remains the responsibility of the Technology Group. Costs related to these assets were already taken into account in the rate-setting.

						2007
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec[a]
Revenue	**6,752**	**2,787**	**10,508**	**2,150**	**1,281**	**12,330**
Income before financial expenses	**3,257**	**1,188**	**879**	**–**	**83**	**5,419**
Total assets	**29,495**	**16,047**	**11,833**	**263**	**7,474**	**64,852**

						2006
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec[a]
Revenue	6,164	2,841	9,543	1,999	1,251	11,161
Income before financial expenses	3,172	1,356	449	1	967	5,953
Total assets	28,674	15,879	11,430	214	7,272	63,254

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

Note: Certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

Segment highlights

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

The **Generation** segment recorded income before financial expenses of $3,257 million, up $85 million over 2006, when a non-recurring foreign exchange gain in the amount of $234 million was recognized on debts and swaps denominated in U.S. dollars. This result is mainly attributable to higher net electricity exports.

The **Transmission** segment recorded income before financial expenses of $1,188 million, versus $1,356 million in 2006. This decrease results mainly from lower transmission revenue for the native load. Following a decision handed down by the Régie de l'énergie in April 2006, a non-recurring amount of $170 million for 2005 was recorded with 2006 revenue as native load transmission revenue, giving rise to a $170-million decrease in 2007.

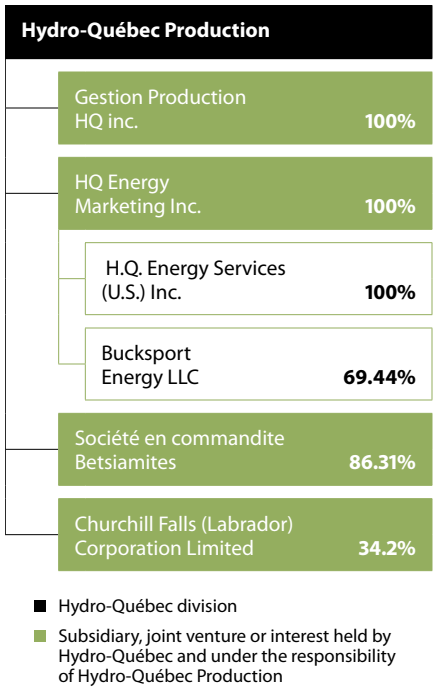
The **Distribution** segment recorded income before financial expenses of $879 million, compared to $449 million in 2006. This growth is due to the fact that a $262-million liability was recorded in 2006 for electricity purchases in excess of the heritage pool and that, in accordance with the conditions set by the Régie de l'énergie, $251 million of this liability was amortized in 2007, reducing amortization expense by the same amount. The increase in revenue from electricity sales was offset in large part by the higher volume of electricity purchases in excess of the heritage pool and by higher transmission costs.

The **Construction** segment recorded a volume of activity of $2,150 million, compared to $1,999 million in 2006. As in 2006, this high volume stems from construction work on several major projects.

Generation

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

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 recorded net income of $2,077 million in 2007, compared to $2,114 million in 2006, a decrease of $37 million. It should be remembered that 2006 income included a non-recurring foreign exchange gain in the amount of $234 million on debts and swaps denominated in U.S. dollars. In 2007, net electricity exports were up by $290 million; revenue from new contracts in excess of the heritage pool with deliveries beginning on March 1, 2007, increased by $212 million; and the net income from special contracts with large industrial customers was up by $225 million. However, these items were partially offset by the payment of water-power royalties totaling $263 million and by higher financial, operating and depreciation and amortization expenses, which increased by $122 million, $102 million and $77 million, respectively.

Electricity sales in Québec

Sales to Hydro-Québec Distribution

In 2007, the volume of total electricity sales to Hydro-Québec Distribution reached 171.5 TWh, as against 165.1 TWh in 2006, for an increase of 6.4 TWh. Revenue generated by these sales was up $307 million to reach $4,922 million. This rise is mainly attributable to an increase of 4.1 TWh, or $212 million, in electricity sales in excess of the heritage pool under new supply contracts (350 MW in baseload power and 250 MW in cycling deliveries) with deliveries beginning on March 1, 2007.

Special contracts with large industrial customers

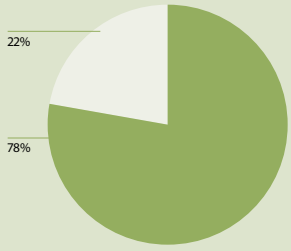
Net income from special contracts with large industrial customers increased by $225 million, due to the management of risks associated with exchange rates and aluminum prices. Were it not for risk management, these contracts would have generated losses of $54 million in 2007 and $33 million in 2006. The risks related to these contracts are assumed by Hydro-Québec Production.

Electricity sales outside Québec

Electricity sales outside Québec generated revenue of $1,483 million for 17.5 TWh in 2007, compared to $1,149 million for 14.5 TWh in 2006. Short-term electricity sales earned $1,258 million for 15.2 TWh, compared to $951 million for 12.1 TWh in 2006, a $307-million increase that is mainly attributable to higher sales volume and favorable market conditions.

Net electricity exports were $1,104 million for a net reservoir drawdown of 10.7 TWh, as compared to $814 million for 7.0 TWh in 2006. They generated a unit contribution of 10.3¢/kWh in 2007, compared to 11.6¢/kWh in 2006.

Breakdown of 2007 Investments by Hydro-Québec Production



Development
Maintenance and improvement

Other revenue

Other revenue decreased by $282 million due to the $234-million non-recurring foreign exchange gain on debts and swaps denominated in U.S. dollars recognized in the second quarter of 2006.

Electricity and fuel purchases

Electricity and fuel purchases amounted to $1,221 million in 2007, a $31-million increase compared to 2006. Short-term purchases for export totaled $373 million for 6.3 TWh, compared to $371 million for 6.8 TWh in 2006.

Operating expenses

Operating expenses totaled $844 million in 2007, up $102 million over 2006. This increase is mainly attributable to inflation and to growth in activity, such as the commissioning of Eastmain-1 and Mercier generating stations.

Depreciation and amortization

Depreciation and amortization expense totaled $837 million in 2007, up $77 million over 2006. This variance is essentially attributable to the commissioning of new facilities, including Eastmain-1 powerhouse in the second half of 2006.

Investing activities

Investments in property, plant and equipment and intangible assets affecting cash amounted to $1,807 million in 2007. Of this amount, $1,404 million went to development activities, primarily for work on the Eastmain-1-A/Sarcelle/Rupert, Péribonka (where the first of three generating units was commissioned in the last quarter of 2007), Chute-Allard and Rapides-des-Cœurs projects.

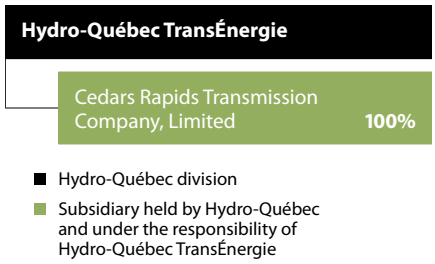
Hydro-Québec Production also invested $403 million in rehabilitating and refitting its fleet. Most of this was for Beauharnois, La Tuque and Outardes-4 generating stations as well as draft-design studies for the refurbishment of Gentilly-2 nuclear generating station.

Transmission

Hydro-Québec TransÉnergie transmits power at the lowest possible cost while meeting demand growth and customer expectations in terms of power quality. It ensures the reliability, long-term operability and optimal deployment of the power transmission system in Québec with a view to sustainable development.

The division's transmission operations in Québec are regulated by the Régie de l'énergie. Following a decision handed down by the Régie on February 15, 2008, the telecommunications assets related to transmission activities and the related investment projects are also regulated as of January 1, 2008.

In August 2007, the Régie designated Hydro-Québec TransÉnergie's Direction du contrôle des mouvements d'énergie (System Control) as the Reliability Coordinator in Québec, thereby confirming the upcoming implementation of a new regime of mandatory reliability standards in Québec. The new regime replaces the old system of voluntary standards coordinated by the North American Electric Reliability Corporation since 1968, in which the division participated. The new regime incorporates the reliability standards that are mandatory for power transmission throughout North America.



Regulatory affairs

For 2007, the revenue authorized by the Régie de l'énergie for rate-setting purposes totaled $2,675 million, including $2,540 million in transmission revenue for the native load (representing a $57-million increase over 2006) and $135 million for short- and long-term point-to-point transmission service. Moreover, in 2007 the Régie established a new variance account corresponding to the difference between revenue forecasts for point-to-point transmission service recognized by the Régie for rate-setting purposes and actual point-to-point transmission service revenue. This mechanism makes it possible to attribute positive or negative revenue variances to native load customers and long-term point-to-point transmission service customers.

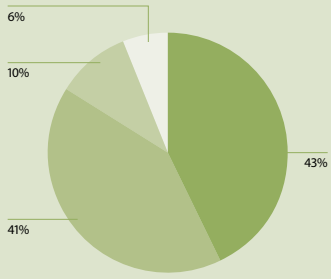
In a preliminary decision dated February 15, 2008, the Régie authorized Hydro-Québec TransÉnergie to modify its transmission rates, effective January 1, 2008. This decision essentially represents a revenue requirement of $2,733 million for 2008, of which $2,529 million is allocated to native load transmission service and $204 million to short- and long-term point-to-point transmission services. The Regie's decision was handed down on February 29, 2008.

Operating results

The division's net income was $396 million in 2007, versus $632 million in 2006. This $236-million decrease stems from lower transmission revenue for the native load, among other things. It should be remembered that, following an April 2006 decision by the Régie de l'énergie, a non-recurring amount of $170 million was recognized in revenue for the second quarter of 2006 as native load transmission revenue for 2005. This gave rise to a $170-million decrease in revenue in 2007. A $68-million increase in financial expenses also contributed to the reduction in net income.

Revenue amounted to $2,787 million, down $54 million compared to 2006. The decrease is almost entirely attributable to a $113-million decline in transmission revenue for the native load, resulting from the combined effect of the $170-million decrease explained above and the $57-million increase authorized by the Régie for 2007.

Breakdown of 2007 Investments by Hydro-Québec TransÉnergie



- Growth
- Maintenance
- Improvement
- Compliance with requirements

Revenue from point-to-point transmission service rose by $58 million over 2006. Since these services generated revenue of $185 million whereas the Régie had approved forecasts of $135 million, the division posted an amount of $50 million to the variance account for point-to-point transmission service in accordance with the Régie decision. This amount is presented under Regulatory deferrals.

Financial expenses totaled $792 million, up $68 million over 2006.

Investing activities

In 2007, Hydro-Québec TransÉnergie invested $778 million in property, plant and equipment and intangible assets affecting cash, or $338 million for development and $440 million for ongoing operations.

More than 40% of the capital outlay in 2007 was related to growth in demand for transmission services. These investments were made to increase transmission capacity and to bring new hydropower plants and wind farms onto the grid.

Some $125 million was invested to connect new hydropower facilities. The connection of Péribonka generating station at a total cost of $171 million, of which $70 million was invested in 2007, consisted in building a 128-km, 161-kV line between the new Péribonka and Simard substations. For the connection of Chute-Allard and Rapides-des-Cœurs, the total cost is estimated at $105 million, including $55 million invested in 2007; the work will be completed in 2008.

Investments totaling $23 million were made to integrate the output of eight wind farms to be commissioned in the Gaspé region by 2012 in response to Hydro-Québec Distribution's first tender call for wind power, issued in 2003. Connecting these wind farms, which represent a total capacity of 990 MW, will require an investment of $600 million between now and 2012.

Finally, construction of the new, 1,250-MW interconnection between Québec and Ontario, which began at the end of 2006 under an agreement between Hydro-Québec TransÉnergie and Hydro One Networks, continued in 2007. The division invested $57 million in the project in 2007, mainly to build the 315/230-kV converter station in the Outaouais region. A 315-kV line will also be built between Chénier and Outaouais substations. The total project cost is estimated at $654 million, and the facilities will be commissioned in stages until 2010.

More than half of the capital outlay in 2007 was devoted to ongoing operations, such as ensuring the long-term operability of facilities, improving service quality and meeting the legal and regulatory requirements for operating a power transmission system. More specifically, the division invested $321 million in replacing equipment and refurbishing facilities. It also devoted $75 million to the improvement of service quality, including a $33-million project to reinforce the transmission system by installing de-icing equipment which will be brought into service at Lévis substation in 2008.

Distribution

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

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

Rate cases

In March 2007, the Régie approved an across-the-board rate increase of 1.9%, taking effect on April 1, 2007. In February 2008, the Régie authorized a 2.9% across-the-board adjustment for 2008–2009. This will enable the division to recover the additional cost of distribution and customer service activities for 2008, as well as part of the cost of native load transmission service for the years 2005 to 2007.

Supplying the Québec market

Hydro-Québec Distribution relies on various sources to supply the Québec market. To meet requirements in excess of the heritage pool (165 TWh) reserved for it by Hydro-Québec Production, the division issues short- and long-term calls for tender. For requirements of less than three months, it may also buy electricity directly on the market, without a call for tender, under an exemption granted by the Régie. For unforeseen needs that cannot be met otherwise, it relies on a framework agreement with Hydro-Québec Production covering the period from January 1, 2007, to December 31, 2008.

The L'Anse-à-Valleau wind farm made its first deliveries in November 2007, joining the Baie-des-Sables wind farm, which was inaugurated at the end of 2006. This brings the division's wind power purchases to approximately 0.6 TWh per year, for an installed capacity of 210 MW.

Hydro-Québec Distribution is continuing its efforts to promote energy efficiency. The *Strategic Plan 2006–2010* set the annual energy savings target at 4.7 TWh by 2010, with an eventual target of 8 TWh by 2015.

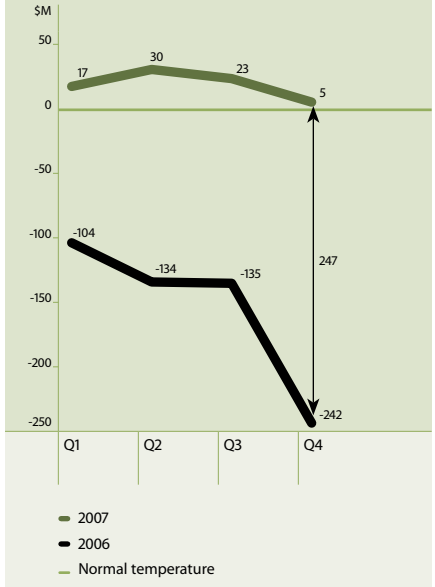
On November 1, 2007, Hydro-Québec Distribution submitted its Electricity Supply Plan 2008–2017 to the Régie de l'énergie. This plan forecasts the electricity needs of the Québec market, taking into account the energy savings expected from energy efficiency programs and the inclusion of wind power in the division's available resources. The Electricity Supply Plan is prepared every three years.

Hydro-Québec Distribution

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

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

Cumulative Effect of Temperatures Compared to Normal



Operating results

Hydro-Québec Distribution had net income of $395 million in 2007, a $353-million increase over 2006. The growth is due to the fact that a $262-million liability was recorded for electricity purchases in excess of the heritage pool in 2006, and that this liability was amortized in 2007 according to the conditions established by the Régie de l'énergie, which reduced depreciation and amortization expense by $251 million. The increase in revenue from electricity sales was offset in large part by a higher volume of electricity purchases in excess of the heritage pool and by higher transmission costs and financial expenses.

Electricity sales in Québec

ELECTRICITY SALES IN QUÉBEC BY CATEGORY

	Sales volume			Sales revenue		
	2007	2007–2006 change[a]		**2007**	2007–2006 change[a]	
Customer category	TWh	TWh	%	$M	$M	%
Residential and farm	**60.0**	3.3	5.8	**4,144**	369	9.8
General and institutional	**34.7**	2.3	7.1	**2,602**	246	10.4
Industrial	**73.0**	(0.3)	(0.4)	**3,336**	314	10.4
Other	**5.2**	0.3	6.1	**273**	24	9.6
Total	**172.9**	5.6	3.3	**10,355**	953	10.1

a) 2006 sales volume and revenue have been reclassified to reflect the presentation adopted for 2007.

Electricity sales revenue reached $10,355 million, up $953 million over 2006. This increase is essentially the result of colder temperatures in 2007, higher revenues related to special contracts with certain large industrial customers due mainly to the impact of risk management related to exchange rates and aluminum prices, as well as rate adjustments that came into effect on April 1, 2006 and 2007. It should be noted that the risks associated with special contracts are assumed by Hydro-Québec Production.

FACTORS IN THE 2007–2006 CHANGE IN SALES BY CATEGORY

	Volume effects					Price effects			**Total**
	Baseload demand		Temperature		**Total**	Rate adjustments	Other	**Total**	
Customer category	TWh	$M	TWh	$M	$M	$M	$M	$M	$M
Residential and farm	0.3	23	3.0	207	**230**	132	7	**139**	**369**
General and institutional	1.6	124	0.7	34	**158**	80	8	**88**	**246**
Industrial	(0.3)	(26)	–	–	**(26)**	78	262	**340**	**314**
Other	0.1	3	0.2	6	**9**	7	8	**15**	**24**
Total	1.7	124	3.9	247	**371**	297	285	**582**	**953**

The sales volume stood at 172.9 TWh, up 5.6 TWh over 2006, of which 3.9 TWh is entirely the result of colder temperatures in 2007 than in 2006. This rise is especially attributable to residential customers (residential and farm category), who are more sensitive to temperature changes due to their heating needs. By contrast, the sales volume for the industrial category, excluding special contracts, declined by 2.2 TWh because of an economic slowdown in the pulp and paper sector and the closure of the Norsk Hydro Canada plant in Bécancour. Finally, a 1.9-TWh sales volume increase is attributable to special contracts with certain large industrial customers.

Electricity and fuel purchases and regulatory deferrals

The cost of net electricity and fuel purchases rose by $424 million compared to 2006. This increase is mainly attributable to a higher volume of electricity purchases in excess of the heritage pool owing to colder temperatures in 2007.

Where regulatory deferrals, which result from an accounting practice authorized by the Régie de l'énergie, are concerned, the division recorded a liability in the amount of $36 million in 2007 since the actual cost of electricity purchases in excess of the heritage pool was lower than the cost forecasted for the purpose of distribution rate-setting by the Régie de l'énergie. The regulatory liability recorded in 2006 amounted to $262 million. Accounting for these liabilities by way of regulatory deferrals resulted in higher expenses in 2006 and 2007.

Cost of native load transmission service and regulatory deferrals

Transmission service costs, including regulatory deferrals, increased by $170 million over 2006. The costs integrated into Hydro-Québec Distribution's rates rose from $2,313 million in 2006 to $2,483 million in 2007, due to the effect of the annual $170-million increase authorized by the Régie de l'énergie in April 2006.

In March 2007, the Régie handed down a decision regarding Hydro-Québec TransÉnergie's rates, effective January 1, 2007. This decision translated into a $57-million increase in native load transmission revenue, reflecting the cost of the infrastructure needed to meet demand growth in Québec. Since distribution rates for 2007 had already been set, the $57-million increase resulted in the recognition of a regulatory asset in the same amount.

Amortization of regulatory assets and liabilities

In 2007, a net decrease of $124 million was recorded in the amortization expense for regulatory assets and liabilities. Among other things, this is attributable to the fact that, of the $262 million of regulatory liabilities recognized in 2006 for cost variances in electricity purchases in excess of the heritage pool, $251 million was amortized in 2007, which reduced the depreciation and amortization expense by an equivalent amount. Conversely, the partial amortization of regulatory assets of $340 million related to transmission service costs for the native load, and recognized in 2006 for 2005 and 2006, increased this expense by $70 million.

Operating expenses

Operating expenses were $1,121 million in 2007, versus $1,071 million in 2006, an increase of $50 million. This increase is attributable to inflation, stepped-up system maintenance and vegetation control and the additional costs associated with the third and final phase in implementing the Customer Information System (CIS) to improve customer service quality.

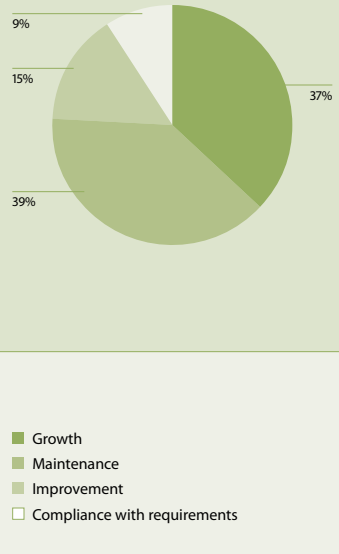
Investing activities

Under the category of investments affecting cash, Hydro-Québec Distribution invested $721 million in property, plant and equipment and intangible assets in 2007.

Of this amount, $265 million went toward meeting growth in demand, including $192 million to hook up new customers. The division also invested $280 million to ensure long-term distribution system operability, and $112 million to improve quality of service, including $86 million for the CIS project and $18 million for the distribution system automation program, which will permit remote monitoring of equipment and improvements to the service continuity index.

Hydro-Québec Distribution also invested $172 million in the Energy Efficiency Plan. It should be noted that in 2007, energy efficiency programs yielded savings of approximately 866 GWh.

Breakdown of 2007 Investments by Hydro-Québec Distribution



Construction

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

As engineering and environmental specialists, Hydro-Québec Équipement and SEBJ also offer 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, land surveying and quality control.

Hydro-Québec Équipement

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

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

Volume of activity

Hydro-Québec Équipement and SEBJ carried out activities worth a total of $2,150 million in 2007, compared to $1,999 million in 2006. As in 2006, this high volume can be attributed to several large-scale projects. Work done for Hydro-Québec Production totaled $1,501 million, versus $1,254 million in 2006, while work done for Hydro-Québec TransÉnergie totaled $599 million, versus $719 million in 2006.

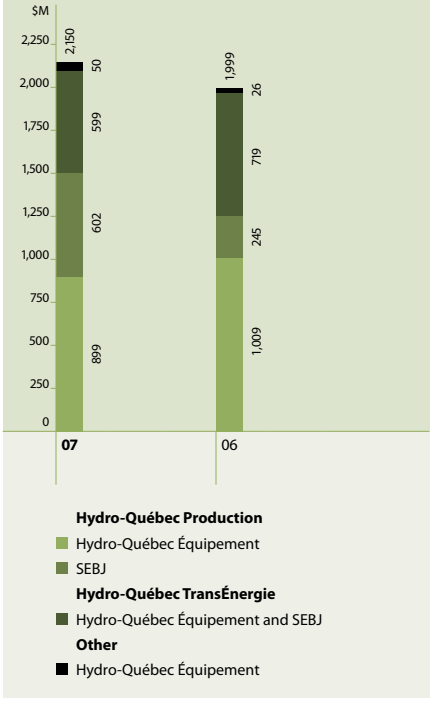
Hydro-Québec Équipement

In 2007, Hydro-Québec Équipement carried out activities worth a total of $1,544 million, versus $1,754 million in 2006. This work related to a number of generation and transmission projects, especially construction of the Péribonka, Chute-Allard and Rapides-des-Cœurs developments and Mercier generating station, the connection of these facilities to the transmission system and the rehabilitation of Beauharnois and La Tuque generating stations. The division also continued work to increase transmission system capacity—including work on a new, 1,250-MW interconnection with Ontario—and to install line de-icing equipment at Lévis substation.

Société d'énergie de la Baie James

SEBJ's activities—mainly on behalf of Hydro-Québec Production—represented a total of $606 million in 2007, compared to $245 million in 2006. This increase is due to the fact that work started on the Eastmain-1-A/Sarcelle/Rupert jobsite in January 2007.

Breakdown of Construction Segment Activities



Corporate and Other Activities

This heading includes corporate activities, the Human Resources and Shared Services Group, the Technology Group and the subsidiary Hydro-Québec International.

Results

Corporate and Other Activities recorded net income of $27 million in 2007, versus $944 million in 2006. This decrease is essentially attributable to the sale of foreign holdings in 2006, which generated gains of $917 million, including $813 million for Transelec, in Chile.

Corporate activities

Corporate activities consist of financial services and corporate affairs. Among other things, the Corporate Affairs Group and General Secretariat coordinates strategic planning.

The Finance Group manages debt, financial expenses and financial risks (such as interest rate and foreign exchange risks and the risk related to aluminum prices) for the entire Corporation. In addition, the Group oversees risk management activities by the divisions and corporate units, while also providing tax and accounting expertise for all the Corporation's business segments. It is also responsible for producing and analyzing the consolidated financial statements, including segmented information, and for activities related to the Business Plan, management of credit and market risks and management of the pension plan, whose assets totaled nearly $13 billion as at December 31, 2007.

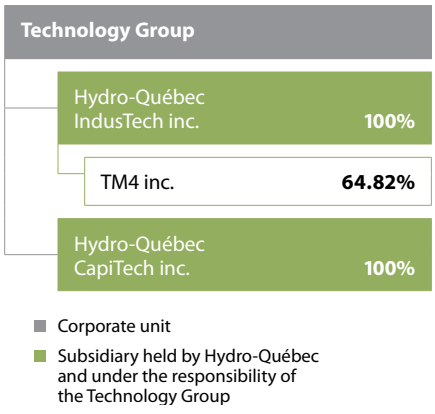
Human Resources and Shared Services Group

The Human Resources and Shared Services Group includes the Human Resources Unit and the Shared Services Centre. It develops strategies, guidelines, corporate programs and objectives in matters pertaining to human resources, procurement and services. The Group's role consists in providing the products and services that are common to the entire company.

The Human Resources Unit has a twofold mission: to ensure that management benefits from optimum human resources conditions and to provide related products and advisory services.

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

The revenue of the Human Resources and Shared Services Group totaled $499 million in 2007, versus $488 million in 2006, up 2.3%.



Technology Group

The Technology Group is made up primarily of the Telecommunications Unit, Hydro-Québec's research institute, and the subsidiaries Hydro-Québec IndusTech and Hydro-Québec CapiTech. Since June 2007, it has also included the Information Systems Unit. Its role is to ensure the integrated management of technological innovation and the optimal management of telecommunications and information systems infrastructure. With this in mind, it has begun developing an overall vision for systems governance, architecture and security to build on the convergence of technologies.

Operating results

The Technology Group had a net loss of $18 million in 2007, compared to $55 million in 2006. The variance is explained by the discontinuation of AVESTOR's activities in December 2006.

Telecommunications and Information Technology units

The Telecommunications and Information Technology units enhance the efficiency of divisions and corporate units by offering technological solutions in line with Hydro-Québec's business priorities.

These units recorded revenue of $567 million in 2007, versus $560 million in 2006.

Research institute

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

Hydro-Québec IndusTech

The mission of Hydro-Québec IndusTech is to partner with the private sector in the industrialization and marketing of technologies resulting from Hydro-Québec's research activities. Hydro-Québec IndusTech holds an ownership interest in TM4 with Groupe Industriel Marcel Dassault. TM4 develops electric drivetrains.

Hydro-Québec CapiTech

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

Investing activities

In 2007, the Technology Group's investments totaled $129 million, of which $107 million was earmarked for maintaining asset quality and $15 million for meeting growth in demand for information and telecommunications technologies.

Hydro-Québec International

Hydro-Québec International completed the sale of its foreign holdings by concluding the sale of DirectLink, in Australia, on February 28, 2007. Income from discontinued operations totaled $21 million in 2007, versus $964 million in 2006, a variance of $943 million explained in large part by an $813-million gain on the sale of the interest in Transelec (Chile) in 2006.

Outlook

In 2008, Hydro-Québec expects to earn net income of $2.6 billion, which is $100 million more than the amount indicated in the financial outlook of the *Strategic Plan 2006–2010*. This projection takes into account the fact that water-power royalties paid to the Québec government by Hydro-Québec Production will increase by approximately $300 million, primarily because in 2007, a transition year, the half-rate rule applied.

Hydro-Québec plans to invest $4.4 billion in 2008. A substantial portion of these investments, 60%, will be devoted to development and growth activities, whereas 40% will be used to finance work to ensure the long-term operability of facilities.

Hydro-Québec Production will continue to increase hydroelectric production capacity in Québec. In 2008, it will continue work on the Eastmain-1-A/Sarcelle/Rupert project (construction began in 2007) and permitting for the Romaine complex. It will also complete the commissioning of Péribonka generating station and will gradually begin commissioning Chute-Allard and Rapides-des-Cœurs generating stations. In addition, the division will continue to facilitate the integration of wind power by compensating for fluctuations in wind farm output.

Hydro-Québec TransÉnergie will continue its efforts to enhance service quality and the reliability and security of the power transmission system. To meet the growing demand in Québec, the division will carry out several major projects to bring new hydroelectric and wind power facilities onto the grid, in particular Eastmain-1-A and Sarcelle powerhouses and the wind farms built in response to Hydro-Québec Distribution's first call for tenders. As well, the division will work to ensure the long-term operability of its transmission assets, including interconnections with neighboring systems. It will also complete the connection of Péribonka, Chute-Allard and Rapides-des-Cœurs generating stations while continuing work related to the new interconnection with Ontario.

Hydro-Québec Distribution will continue to deliver reliable electricity and quality services to its Québec customers. At the beginning of 2008, it completed the final step in implementing the Customer Information System. It will pursue its investments to automate the distribution grid and ensure the long-term operability of its facilities while analyzing various solutions to improve its operating efficiency, such as remote meter reading using radio technology. During the year, the division will also disclose the bidders selected in its tender call for a second block of wind power. Finally, it will continue to implement the Energy Efficiency Plan (which includes measures for low-income households) to achieve the objective of 4.7 TWh in energy savings set for 2010.

Integrated Enterprise Risk Management

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

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

HYDRO-QUÉBEC'S ANNUAL RISK MANAGEMENT PROCESS

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

Financial risks

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

Generation

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

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

Transmission

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

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

Distribution

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

In addition, to maintain the quality of electrical service, the Distributor takes steps to ensure the long-term operability of the distribution system and applies a series of measures, including compliance with applicable standards for overhead and underground systems, an integrated strategy for system renewal work, system maintenance and vegetation control.

Construction

The booming construction market, strong demand for skilled labor and market-specific inflation are exerting upward pressure on Hydro-Québec's project costs. The company has developed strategies to mitigate the impacts of economic conditions on procurement and on construction projects. It applies strict project management practices to contain costs while meeting deadlines and project requirements.

Corporate and Other Activities

Environmental protection is a central concern of Hydro-Québec. Most activities that have an impact on the environment are governed by ISO 14001–certified environmental management systems. In addition, every year, the company reviews its management of environmental issues and publishes a Sustainability Report.

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

Hydro-Québec has a corporate emergency response plan to ensure service continuity and rapid restoration in case of an exceptional event. This plan includes material, technical and organizational means to quickly mobilize staff and effectively coordinate all internal and external responders, including public authorities.

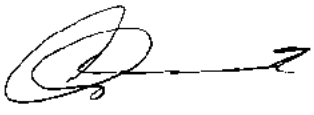
Management Report

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

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

The external auditors are appointed by the Québec government, the sole shareholder of the Corporation. The 2007 and 2006 consolidated financial statements have been audited jointly by the external auditors, KPMG LLP and Ernst & Young LLP.



Michael L. Turcotte

Chairman of the Board

Thierry Vandal

President and
Chief Executive Officer

Daniel Garant

Executive Vice President,
Finance and
Chief Financial Officer

Montréal, Québec
February 8, 2008

Auditors' Report

To the Minister of Finance of Québec:

We have audited the consolidated balance sheets of Hydro-Québec as at December 31, 2007 and 2006, and the consolidated statements of operations, retained earnings, cash flows and comprehensive income for the years then ended. These financial statements are the responsibility of Hydro-Québec's Management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Hydro-Québec as at December 31, 2007 and 2006, and the results of its operations and its cash flows for the years then ended, in accordance with Canadian generally accepted accounting principles. As required by the *Auditor General Act* (R.S.Q., c. V-5.01), we report that, in our opinion, except for the application of changes in accounting policies described in Note 2 to the consolidated financial statements, these principles have been applied on a basis consistent with that of the preceding year.

KPMG LLP

Chartered Accountants

Ernst & Young LLP

Chartered Accountants

Montréal, Québec

February 8, 2008

Consolidated Financial Statements

Consolidated Statements of Operations

Years ended December 31 In millions of Canadian dollars	Notes	2007	2006
Revenue		**12,330**	11,161
Expenditure			
Operations		**2,545**	2,394
Electricity and fuel purchases		**1,555**	1,315
Depreciation and amortization	4	**1,991**	2,007
Taxes	5	**816**	529
Regulatory deferrals	3	**29**	(93)
		6,936	6,152
Operating income		**5,394**	5,009
Financial expenses	6	**2,512**	2,212
Income from continuing operations		**2,882**	2,797
Income from discontinued operations	7	**25**	944
Net income		**2,907**	3,741

Consolidated Statements of Retained Earnings

Years ended December 31 In millions of Canadian dollars	Notes	2007	2006
Balance at beginning of year		**14,474**	13,075
Adjustments related to the adoption of new accounting policies	2	**270**	–
Net income		**2,907**	3,741
		17,651	16,816
Dividends declared	18	**2,095**	2,342
Balance at end of year		**15,556**	14,474

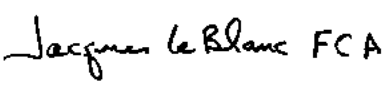
The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Balance Sheets

As at December 31 In millions of Canadian dollars	Notes	2007	2006
ASSETS			
Current assets			
Cash and cash equivalents		**54**	52
Short-term investments	16	**3,073**	3,178
Accounts receivable		**1,738**	1,608
Derivative instruments	16	**992**	1,491
Materials, fuel and supplies		**360**	365
		6,217	6,694
Property, plant and equipment	8	**53,228**	51,854
Investments	9	**228**	232
Derivative instruments	16	**1,998**	1,093
Intangible assets	10	**967**	923
Regulatory assets	3	**1,057**	1,031
Other assets	11	**1,157**	1,427
		64,852	63,254
LIABILITIES			
Current liabilities			
Borrowings	16	**73**	25
Accounts payable and accrued liabilities		**1,877**	1,819
Dividends payable	18	**2,095**	2,342
Accrued interest		**890**	936
Regulatory liabilities	3	**97**	251
Current portion of long-term debt	12	**1,087**	1,063
Derivative instruments	16	**369**	340
		6,488	6,776
Long-term debt	12	**33,161**	33,027
Derivative instruments	16	**2,835**	1,111
Asset retirement obligations	13	**464**	431
Regulatory liabilities	3	**8**	17
Other long-term liabilities	14	**718**	2,715
Perpetual debt	15	**286**	337
		43,960	44,414
EQUITY	18		
Share capital		**4,374**	4,374
Retained earnings		**15,556**	14,474
Accumulated other comprehensive income		**962**	(8)
		16,518	14,466
		20,892	18,840
		64,852	63,254
Commitments and contingencies	21		

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

On behalf of the Board of Directors,



Jacques Leblanc
Chair of the Audit Committee

Michael L. Turcotte
Chairman of the Board

Consolidated Statements of Cash Flows

Years ended December 31 In millions of Canadian dollars	Notes	2007	2006
Operating activities			
Net income		**2,907**	3,741
Income from discontinued operations	7	**(25)**	(944)
Income from continuing operations		**2,882**	2,797
Adjustments			
Depreciation and amortization	4	**1,991**	2,007
Amortization of debt premiums, discounts and issue expenses	6	**111**	99
Exchange gain		**(202)**	(470)
Difference between contributions paid and pension cost		**287**	(95)
Regulatory deferrals	3	**29**	(93)
Other		**252**	(146)
Change in non-cash working capital items	19	**(191)**	(94)
		5,159	4,005
Investing activities			
Property, plant and equipment and intangible assets		**(3,464)**	(3,348)
Investments		**29**	12
Disposal of investments, net of divested cash and cash equivalents	7	**51**	2,022
Costs related to Energy Efficiency Plan	3	**(172)**	(149)
Net disposal (acquisition) of short-term investments		**155**	(2,807)
Other		**(5)**	(5)
		(3,406)	(4,275)
Financing activities			
Issuance of long-term debt		**2,026**	3,781
Repayment of long-term debt at maturity and sinking fund redemption		**(993)**	(1,862)
Redemption of long-term debt		**–**	(789)
Inflows resulting from credit risk management	16	**1,374**	1,140
Outflows resulting from credit risk management	16	**(1,855)**	(975)
Net change in short-term borrowings		**48**	5
Dividends paid		**(2,342)**	(1,126)
Other		**(2)**	9
		(1,744)	183
Change in foreign exchange on cash and cash equivalents		**(14)**	–
Cash flows from continuing operations		**(5)**	(87)
Cash flows from discontinued operations	7	**2**	52
Net change in cash and cash equivalents		**(3)**	(35)
Cash and cash equivalents at beginning of year		**57**	92
Cash and cash equivalents at end of year		**54**	57
Cash and cash equivalents			
Continuing operations		**54**	52
Discontinued operations		**–**	5
		54	57
Supplementary cash flow information	19		

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

Consolidated Statements of Comprehensive Income

Years ended December 31 In millions of Canadian dollars	Note	2007	2006
Net income		**2,907**	3,741
Other comprehensive income	18		
Change in deferred gains on items designated as cash flow hedges		**693**	–
Reclassification to operations of deferred gains on items designated as cash flow hedges		**(207)**	–
		486	–
Other		**5**	65
Comprehensive income		**3,398**	3,806

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

Notes to Consolidated Financial Statements

Years ended December 31, 2007 and 2006
Amounts in tables are in millions of Canadian dollars, unless otherwise indicated.

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

Note 1 Significant Accounting Policies

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

Regulation

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

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

TRANSMISSION

The Corporation's power transmission rates for 2007 and 2006 were determined in Régie decisions D-2007-34 and D-2006-66, respectively. The authorized return on the rate base was set at 7.78% in 2007 and 8.34% in 2006, assuming a capital structure with 30% equity.

DISTRIBUTION

The Corporation's electricity rates were determined in decisions D-2007-22 and D-2006-46, in which the Régie granted across-the-board rate increases of 1.92% and 5.33%, effective April 1, 2007, and April 1, 2006, respectively. The authorized return on the rate base was set at 7.79% in 2007 and 7.75% in 2006, assuming a capital structure with 35% equity.

Scope of consolidation

The consolidated financial statements include the accounts of the Corporation, its subsidiaries and its joint ventures as well as those of variable interest entities (VIEs) where Hydro-Québec is the primary beneficiary (referred to collectively as Hydro-Québec). Interests in joint ventures are accounted for using the proportionate consolidation method.

Use of estimates

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

Revenue

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

Research and development (R&D) costs

R&D costs are charged to operations when they are incurred, except for capitalizable development costs that are reasonably sure to be recovered. Development costs are amortized on a straight-line basis over a five-year period.

Income taxes

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

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

Foreign currency translation

SELF-SUSTAINING FOREIGN OPERATIONS

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

INTEGRATED FOREIGN OPERATIONS AND FOREIGN CURRENCY TRANSACTIONS

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

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

Note 1 Significant Accounting Policies (continued)

Materials, fuel and supplies

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

Property, plant and equipment

Property, plant and equipment are carried at cost, which comprises materials, labor, other costs directly related to construction activities, and financial expenses capitalized during construction. Property, plant and equipment also include 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 is added to the carrying amount. Moreover, contributions from third parties are applied against the cost of the related property, plant and equipment.

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

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

Hydraulic generation	40 to 50 years
Thermal generation, including nuclear	15 to 50 years
Transmission substations and lines	30 to 50 years
Distribution substations and lines	25 to 40 years
Corporate and other activities	3 to 50 years

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

Maintenance and repair costs are charged to operations as they are incurred.

Investments

Hydro-Québec is the sole owner of a venture capital company whose mission is to make strategic investments. The investments held by this company are accounted for at fair value in accordance with the rules applicable to investment companies. The fair value is determined according to the quoted market price at the balance sheet date in the case of listed shares, and according to valuation methods recognized by capital markets in the case of unlisted shares.

Investments in companies over which Hydro-Québec can exercise significant influence are accounted for on an equity basis.

Intangible assets

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

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

Intangible assets with a finite useful life are amortized over their useful life according to the straight-line method over the following periods:

Software and licences	3 to 10 years
Rights	40 to 50 years
Environmental studies	5 years
Patents	20 years

Impairment of long-lived assets

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

Employee future benefits

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

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

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

- Past service costs arising from plan amendments and transitional balances relating to the pension plan and other post-retirement benefits as at January 1, 1999, are amortized using the straight-line method over periods not exceeding active employees' average remaining years of service, which totaled 12 years as at January 1, 2007, and January 1, 2006.

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

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

Asset retirement obligations

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

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

Agreements with Aboriginal communities and regional county municipalities

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

Financial instruments

Financial instruments are measured at fair value on initial recognition. Their measurement in subsequent periods and the recognition of changes in fair value depend on the category in which they are classified.

The following table presents the classification of Hydro-Québec's financial instruments in the various categories:

Category	Financial instruments
Financial assets and liabilities held for trading	Cash equivalents (with initial maturities of three months or less) Derivative instruments
Available-for-sale financial assets	Short-term investments (maturing in more than three months) Investment in bonds
Loans and receivables	Accounts receivable Government reimbursement for the 1998 ice storm (presented in Other assets)
Other financial liabilities	Borrowings Accounts payable and accrued liabilities Dividends payable Accrued interest Current portion of long-term debt Long-term debt Perpetual debt

Loans and receivables and other financial liabilities are measured at amortized cost, including debt premiums, discounts and issue expenses.

Financial assets and liabilities held for trading are recorded at fair value at the balance sheet date. Gains and losses arising from changes in fair value are recognized in operations for the period during which they occur, except in the case of derivative instruments designated as hedges in a cash flow hedging relationship. Available-for-sale financial assets are recorded at fair value at the balance sheet date. Deferred gains and losses arising from changes in fair value are recorded in Other comprehensive income until they are realized, at which time they are reclassified to operations. Commodity futures that can be settled net in cash are recorded at the date of settlement if there is a probability of delivery or receipt in accordance with expected needs.

As part of its integrated enterprise risk management, Hydro-Québec uses various financial instruments to manage foreign exchange, interest rate and market risks, including exposure to fluctuating energy and commodity prices. The Corporation applies cash flow or fair value hedge accounting to the eligible hedging relationships. It formally documents all relationships between hedging instruments and hedged items. This process involves associating all derivatives with specific assets and liabilities on the balance sheet, or with forecasted or probable transactions. The Corporation also formally measures the effectiveness of hedging relationships at inception and then monthly thereafter.

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 in Other comprehensive income, and the gains and losses related to the ineffective portion are immediately recognized in operations, in the same line item as the hedged item. Amounts included in Accumulated other comprehensive income are reclassified to operations, also in the same component as the hedged item, during the periods in which the change in cash flows attributable to the hedged item impacts operations. If a derivative instrument no longer satisfies hedging conditions or is sold or liquidated, or if Hydro-Québec terminates its designation as a hedging relationship, hedge accounting ceases to be applied on a prospective basis. If the hedged item ceases to exist, the unrealized gains or losses are immediately reclassified to operations.

In the case of a fair value hedge, the derivative instrument is recorded at fair value, and gains and losses stemming from changes in the fair value, including those related to the ineffective portion of the hedge, are recognized in operations in the same line item as the hedged item. Changes in the fair value of the hedged item attributable to the hedged risk are recognized as adjustments to the hedged item's carrying amount and are offset against operations.

In addition, an embedded derivative must be separated from its host contract and recorded at fair value on the balance sheet under certain conditions. Hydro-Québec has opted to apply this accounting treatment to all host contracts issued, acquired or substantially amended on or after January 1, 2003.

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

Comparative information

Certain figures of the previous year have been reclassified to reflect the presentation adopted for the current year.

Note 2 Changes in Accounting Policies

Recent changes

2007

FINANCIAL INSTRUMENTS

On January 1, 2007, Hydro-Québec adopted the recommendations of the *Canadian Institute of Chartered Accountants (CICA) Handbook* Section 3855, "Financial Instruments – Recognition and Measurement," which states the requirements for the recognition and measurement of financial instruments, and Section 3865, "Hedges," which specifies how hedge accounting is applied and the required disclosures to be made in this context. It also adopted the recommendations of Section 3861, "Financial Instruments – Disclosure and Presentation," and Section 1530, "Comprehensive Income." This last section establishes standards for the reporting and presentation of comprehensive income, which includes net income and other comprehensive income.

The impacts of adopting the new accounting policies were as follows as at January 1, 2007:

- Retained earnings increased by $270 million, owing mainly to the rescission of transitional rules related to the application of CICA Accounting Guideline AcG-13, "Hedging Relationships," to the cumulative ineffectiveness of hedges, and to the transition from the straight-line method to the effective interest method for the amortization of financial assets and liabilities.
- Accumulated other comprehensive income increased by $479 million, owing mainly to the recognition of the effective portion of cash flow hedging relationships.
- Long-term debt increased by $551 million, mainly as a result of being presented at amortized cost using the effective interest method.
- Other long-term liabilities decreased by $2,051 million, owing to the recognition of cash flow hedging relationships, the write-off of unamortized transitional deferred gains related to the application of AcG-13, and the presentation of financial assets and financial liabilities at amortized cost using the effective interest method.
- The net value of derivative instruments decreased by $701 million, which represents the variance between the fair value of derivative instruments and the portion already recorded on the balance sheet.

Prior period figures have not been restated in accordance with the new accounting policies, but certain balances on the consolidated balance sheet as at December 31, 2006, have been reclassified. Derivative instruments formerly presented in Accounts receivable, Swaps, Long-term debt, Current portion of long-term debt, Accounts payable and accrued liabilities, and Accrued interest have now been reclassified to Derivative instruments on the balance sheet. If these new accounting policies had not been adopted, the net income of the Corporation would have been $14 million higher in 2007, mainly due to the rescission of transitional rules related to the application of AcG-13.

EQUITY

On January 1, 2007, Hydro-Québec prospectively adopted the recommendations of *CICA Handbook* Section 3251, "Equity," which superseded Section 3250, "Surplus." Section 3251 establishes standards for the presentation of equity and changes in equity as a result of the new requirements in Section 1530, "Comprehensive Income." With the adoption of these standards, translation adjustments, which were previously presented separately in Equity, were reclassified to Accumulated other comprehensive income.

ACCOUNTING CHANGES

Hydro-Québec also adopted the recommendations of *CICA Handbook* Section 1506, "Accounting Changes," which prescribes the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The adoption of these recommendations had no impact on the consolidated financial statements.

2006

NON-MONETARY TRANSACTIONS

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

CONDITIONAL ASSET RETIREMENT OBLIGATIONS

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

Future changes

FINANCIAL INSTRUMENTS – DISCLOSURE AND PRESENTATION

In 2006, the CICA released *CICA Handbook* Section 3862, "Financial Instruments – Disclosures," and Section 3863, "Financial Instruments – Presentation," which superseded Section 3861. These new standards require the presentation of information allowing users to assess the importance of a financial instrument for the entity's performance and financial position. They will apply to the Corporation's interim and annual financial statements relating to financial years beginning on January 1, 2008, and beyond.

CAPITAL DISCLOSURES

In 2006, the CICA released *CICA Handbook* Section 1535, "Capital Disclosures," requiring disclosure of how capital is managed by Management. This section will apply to the Corporation's interim and annual financial statements relating to financial years beginning on January 1, 2008, and beyond.

INVENTORIES

In 2007, the CICA released *CICA Handbook* Section 3031, "Inventories," which superseded Section 3030, also entitled "Inventories." Section 3031 establishes the standards for the measurement of inventories, including the determination of their cost. It will apply to the Corporation's interim and annual financial statements relating to financial years beginning on or after January 1, 2008. The adoption of the recommendations in this new section is not expected to have any significant impact on the net income or total assets of the Corporation.

Note 3 Effects of Rate Regulation on the Consolidated Financial Statements

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

Regulatory assets and liabilities

VARIANCES IN ANNUAL COST OF TRANSMISSION SERVICE FOR THE NATIVE LOAD

Variances resulting from any modification of the annual cost of native load transmission service that has not been taken into account in the setting of electricity rates are recorded in a separate account and amortized according to conditions set by the Régie. Financial expenses arising from these variances are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. This accounting practice relates to the Corporation's power distribution activities and was authorized by the Régie in decisions D-2003-93, D-2006-34 and D-2007-12. Were these activities not regulated, the Corporation's expenditure would have been lower and net income for 2007 would have been $11 million higher ($355 million lower in 2006).

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

When property, plant and equipment or intangible assets are retired, the cost of such assets and of their dismantlement, net of accumulated amortization and salvage value, are charged to a separate account and amortized over a maximum period of 10 years, using the sinking fund method at a rate of 3%. The Régie authorized this accounting practice in decisions D-2002-95 and D-2003-93, which relate to the Corporation's power transmission and distribution activities, respectively. Were these activities not regulated, the related costs would be recognized in operations for the year, and net income for 2007 would have been $22 million higher ($17 million in 2006).

COSTS RELATED TO THE ENERGY EFFICIENCY PLAN (THE "PLAN")

The costs related to implementation of the Plan, such as specific energy conservation programs, are charged to a separate account and amortized over 10 years on a straight-line basis, except for the costs incurred prior to January 1, 2006, which are amortized over five years. This period begins in the year after the costs were recorded. Financial expenses arising from these costs are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. This accounting practice relates to the Corporation's power distribution activities and was authorized by the Régie in decisions D-2002-25, D-2002-288 and D-2006-56. Were these activities not regulated, the costs would normally be recognized in operations for the year in which they are incurred, and net income for 2007 would have been $129 million lower ($121 million in 2006).

COSTS INCURRED UNTIL THE RESCISSION OF DUAL-ENERGY RATE BT

The costs incurred until the rescission of dual-energy Rate BT were charged to a separate account and have been amortized on a straight-line basis over five years since the rescission date of April 1, 2006. These costs mainly include the deficit resulting from the variance between the supply cost recognized by the Régie and energy prices in effect, multiplied by the quantity of electricity delivered to customers at Rate BT between January 1, 2004, and March 31, 2006. Financial expenses arising from these costs were capitalized at the rate of return authorized by the Régie on the rate base until March 31, 2006. This accounting practice was authorized by the Régie in decisions D-2004-47, D-2004-170 and D-2006-34, which relate to the Corporation's power distribution activities. Were these activities not regulated, the costs would have been recognized in operations for the year in which they were incurred, and net income for 2007 would have been $30 million higher ($49 million lower in 2006).

COSTS RELATED TO A MAJOR DISCONTINUED PROJECT

A power transmission system project was discontinued in 2005. The costs deemed to be irrecoverable were deferred and amortized over three years on a straight-line basis. The Régie authorized this accounting practice in decision D-2002-95, which relates to the Corporation's power transmission activities. Were these activities not regulated, the costs would have been recognized in operations for 2005, and net income for 2007 would have been $10 million higher ($10 million in 2006).

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

Volume and price variances recognized for a given year between the actual costs of electricity purchases in excess of the heritage pool and the costs forecasted in the rate cases and acknowledged by the Régie for rate-setting purposes are recorded in a separate account and amortized according to conditions set by the Régie. Financial expenses arising from these variances are capitalized at the rate of return authorized by the Régie on the rate base until such time as amortization begins. This accounting practice was authorized by the Régie in decisions D-2005-34, D-2005-132, D-2006-34 and D-2007-12, which relate to the Corporation's power distribution activities. Were these activities not regulated, the actual costs would be recognized in operations for the year in which they are incurred, and net income for 2007 would have been $177 million lower ($245 million higher in 2006).

COSTS RELATED TO THE DE-ICING SYSTEM AT LÉVIS SUBSTATION

Certain costs related to the Lévis substation de-icing system, a project designed in the wake of the 1998 ice storm to secure the transmission lines supplying the greater Québec City area, are charged to a separate account. As the de-icing system is commissioned, these costs are depreciated using the sinking fund method at a rate of 3%, over a period corresponding to the average remaining useful life of the assets enhanced by the project. Financial expenses arising from these costs are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. The Régie authorized this accounting practice in decision D-2004-175, which relates to the Corporation's power transmission activities. Were these activities not regulated, the costs would be recognized in operations for the year in which they are incurred, and net income for 2007 would have been $6 million lower ($11 million in 2006).

VARIANCES IN REVENUE FROM POINT-TO-POINT TRANSMISSION SERVICES

Variances recognized for a given year between actual revenue from point-to-point transmission services and revenue forecasted in the rate cases and acknowledged by the Régie for rate-setting purposes are recorded in a separate account and amortized according to conditions set by the Régie. Financial expenses arising from these variances are capitalized at the rate of return authorized by the Régie on the rate base until such time as amortization begins. This accounting practice was authorized by the Régie in decisions D-2007-08 and D-2008-019, which relate to the Corporation's power transmission activities. Were these activities not regulated, expenditure would have been lower and net income for 2007 would have been $50 million higher.

Note 3 Effects of Rate Regulation on the Consolidated Financial Statements (continued)

REGULATORY ASSETS

	Expected years of amortization	2007	2006
Variances in annual cost of transmission service for native load[a]	Conditions to be determined by the Régie	**344**	355
Net costs related to retirement of property, plant and equipment and intangible assets	2008–2017	**219**	241
Costs related to Energy Efficiency Plan	2008–2017	**381**	252
Costs incurred until rescission of dual-energy Rate BT	2008–2011	**95**	125
Costs related to a major discontinued project	–	**–**	10
Cost variances related to electricity purchases in excess of heritage pool[a]	–	**–**	36
Costs related to de-icing system at Lévis substation	2008–2047	**18**	12
		1,057	1,031

REGULATORY LIABILITIES

	Expected years of amortization	2007	2006
Cost variances related to electricity purchases in excess of heritage pool[a]	2008	**(55)**	(268)
Variances in revenue from point-to-point transmission services[a]	2008 and 2009	**(50)**	–
		(105)	(268)
Current portion		**(97)**	(251)
		(8)	(17)

a) The change in the variance accounts, net of an amortization credit of $145 million (nil in 2006) and capitalized financial expenses of $1 million ($17 million in 2006), corresponds to the Regulatory deferrals presented in the Consolidated Statements of Operations, namely, an increase in expenditure of $29 million (reduction of $93 million in 2006).

RISKS AND UNCERTAINTIES

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

Other regulatory practices

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

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

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

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

In decision D-2007-134 of December 2007, the Régie approved an agreement whereby energy deliveries provided for in a power purchase contract with another power producer will be suspended for 2008. On December 31, 2007, a $52-million commitment associated with this agreement was recorded on the balance sheet but had no impact on operating results.

Note 4 Depreciation and Amortization

	Note	2007	2006
Property, plant and equipment		**1,853**	1,745
Intangible assets		**109**	114
Regulatory assets and liabilities	3	**(9)**	111
Deferred charges		**12**	13
Write-off of projects		**26**	24
		1,991	2,007

Note 5 Taxes

	2007	2006
Capital tax	**278**	261
Public utilities tax	**240**	230
Water-power royalties[a]	**263**	–
Municipal, school and other taxes	**35**	38
	816	529

a) The payment of water-power royalties results from the fact that the Corporation became subject to the Watercourses Act *in 2007. For this transition year, the half-rate rule applied.*

Note 6 Financial Expenses

	2007	2006
Interest		
Interest on debt securities	**2,584**	2,367
Amortization of debt premiums, discounts and issue expenses	**111**	99
	2,695	2,466
Net exchange loss (gain)	**18**	(21)
Loan guarantee fees paid to the shareholder	**169**	158
	187	137
Less		
Capitalized financial expenses	**283**	312
Net investment income	**87**	79
	370	391
	2,512	2,212

Note 7 Discontinued Operations and Assets Held for Sale

▸ On February 28, 2007, Hydro-Québec concluded the sale of its interest in HQI Australia Pty Ltd (DirectLink), through its wholly owned subsidiary Hydro-Québec International (HQI), for a cash consideration of $52 million, giving rise to a gain of $18 million.

▸ On January 18, 2006, Hydro-Québec concluded the sale of its interest in Hidroeléctrica Río Lajas S.A., through HQI, for a cash consideration of $5 million, giving rise to a loss of $0.3 million.

▸ On February 27, 2006, Hydro-Québec concluded the sale of its interest in Cross-Sound Cable Company, LLC, for a cash consideration of $182 million, giving rise to a $29-million gain. The transaction included the sale of units held and the repayment of the loan extended by Hydro-Québec to Cross-Sound Cable Company, LLC.

▸ On March 29, 2006, Hydro-Québec concluded the sale of its interest in MurrayLink HQI Australia Pty Ltd, through HQI, for a cash consideration of $60 million. This transaction gave rise to a $2-million loss.

▸ On June 30, 2006, Hydro-Québec sold its interest in HQI Transelec Chile S.A. (Transelec), through HQI, for a cash consideration of $1.8 billion. This transaction gave rise to a gain of $813 million, net of $225 million in related income taxes. The sales contract further provides for price adjustments based on the market value of the regulated trunk transmission asset base.

The ministerial order establishing the value of the regulated trunk transmission asset base was issued on January 15, 2008, and Hydro-Québec will account for an estimated net gain of US$117 million in the first quarter of 2008.

In addition, the retrospective effect of this revised valuation on Transelec's revenue for the period from March 13, 2004, to June 30, 2006, should, in Management's opinion, result in an additional adjustment of the selling price, which will be accounted for as HQI receives the additional revenue.

▸ On August 1, 2006, Hydro-Québec concluded the sale of its interest in HQI Latin America Ltd. (Fortuna generating station in Panama), through HQI, for a cash consideration of $113 million. This transaction gave rise to a gain of $38 million.

▸ On December 12, 2006, Hydro-Québec concluded the sale of its interest in Consorcio TransMantaro S.A., through HQI, for a cash consideration of $84 million. This transaction gave rise to a gain of $39 million.

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

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

	2007	2006
Operations		
Revenue	**3**	256
Income before net gain on disposal	**6**	27
Gain on disposal	**19**	1,169
Income taxes	**–**	(252)
Net gain on disposal	**19**	917
Income from discontinued operations	**25**	944
Cash flows		
Operating activities	**2**	11
Investing activities	**(1)**	64
Financing activities	**–**	(18)
Change in foreign exchange on cash and cash equivalents	**1**	(5)
Cash flows from discontinued operations	**2**	52

As at the disposal date, the assets and liabilities of these interests were as follows:

	2007	2006
Cash and cash equivalents	**1**	135
Other current assets	**9**	69
Long-term assets	**34**	2,176
Current liabilities	**2**	187
Long-term liabilities	**10**	1,291
Net assets disposed of	**32**	902

Note 8 Property, Plant and Equipment

	In service	Accumulated depreciation	Under construction	2007 Total
Generation				
Hydraulic	32,129	8,211	3,344	**27,262**
Thermal, including nuclear	2,715	1,933	158	**940**
Other	725	314	23	**434**
	35,569	10,458	3,525	**28,636**
Transmission				
Substations and lines	20,838	6,530	669	**14,977**
Other	741	492	22	**271**
	21,579	7,022	691	**15,248**
Distribution				
Substations and lines	11,434	4,270	191	**7,355**
Other	1,801	1,016	123	**908**
	13,235	5,286	314	**8,263**
Construction	31	14	2	**19**
Corporate and Other Activities	2,167	1,231	126	**1,062**
	72,581	24,011	4,658	**53,228**

	In service	Accumulated depreciation	Under construction	2006 Total
Generation				
Hydraulic	31,139	7,708	2,752	26,183
Thermal, including nuclear	2,677	1,755	123	1,045
Other	759	322	37	474
	34,575	9,785	2,912	27,702
Transmission				
Substations and lines	20,227	6,097	594	14,724
Other	753	515	30	268
	20,980	6,612	624	14,992
Distribution				
Substations and lines	10,908	3,941	225	7,192
Other	1,803	1,013	101	891
	12,711	4,954	326	8,083
Construction	47	31	1	17
Corporate and Other Activities	2,101	1,158	117	1,060
	70,414	22,540	3,980	51,854

Note 9 Investments

	Note	2007	2006
At equity			
Churchill Falls (Labrador) Corporation Limited	21	**77**	69
CITEQ inc.		**(5)**	(5)
		72	64
At fair value			
Churchill Falls (Labrador) Corporation Limited Bonds[a]	21	**55**	52
Venture capital[b]		**40**	54
		95	106
Other		**61**	62
		228	232

a) *These 7.5% bonds mature in 2010 and are secured by a general mortgage.*

b) *Both the gross and net unrealized gains on investments held by the venture capital company amounted to $2 million as at December 31, 2007 ($13 million as at December 31, 2006). Net gains of $12 million were realized in 2007 (losses of $2 million in 2006).*

Note 10 Intangible Assets

	2007			2006		
	Cost	Accumulated amortization	Net carrying amount	Cost	Accumulated amortization	Net carrying amount
Subject to amortization						
Software and licences[a]	1,322	763	**559**	1,147	652	495
Rights	113	54	**59**	113	40	73
Environmental studies	55	49	**6**	134	118	16
Patents	8	4	**4**	8	2	6
	1,498	870	**628**	1,402	812	590
Not subject to amortization						
Servitudes			**339**			333
			967			923

a) *The net carrying amount includes $406 million in assets under development as at December 31, 2007 ($311 million as at December 31, 2006).*

Note 11 Other Assets

	Note	2007	2006
Accrued benefit asset	20	**828**	1,115
Deferred charges		**168**	112
Government reimbursement for the 1998 ice storm[a]		**107**	123
Nuclear fuel waste management trust fund[b]		**44**	36
Goodwill[c]		**10**	10
Assets held for sale		**–**	31
		1,157	1,427

a) *Payable in quarterly installments of $6 million until January 15, 2014, and a final installment of $1 million on April 15, 2014. These installments include interest at the annual rate of 7.2%. The fair value of this financial asset was $110 million as at December 31, 2007 ($129 million as at December 31, 2006).*

b) *On November 15, 2002, the* Nuclear Fuel Waste Act *came into force. Under this Act, nuclear energy corporations in Canada were required to set up a waste management organization whose role would be to propose a long-term approach for managing spent nuclear fuel to the Government of Canada. Nuclear energy corporations were also required to set up a trust fund to finance the costs of long-term nuclear fuel waste management. In November 2005, the Nuclear Waste Management Organization (NWMO) filed its report with the Government of Canada and recommended an approach which was adopted in June 2007.*

In October 2007, the members of the NWMO ratified an agreement that sets forth a formula for financing the costs of long-term nuclear waste management. This formula will be used to determine each member's share for the next five years. It will come into effect only after approval by the Government of Canada, which is expected to hand down its decision in 2008. Each member's share will be determined according to the number of spent nuclear fuel bundles it had in storage as at June 30, 2006. It will also take into account the date on which each member plans to send the spent nuclear fuel bundles to the national repository.

In order to meet its financial obligations, the Corporation deposited an initial amount of $20 million in a trust fund in 2002. Additional annual payments of $4 million were made from 2002 to 2007, in compliance with the law. The sums are invested in short-term marketable securities, and interest accrued on trust assets is reinvested in the trust.

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

Note 12 Long-Term Debt

Composition and maturities

The following table presents debentures and other long-term debt (at amortized cost in 2007 and at notional amount in 2006[a]), translated into Canadian dollars at the closing exchange rates as at the balance sheet date and listed by year of maturity:

				Corporation	Subsidiaries	**2007**	2006
Maturity	Canadian dollars	U.S. dollars	Other currencies	Total		Total	Total
2007							1,063
2008	111	4	970	1,085	2	**1,087**	1,153
2009	1,894	30	4	1,928	3	**1,931**	1,628
2010	748	20	–	768	3	**771**	402
2011	1,644	847	77	2,568	3	**2,571**	2,997
2012[b]	877	196	9	1,082	3	**1,085**	–
1 to 5 years	5,274	1,097	1,060	7,431	14	**7,445**	7,243
6 to 10 years[b]	94	1,307	482	1,883	14	**1,897**	3,690
11 to 15 years	5,050	1,985	–	7,035	–	**7,035**	4,253
16 to 20 years	97	1,865	–	1,962	–	**1,962**	5,172
21 to 25 years	1,185	1,758	–	2,943	–	**2,943**	3,596
26 to 30 years	5,046	–	–	5,046	–	**5,046**	4,693
31 to 35 years	4,340	–	–	4,340	–	**4,340**	3,805
36 to 40 years	3,099	–	–	3,099	–	**3,099**	1,023
41 to 45 years	63	–	–	63	–	**63**	65
46 to 50 years	10	–	–	10	–	**10**	11
51 to 55 years	557	–	–	557	–	**557**	525
56 to 60 years	14	–	–	14	–	**14**	14
	24,829	8,012	1,542	34,383[c]	28	**34,411**	34,090
Plus							
Adjustment for fair-value hedged risk				(163)	–	**(163)**	–
				34,220	28	**34,248**	34,090
Less							
Current portion	111	4	970	1,085	2	**1,087**	1,063
	24,718	8,008	572	33,135	26	**33,161**	33,027

a) Excluding debts with a significant discount or premium, which are presented at amortized cost.

b) Certain debts carry sinking fund requirements.

c) Includes $33,790 million in bonds guaranteed by the Québec government as at December 31, 2007 ($33,436 million as at December 31, 2006).

Note 12 Long-Term Debt (continued)

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

The following table presents debt, including the current portion of long-term debt, broken down by currency at the time of issue. Swaps related to the debt were taken into account in determining the percentages of debt by currency at the time of repayment.

	2007				2006			
			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	%	%
Corporation's debt								
Canadian dollars	24,829	**24,829**	**72**	**96**	22,282	22,282	65	95
U.S. dollars	8,135	**8,012**	**24**	**4**[a]	8,628	10,053	30	5[a]
Other currencies								
Euros	671	**968**	**3**		673	1,034	3	
Yen	2,508	**22**	**–**		4,500	43	–	
Pounds sterling	237	**465**	**1**		240	548	2	
Swiss francs	100	**87**	**–**		96	93	–	
		34,383				34,053		
Plus								
Adjustment for fair-value hedged risk		**(163)**				–		
Subsidiaries' debt								
U.S. dollars	29	**28**	**–**	**–**	32	37	–	–
		34,248	**100**	**100**		34,090	100	100

a) Of this amount, 99.3% was used to hedge sales in U.S. dollars as at December 31, 2007 (98.8% as at December 31, 2006).

Interest rates

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

%				2007	2006
Maturity	Canadian dollars	U.S. dollars	Other currencies	Weighted average	Weighted average
1 to 5 years	7.86	8.23	10.38	**8.14**	6.46
6 to 10 years	7.74	8.76	11.70	**9.58**	9.57
11 to 15 years	10.48	8.97	–	**9.99**	10.37
16 to 20 years	7.35	8.52	–	**8.50**	9.12
21 to 25 years	6.66	9.28	–	**8.40**	8.45
26 to 30 years	5.99	–	–	**5.99**	5.99
31 to 35 years	5.17	–	–	**5.17**	5.16
36 to 40 years	4.88	–	–	**4.88**	4.80
41 to 45 years	6.44	–	–	**6.44**	6.44
46 to 50 years	–	–	–	**–**	–
51 to 55 years	6.62	–	–	**6.62**	6.62
Weighted average	6.65	8.94	11.49	**7.32**	7.52

The variable-rate portion of Hydro-Québec's debt amounted to 6.8%, or 7.8% including perpetual debt, as at December 31, 2007 (7.3%, or 8.2% including perpetual debt, as at December 31, 2006). For information purposes, a change of one percentage point in interest rates would change the consolidated net income by $19 million ($31 million in 2006), if the impact of debt-related swaps were included (Note 16).

Fair value

As at December 31, 2007, the fair value of Hydro-Québec's debt amounted to $44,753 million ($46,015 million as at December 31, 2006), taking into account the sinking funds. Including debt-related swaps, total indebtedness stood at $46,044 million ($45,626 million as at December 31, 2006).

Fair value is obtained by discounting future cash flows, based on forward interest rates derived from interest rates at close of business on the balance sheet date for similar instruments available on capital markets. Changes in fair value reflect sensitivity to capital market interest rates. However, Management's primary intention is to hold these debt securities until maturity. Therefore, as at December 31, 2007, Hydro-Québec did not foresee any significant repayments that could result in the realization of this fair value.

Standby credit

Hydro-Québec has undrawn standby credit facilities of US$2,000 million that expire in 2012. Any borrowings under these lines of credit will bear interest at a rate based on the London Interbank Offered Rate (LIBOR). A US$750-million swing line loan at the U.S. base rate is included in the US$2,000-million credit facility.

Note 13 Asset Retirement Obligations

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

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

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

	Dismantling of nuclear generating station[a]	Removal of spent nuclear fuel[a, b]	Dismantling of other assets	2007 Total
Balance at beginning of year	288	127	16	**431**
Liabilities incurred	–	3	–	**3**
Accretion expense	18	12	1	**31**
Liabilities settled	–	(1)	(2)	**(3)**
Revision of estimated cash flows and expected timing of payments	–	–	2	**2**
Balance at end of year	306	141	17	**464**

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

a) When Gentilly-2 nuclear generating station was designed, the Corporation planned to operate it for 30 years, until 2013. The Corporation initiated a draft-design study to evaluate whether its useful life could be extended by approximately 28 years through refurbishment. If the refurbishment is not carried out, Management could decide to decommission the station a few years earlier for technical and financial reasons. Pending the decision, expected in 2008, the consolidated financial statements reflect end of life in 2011 for purposes of calculating the depreciation of the station and the amortization of the decommissioning costs. Consequently, once the decision is made, the estimated undiscounted cash flows and the expected timing of payment of the cash flows required to settle the obligations could change and thus, asset retirement obligations and decommissioning costs as well as the depreciation, amortization and accretion expenses, as recorded in these consolidated financial statements, may vary significantly based on the end-of-life date retained and the increase inherent in the method used to calculate depreciation and amortization. Inflation rates varying between 1.8% and 3.6% were used to determine the asset retirement obligations. As at December 31, 2007, the net carrying amount of Gentilly-2 was $522 million ($662 million as at December 31, 2006).

b) The discounted value established for purposes of estimating the obligation related to spent nuclear fuel disposal is similar to the estimate obtained using the method recommended by the NWMO and adopted by the Government of Canada in June 2007.

Note 13 Asset Retirement Obligations (continued)

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

	Dismantling of nuclear generating station[a]	Removal of spent nuclear fuel[a]	Dismantling of other assets
Total undiscounted amount of the estimated cash flows required to settle the obligations			
As at December 31, 2007	795	598	18
As at December 31, 2006	795	598	18
Expected timing of payment of the cash flows required to settle the obligations			
As at December 31, 2007	Between 2011 and 2057	Between 2008 and 2159	Between 2008 and 2031
As at December 31, 2006	Between 2011 and 2057	Between 2007 and 2159	Between 2007 and 2031
Credit quality–adjusted risk-free rate at which the estimated cash flows have been discounted (%)			
Initial recognition of obligations	6.4	6.4	6.4
Subsequent recognition of additional obligations	5.5	5.5	5.7

a) When Gentilly-2 nuclear generating station was designed, the Corporation planned to operate it for 30 years, until 2013. The Corporation initiated a draft-design study to evaluate whether its useful life could be extended by approximately 28 years through refurbishment. If the refurbishment is not carried out, Management could decide to decommission the station a few years earlier for technical and financial reasons. Pending the decision, expected in 2008, the consolidated financial statements reflect end of life in 2011 for purposes of calculating the depreciation of the station and the amortization of the decommissioning costs. Consequently, once the decision is made, the estimated undiscounted cash flows and the expected timing of payment of the cash flows required to settle the obligations could change and thus, asset retirement obligations and decommissioning costs as well as the depreciation, amortization and accretion expenses, as recorded in these consolidated financial statements, may vary significantly based on the end-of-life date retained and the increase inherent in the method used to calculate depreciation and amortization. Inflation rates varying between 1.8% and 3.6% were used to determine the asset retirement obligations. As at December 31, 2007, the net carrying amount of Gentilly-2 was $522 million ($662 million as at December 31, 2006).

Note 14 Other Long-Term Liabilities

	Note	2007	2006
Deferred exchange gain[a]		–	1,229
Debt premiums, discounts and issue expenses[a]		–	694
Accrued benefit liability	20	**601**	544
Credit risk management[a]		–	128
Accounts payable		**117**	113
Liabilities related to assets held for sale		–	7
		718	2,715

a) These items were written off or reclassified (Note 2) following the adoption of new accounting policies regarding financial instruments.

Note 15 Perpetual Debt

Perpetual notes in the amount of $286 million (US$289 million) as at December 31, 2007, and $337 million (US$289 million) as at December 31, 2006, bear interest at a rate determined semiannually based on LIBOR, plus 0.0625%. They are guaranteed by the Québec government and are redeemable only at the Corporation's option. No portion was redeemed in 2007. In 2006, a portion amounting to US$36 million was redeemed on the secondary market and then canceled. Various derivative instruments recorded at fair value are used to mitigate exchange risk associated with this debt.

As at December 31, 2007, the fair value of the perpetual notes was $290 million ($347 million as at December 31, 2006). As at December 31, 2007 and 2006, the rate for these notes was 5.2% and 5.6%, respectively.

Note 16 Financial Instruments

Derivative instruments

MANAGEMENT OF RISK ASSOCIATED WITH LONG-TERM DEBT

▸ Foreign exchange and interest risk – Hydro-Québec uses currency swaps to manage foreign exchange risk associated with long-term debt, and interest rate swaps to modify interest rate risk exposure over the long term. 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 operations of foreign exchange and interest rate hedging transactions for long-term debt is recorded in Financial expenses.

MANAGEMENT OF RISK ASSOCIATED WITH SALES IN U.S. DOLLARS

▸ Foreign exchange risk – Hydro-Québec uses currency swaps and a portion of U.S.-dollar-denominated debt to manage foreign exchange risk associated with probable U.S.-dollar sales, designating them as cash flow hedges. The impact of these hedging transactions on operations is recorded in Revenue. Hydro-Québec regularly assesses the probability of realizing future sales denominated in U.S. dollars.

The following table shows the notional amounts of swaps used to manage risk associated with long-term debt and sales in U.S. dollars, expressed in Canadian dollars and other currencies:

						2007[a]	2006[a]
Maturity	1 to 5 years	6 to 10 years	11 to 15 years	16 to 20 years	More than 20 years	Total	Total
Swaps							
Canadian dollars	1,778	(752)	(2,465)	(2,270)	(2,704)	**(6,413)**	(6,853)
U.S. dollars	(996)	395	2,030	1,900	2,089	**5,418**	5,325
Other currencies							
Yen	1,500	1,000	–	–	–	**2,500**	4,500
Euros	612	61	–	–	–	**673**	673
Pounds sterling	40	200	–	–	–	**240**	240
Swiss francs	97	–	–	–	–	**97**	97
Forward contracts							
U.S. dollars	–	–	–	–	–	**–**	36

a) Figures in parentheses represent amounts to be paid.

The following table shows the fair value of swaps used to manage risk associated with long-term debt and U.S.-dollar sales, expressed in Canadian dollars and other currencies:

	2007	2006
Instruments designated as cash flow hedges for the debt	**(2,451)**	(1,424)
Instruments designated as fair value hedges for the debt	**(274)**	(118)
Instruments designated as cash flow hedges for sales in U.S. dollars[a]	**894**	670
	(1,831)	(872)
Instruments not designated as hedges[b]	**1,548**	1,261
	(283)	389

a) A portion of the long-term debt, with a notional amount of US$1,504 million as at December 31, 2007, was also designated as a cash flow hedge for U.S.-dollar sales.

b) Transactions carried out as part of the Corporation's risk management, including $1,435 million in consideration of amounts received or disbursed with respect to credit risk mitigation arrangements.

MANAGEMENT OF SHORT-TERM FINANCIAL RISKS

▸ Foreign exchange risk – Hydro-Québec uses options and forward contracts to manage its foreign exchange risk exposure over the short term. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact of foreign exchange hedging transactions on operations is recorded in the line item corresponding to the hedged item, namely in Revenue and Electricity and fuel purchases.

The notional amount of the open positions as at December 31, 2007, was US$563 million, with US$107 million in purchase contracts and US$670 million in sales contracts (US$108 million as at December 31, 2006, that is, US$113 million in purchase contracts and US$5 million in sales contracts).

▸ Interest rate risk – Hydro-Québec uses options, interest rate swaps and forward rate agreements to manage short-term interest rate risk. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact of short-term interest rate risk hedging transactions on operations is recorded in Financial expenses.

For information purposes, a 1% variance in interest rates would not result in any variance in consolidated net income ($2 million in 2006).

▸ Market risk – Hydro-Québec uses mainly options, commodity swaps and commodity futures to manage risk resulting from fluctuations in energy and commodity prices. When these derivative instruments are designated as hedging items, they are recognized as cash flow hedges. The effect on operations of transactions to hedge the risk of variability in energy and commodity prices is recorded in the line item corresponding to the hedged item, namely in Revenue or Electricity and fuel purchases. Hydro-Québec regularly assesses the probability of making such transactions.

In order to hedge its exposure to risk of variability in energy and commodity prices, Hydro-Québec traded in derivative instruments for which open positions as at December 31, 2007, totaled 227,525 tonnes of aluminum (153,925 tonnes as at December 31, 2006) and in electricity swaps whose open positions as at December 31, 2007, were for 6.5 TWh (2.7 TWh as at December 31, 2006).

Note 16 Financial Instruments (continued)

The fair value of derivative instruments used for short-term financial risk management is presented by specific risk in the following table. Most of these derivatives will mature in 2008.

	2007	2006	
	Fair value[a]	Carrying amount	Fair value
Foreign exchange risk			
Forward exchange contracts and options	**14**	–	–
Interest rate risk			
Forward rate agreements, options and swaps	**5**	5	5
Risk of variability in energy and commodity prices			
Forward contracts, options and swaps	**50**	3	35
	69	8	40

a) In 2007, the carrying amount was equal to the fair value.

The fair value of derivative instruments used to manage short-term financial risk, depending on whether or not they are designated as hedges, is presented in the following table:

	2007	2006
Instruments designated as cash flow hedges	**66**	31
Instruments not designated as hedges	**3**	9
	69	40

Effect of hedges on operations

EFFECT OF CASH FLOW HEDGES ON OPERATIONS

As at December 31, 2007, the net gain related to the ineffectiveness of cash flow hedges recognized in operations totaled $9 million.

Moreover, as at December 31, 2007, Hydro-Québec estimated at $222 million the amount of existing net gains (losses) presented in Accumulated other comprehensive income that would be reclassified to operations in the next 12 months.

In 2007, Hydro-Québec reclassified a net gain of $10 million from Accumulated other comprehensive income to operations as a result of the discontinuance of cash flow hedges because it had become improbable that the transactions would be made by the end of the originally specified time period. Similarly, an exchange gain of $234 million was recognized in 2006.

As at December 31, 2007, the maximum period over which Hydro-Québec hedged its exposure to the variability of future cash flows for anticipated transactions was 23 years (24 years as at December 31, 2006).

EFFECT OF FAIR VALUE HEDGES ON OPERATIONS

As at December 31, 2007, the net gain related to the ineffectiveness of fair value hedges recognized in operations totaled $3 million.

EFFECT ON OPERATIONS OF REVALUATION OF INSTRUMENTS NOT DESIGNATED AS HEDGES

As at December 31, 2007, the net gain recognized in operations as a result of revaluing, at fair value, derivative instruments not subject to hedge accounting totaled $42 million.

Other financial instruments

The carrying amount of short-term investments, accounts receivable, current borrowings, accounts payable and accrued liabilities, dividends payable and accrued interest approximates their fair value, due to their short-term maturities. The carrying amount of the government reimbursement for the 1998 ice storm approximates its fair value, which is estimated by discounting the expected cash flows based on effective interest rates for instruments with similar conditions and maturities. As at December 31, 2007, the weighted average interest rate on short-term investments was 4.20% (4.19% as at December 31, 2006), whereas it was 4.38% on current borrowings (4.04% as at December 31, 2006).

Credit risk

Derivative instruments include an element of risk since a counterparty might not meet its obligations. However, this risk is moderate as Hydro-Québec generally deals with Canadian and international financial institutions with high credit ratings. Credit risk exposure is reduced by applying a credit policy to limit credit risk concentration and a counterparty credit risk assessment and monitoring program, as well as by setting credit limits. With the main financial institutions with which it engages in derivatives trading, Hydro-Québec enters into agreements limiting the market value of the derivatives portfolio. Any variation in market value beyond the agreed-upon limit results in a receipt or a disbursement of cash. As at December 31, 2007, no counterparty had defaulted on its obligations toward Hydro-Québec regarding investments and derivatives.

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

Note 17 Interests in Joint Ventures

The proportionate share of the joint venture items included in the consolidated financial statements is presented in the following table. These joint ventures consist of the interests managed by the Technology Group and Hydro-Québec Production.

	2007	2006
Operations		
Revenue	**21**	35
Expenditure and financial expenses	**26**	35
Income from discontinued operations	**1**	43
Net (loss) income	**(4)**	43
Balance sheets		
Current assets	**13**	63
Long-term assets	**29**	38
Current liabilities	**14**	25
Long-term liabilities	**30**	34
Net (liabilities) assets	**(2)**	42
Cash flows		
Operating activities	**(4)**	(4)
Investing activities	**(2)**	(2)
Financing activities	**(1)**	5
Discontinued operations	**(3)**	20
Net change in cash and cash equivalents	**(10)**	19

Note 18 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, 2007 and 2006.

Retained earnings

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

However, in respect of a given financial year, no dividend may be declared in an amount that would have the effect of reducing the capitalization rate to less than 25% at the end of the year. The Québec government declares the dividends for a given year within 30 days after the Corporation has sent it the financial data related to the distributable surplus. Upon expiry of the prescribed period, 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 2007, the Québec government declared dividends of $2,095 million ($2,342 million in 2006).

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

Note 18 Equity (continued)

Accumulated other comprehensive income

	Cash flow hedges	Other	2007 Total
Balance at beginning of year	–	(8)	**(8)**
Adjustments related to the adoption of new accounting policies	479	–	**479**
Change for the year	486	5	**491**
Balance at end of year	965	(3)	**962**

	Cash flow hedges	Other	2006 Total
Balance at beginning of year	–	(73)	(73)
Change for the year	–	65	65
Balance at end of year	–	(8)	(8)

Note 19 Supplementary Cash Flow Information

	2007	2006
Change in non-cash working capital items		
Accounts receivable	**(172)**	88
Materials, fuel and supplies	**5**	(20)
Accounts payable and accrued liabilities	**23**	(217)
Accrued interest	**(47)**	55
	(191)	(94)
Investing activities not affecting cash		
Increase in property, plant and equipment and intangible assets	**90**	303
Interest paid	**2,131**	2,042
Income taxes paid	**2**	258

Note 20 Employee Future Benefits

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

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

The Corporation's employee benefit plans are defined benefit plans. Accrued benefit obligations of these plans, valued by independent actuaries, and assets, at fair value, are valued as at December 31 of each year. The most recent actuarial valuation for purposes of Pension Plan funding was as at December 31, 2006, and the next valuation must be performed no later than December 31, 2009.

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

	Pension Plan		Other plans	
	2007	2006	**2007**	2006
Accrued benefit obligations				
Balance at beginning of year	**12,720**	11,925	**850**	837
Current service cost	**336**	331	**38**	34
Employee contributions	**66**	54	**–**	–
Benefit payments and refunds	**(460)**	(420)	**(49)**	(44)
Interest on obligations	**659**	618	**46**	42
Actuarial (gains) losses	**(714)**	212	**44**	(19)
Balance at end of year	**12,607**	12,720	**929**	850
Plan assets at fair value				
Balance at beginning of year	**12,811**	11,331	**56**	51
Actual return on plan assets	**538**	1,497	**2**	2
Employee contributions	**66**	54	**–**	–
Current contributions by the Corporation	**5**	319	**11**	11
Special contributions by the Corporation	**–**	62	**–**	–
Benefit payments and refunds	**(460)**	(420)	**(12)**	(8)
Administrative fees	**(34)**	(32)	**–**	–
Balance at end of year	**12,926**	12,811	**57**	56
Surplus (deficit) at end of year	**319**	91	**(872)**	(794)
Unamortized past service costs	**217**	256	**–**	–
Unamortized net actuarial loss	**1,205**	1,833	**190**	156
Unamortized transitional (asset) obligation	**(913)**	(1,065)	**81**	94
Accrued benefit asset (liability)	**828**	1,115	**(601)**	(544)

Additional disclosures with respect to plan assets

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

	Pension Plan		Other plans	
%	**2007**	2006	**2007**	2006
Equities	**46**	53	**–**	–
Bonds	**39**	33	**95**	91
Short-term investments	**9**	8	**–**	5
Real estate investments	**6**	5	**–**	–
Other	**–**	1	**5**	4
	100	100	**100**	100

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

	Pension Plan		Other plans	
	2007	2006	**2007**	2006
Bonds	**1,266**	961	**55**	51

Note 20 Employee Future Benefits (continued)

Cash payments

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

	2007	2006
Contributions by the Corporation		
Pension Plan	**5**	381
Other funded plans	**11**	11
Benefit payments		
Unfunded plans	**38**	35
Cash payments	**54**	427

The Corporation and its employees resumed their contributions to the Pension Plan on December 15, 2003. Each year the employee and employer contribution rates increase by 1% and 1.8%, respectively, up to no more than 5.2% of pensionable earnings. In 2007, employee contributions amounted to 4% of pensionable earnings in the Pension Plan (3% in 2006). Moreover, the actuarial valuation for funding purposes as at December 31, 2006, disclosed a surplus that could allow the Corporation to take a contribution holiday in 2007 (contribution of 5.2% in 2006). This contribution holiday, applied pursuant to Pension Plan Bylaw 707, has been in effect since February 16, 2007, namely the filing date of the actuarial valuation with the Régie des rentes du Québec. Earlier in the year, the Corporation had made a contribution of $5 million to the Pension Plan.

In 2006, the Corporation made a current contribution of $319 million to the Pension Plan, including an additional contribution of $242 million to cover current service costs and a special contribution of $62 million to cover the actuarial deficit.

ELEMENTS OF ACCRUED BENEFIT COST RECOGNIZED FOR THE YEAR

	Pension Plan		Other plans	
	2007	2006	**2007**	2006
Current service cost[a]	**336**	331	**38**	34
Administrative fees[b]	**34**	32	**–**	–
Interest on obligations	**659**	618	**46**	42
Actual return on plan assets	**(538)**	(1,497)	**(2)**	(2)
Actuarial (gains) losses	**(714)**	212	**44**	(19)
(Credit) cost before adjustments required to recognize the long-term nature of employee future benefits	**(223)**	(304)	**126**	55
Difference between actual and expected return on assets	**(201)**	802	**–**	–
Difference between actuarial losses (gains) on accrued benefit obligations and actuarial losses recognized	**829**	(99)	**(34)**	25
Difference between adjustments for plan amendments and amortization of past service costs	**39**	39	**–**	–
Amortization of transitional (asset) obligation	**(152)**	(152)	**14**	14
	515	590	**(20)**	39
Cost recognized for the year	**292**	286	**106**	94

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

b) Administrative fees billed to the Pension Plan by the Corporation amounted to $13 million for 2007 ($12 million for 2006).

Significant actuarial assumptions

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

	Pension Plan		Other plans	
%	**2007**	2006	**2007**	2006
Accrued benefit obligations				
Rate at end of year				
Discount rate	**5.53**	5.20	**5.53**	5.20
Salary escalation rate[a]	**3.26**	3.38	**–**	–
Accrued benefit cost recognized				
Rate at end of prior year				
Discount rate	**5.20**	5.30	**5.20**	5.30
Expected long-term rate of return on plan assets	**6.25**	6.25	**4.23**	4.07
Salary escalation rate[a]	**3.38**	3.30	**–**	–

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

As at December 31, 2007, health care costs were based on an annual growth rate of 7.7% in 2008. Thereafter, based on the assumption used, this rate will gradually decrease until it ultimately reaches 3.7% in 2016. A change of one percentage point in this annual growth rate would have had the following impact for 2007:

	1% increase	1% decrease
Impact on current service cost and interest cost on accrued benefit obligations for the year	5	(4)
Impact on accrued benefit obligations at end of year	56	(45)

Note 21 Commitments and Contingencies

Electricity purchases

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

As at December 31, 2007, the Corporation was committed under 97 contracts to purchase electricity from other power producers, for an installed capacity of about 3,875 MW. It expects to purchase approximately 13 TWh of energy annually over the terms of these contracts, which extend through 2045. The majority of these contracts include renewal clauses.

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

2008	665
2009	1,035
2010	1,127
2011	1,141
2012	1,219

Guarantees

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

As at December 31, 2007, the potential maximum amount Hydro-Québec could have had to pay under letters of credit or guarantees provided as security totaled $383 million. Of this amount, $306 million was related to energy purchases. Some guarantees expire between 2008 and 2019, while others do not have maturity dates.

Hydro-Québec provided guarantees to the purchasers of its interests with respect to contingent tax liabilities and certain other customary representations. These guarantees, for which no liability was recognized, will be in effect until the applicable limitation periods expire.

In accordance with the terms and conditions of certain debt securities issued outside Canada, the Corporation has a commitment to increase the amount of interest paid to non-residents in the event of changes to Canadian tax legislation governing the taxation of non-residents' income. The Corporation cannot estimate the maximum amount it might have to pay under such circumstances. Should an amount become payable, the Corporation has the option of redeeming most of the securities in question. As at December 31, 2007, the amortized cost of these debts was $5,688 million.

Note 21 Commitments and Contingencies (continued)

Under the contract signed on May 12, 1969, with CF(L)Co, the Corporation could be required to provide additional funding if CF(L)Co were unable to pay its expenses and service its debt. The maximum amount that the Corporation could be required to pay cannot be reasonably evaluated, however, since it is not stated in the contract and since the amount payable would depend on the outcome of future events whose nature and probability cannot be determined. To date, the Corporation has not had to pay any amount under this contract.

Investments

The Corporation expects to invest approximately $4 billion in property, plant and equipment and intangible assets in 2008.

Litigation

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

Note 22 Related Party Transactions

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

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

Note 23 Segmented Information

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

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

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

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

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

Corporate and Other Activities: The corporate units support the divisions in the achievement of their business objectives. They include the Technology Group, the Finance Group, the Human Resources and Shared Services Group, as well as Corporate Affairs and General Secretariat. The Shared Services Centre brings together internal services including goods and services procurement, real estate management, and material and transportation service management.

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

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

Other intersegment products and services are valued at full cost.

Hydro-Québec derives the bulk of its revenue in Québec, and substantially all its property, plant and equipment is located in the province. In 2007, revenue from outside Québec amounted to $1,780 million, with $1,483 million coming from the United States ($1,368 million and $1,054 million, respectively, in 2006).

OPERATIONS AND ASSETS BY SEGMENT

	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	2007 Total
Revenue							
External customers	1,649	37	10,452	–	49	143[a]	**12,330**
Intersegment	5,103	2,750	56	2,150	1,232	(11,291)	**–**
Depreciation and amortization	837	570	446	7	143	(12)	**1,991**
Financial expenses	1,180	792	484	–	56	–	**2,512**
Income from continuing operations	2,077	396	395	–	2	12	**2,882**
Net income	2,077	396	395	–	27	12	**2,907**
Total assets	29,495	16,047	11,833	263	7,474	(260)	**64,852**
Investments in property, plant and equipment and intangible assets							
Affecting cash	1,807	778	721	3	155	–	**3,464**
Not affecting cash	41	14	35	–	–	–	**90**

	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	2006 Total
Revenue							
External customers	1,594[b]	32	9,488	–	48	(1)	11,161
Intersegment	4,570	2,809	55	1,999	1,203	(10,636)	–
Depreciation and amortization	760	535	570	7	144	(9)	2,007
Financial expenses	1,058	724	407	(1)	23	1	2,212
Income from continuing operations	2,114	632	42	2	–	7	2,797
Net income	2,114	632	42	2	944	7	3,741
Total assets	28,674	15,879	11,430	214	7,272	(215)	63,254
Investments in property, plant and equipment and intangible assets							
Affecting cash	1,615	882	690	4	157	–	3,348
Not affecting cash	273	14	16	–	–	–	303

a) Resales of excess supply by Hydro-Québec Distribution on outside markets are presented as offsets of electricity purchases rather than in Revenue.

b) A $234-million foreign exchange gain was recognized on debts and swaps denominated in U.S. dollars. In keeping with the hedge accounting treatment adopted, this amount, which represents the realization of a portion of the deferred foreign exchange gain recorded on the balance sheet, was incorporated into other operating revenue.

Five-Year Review

Consolidated Financial Information

$M	2007	2006	2005	2004	2003
OPERATIONS					
Revenue	**12,330**	11,161	10,887	10,341	10,197
Expenditure					
Operations	**2,545**	2,394	2,248	2,158	2,070
Electricity and fuel purchases	**1,555**	1,315	1,496	1,464	1,380
Depreciation and amortization	**1,991**	2,007	2,023	1,862	1,768
Taxes	**816**	529	594	606	567
Regulatory deferrals	**29**	(93)	(11)	–	–
	6,936	6,152	6,350	6,090	5,785
Operating income	**5,394**	5,009	4,537	4,251	4,412
Financial expenses	**2,512**	2,212	2,186	2,083	2,492
Income from continuing operations	**2,882**	2,797	2,351	2,168	1,920
Income (loss) from discontinued operations	**25**	944	(99)	267	18
Net income	**2,907**	3,741	2,252	2,435	1,938
DIVIDENDS DECLARED	**2,095**	2,342	1,126	1,350	965
BALANCE SHEET SUMMARY					
Total assets	**64,852**	63,254	60,431	58,072	57,823
Long-term debt, including current portion and perpetual debt	**34,534**	34,427	33,007	33,401	35,550
Equity	**20,892**	18,840	17,376	16,220	15,128
INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH					
Property, plant and equipment and intangible assets	**3,464**	3,348	3,293	3,071	2,739
Costs related to Energy Efficiency Plan	**172**	149	91	41	10
Total investments	**3,636**	3,497	3,384	3,112	2,749
FINANCIAL RATIOS					
Interest coverage[a]	**2.13**	2.06	2.00	1.79	1.73
Capitalization (%)[b]	**37.5**	36.1	34.1	32.7	29.9
Self-financing (%)[c]	**61.9**	86.5	58.6	78.4	56.3
Return on equity (%)[d]	**15.0**	20.6	13.3	15.4	13.1
Profit margin from continuing operations (%)[e]	**23.4**	25.1	21.6	21.0	18.8

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

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

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

d) Net income divided by average equity less average accumulated other comprehensive income.

e) Net income from continuing operations divided by revenue.

Note: Throughout the Five-Year Review and the Consolidated Results by Quarter, certain comparative figures have been reclassified to reflect the presentation adopted for 2007.

Operating Statistics

	2007	2006	2005	2004	2003
GWh					
Electricity sales					
In Québec, by category					
Residential and farm	**60,046**	56,722	57,269	58,002	57,217
General and institutional	**34,751**	32,440	33,463	33,137	32,314
Industrial	**73,005**	73,297	73,447	69,722	72,546
Other	**5,353**	4,878	4,998	5,026	5,014
	173,155	167,337	169,177	165,887	167,091
Outside Québec					
Canada/U.S. (long-term)	**2,384**	2,384	2,068	1,930	2,047
Canada/U.S. (short-term)	**17,240**	12,074	13,274	12,462	13,739
	19,624	14,458	15,342	14,392	15,786
Total electricity sales	**192,779**	181,795	184,519	180,279	182,877
$M					
Revenue from electricity sales					
In Québec, by category					
Residential and farm	**4,144**	3,775	3,690	3,690	3,504
General and institutional	**2,602**	2,356	2,284	2,234	2,096
Industrial	**3,336**	3,022	2,892	2,751	2,742
Other	**286**	249	255	247	236
	10,368	9,402	9,121	8,922	8,578
Outside Québec					
Canada/U.S. (long-term)	**225**	198	174	179	207
Canada/U.S. (short-term)	**1,392**	951	1,290	905	1,138
	1,617	1,149	1,464	1,084	1,345
Total revenue from electricity sales	**11,985**	10,551	10,585	10,006	9,923
As at December 31					
Number of customer accounts in Québec, by category					
Residential and farm	**3,554,443**	3,501,709	3,450,455	3,399,776	3,343,271
General and institutional	**299,524**	295,618	283,616	282,748	281,997
Industrial	**11,565**	12,032	12,796	13,117	13,383
Other	**3,440**	5,767	5,643	5,634	5,812
Total customer accounts	**3,868,972**	3,815,126	3,752,510	3,701,275	3,644,463
kWh/customer account					
Average annual consumption in Québec, by category					
Residential and farm	**17,019**	16,318	16,720	17,203	17,237
General and institutional	**116,782**	112,010	118,168	117,352	114,651
Industrial	**6,187,651**	5,904,382	5,668,738	5,262,038	5,395,359
Other	**1,162,811**	855,039	886,406	878,211	864,110

Operating Statistics (continued)

	2007	2006	2005	2004	2003
MW					
Installed capacity[a]					
Hydroelectric	**33,305**	32,973	32,299	31,622	31,347
Nuclear	**675**	675	675	675	675
Conventional thermal	**1,665**	1,665	1,595	1,593	1,592
Wind	**2**	2	2	2	2
Total installed capacity	**35,647**	35,315	34,571	33,892	33,616
GWh					
Total energy requirements[b]	**209,818**	199,447	200,179	193,025	194,792
MW					
Peak power demand in Québec[c]	**35,352**	36,251	33,636	34,956	36,268
km					
Lines (overhead and underground)					
Transmission	**33,008**	32,826	32,544	32,487	32,434
Distribution[d]	**109,618**	108,883	108,344	107,423	106,568
	142,626	141,709	140,888	139,910	139,002

a) Hydro-Québec also has access to almost all the output from Churchill Falls generating station (5,428 MW) and purchases all the output from seven privately owned wind farms with a total installed capacity of 420 MW. In addition, 1,222 MW are available under agreements with other independent suppliers.

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

c) Total power demand at the annual domestic peak for the winter beginning in December, including interruptible power. The 2007–2008 winter peak for Québec occurred at 8 a.m. on January 21, 2008.

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

Other Information

	2007	2006	2005	2004	2003
%					
Rate increases					
Average increase from January 1 to December 31	**2.8**	4.3	1.3	4.1	–
Inflation rate	**2.2**	2.0	2.2	1.8	2.8
Number of employees[a]					
Permanent as at December 31	**19,459**	19,116	19,009	18,835	18,317
Temporary (year's average)	**3,910**	3,799	3,577	3,567	3,596
Women (%)	**31.3**	30.6	29.8	29.4	28.9

a) Excludes employees of subsidiaries and joint ventures.

Consolidated Results by Quarter

$M	1st quarter	2nd quarter	3rd quarter	4th quarter	2007 12-month period
				(unaudited)	(audited)
Revenue	3,732	2,828	2,554	3,216	**12,330**
Expenditure					
Operations	606	617	597	725	**2,545**
Electricity and fuel purchases	422	337	441	355	**1,555**
Depreciation and amortization	482	477	472	560	**1,991**
Taxes	208	187	200	221	**816**
Regulatory deferrals	(14)	(14)	(15)	72	**29**
	1,704	1,604	1,695	1,933	**6,936**
Operating income	2,028	1,224	859	1,283	**5,394**
Financial expenses	618	589	642	663	**2,512**
Income from continuing operations	1,410	635	217	620	**2,882**
Income from discontinued operations	21	–	–	4	**25**
Net income	1,431	635	217	624	**2,907**

$M	1st quarter	2nd quarter	3rd quarter	4th quarter	2006 12-month period
				(unaudited)	(audited)
Revenue	3,199	2,595	2,446	2,921	11,161
Expenditure					
Operations	559	564	591	680	2,394
Electricity and fuel purchases	363	284	303	365	1,315
Depreciation and amortization	489	496	487	535	2,007
Taxes	153	89	143	144	529
Regulatory deferrals	–	–	–	(93)	(93)
	1,564	1,433	1,524	1,631	6,152
Operating income	1,635	1,162	922	1,290	5,009
Financial expenses	530	552	588	542	2,212
Income from continuing operations	1,105	610	334	748	2,797
Income from discontinued operations	24	832	63	25	944
Net income	1,129	1,442	397	773	3,741

Corporate Management

Thierry Vandal
President and Chief Executive Officer

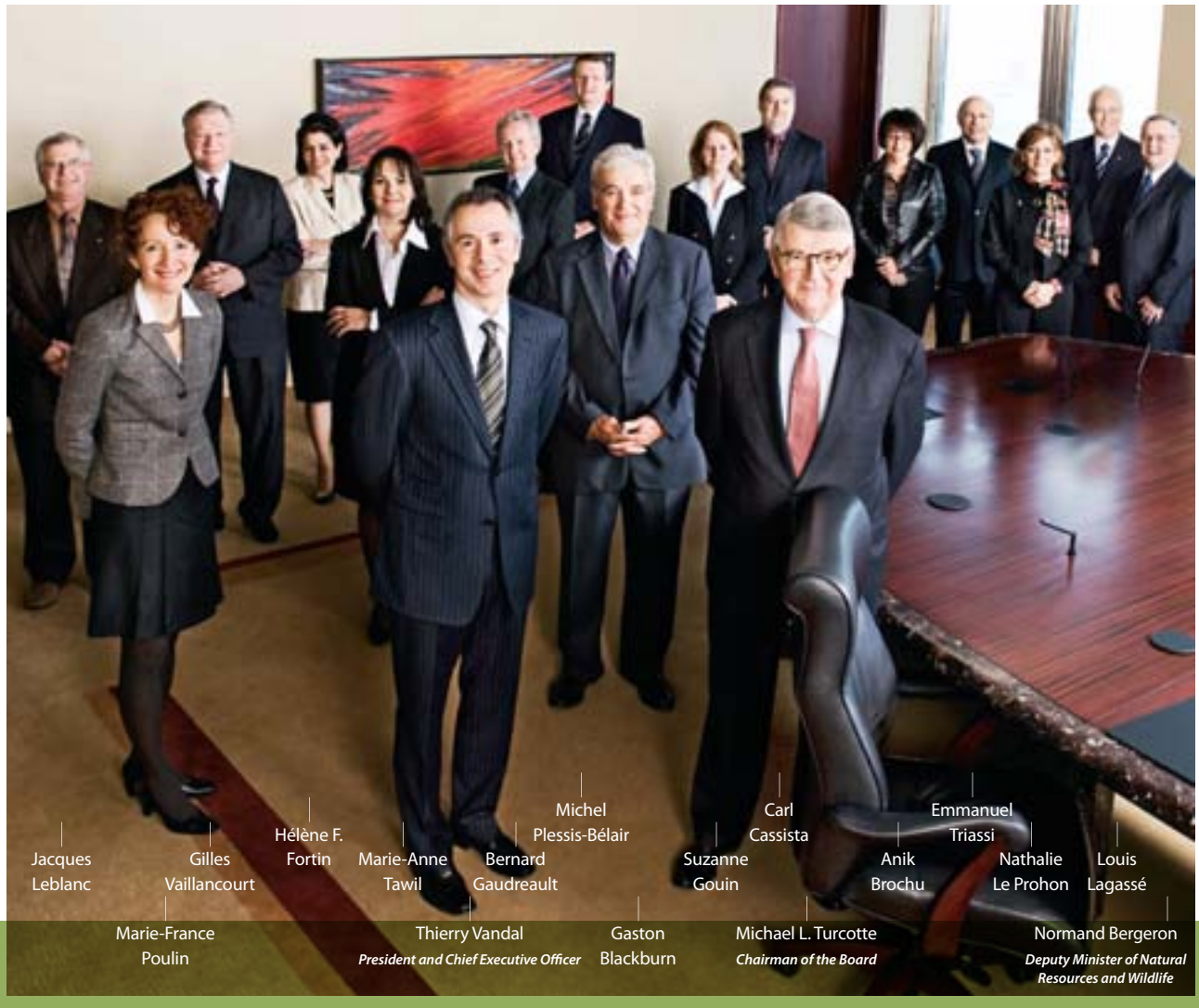
Marie-José Nadeau
Executive Vice President,
Corporate Affairs and Secretary General

Daniel Garant
Executive Vice President,
Finance and Chief Financial Officer

Élie Saheb
Executive Vice President,
Technology

Maurice Charlebois
Executive Vice President,
Human Resources and Shared Services

Board of Directors



Directors

Michael L. Turcotte
Chairman of the Board, Hydro-Québec
Appointment: November 17, 2005
Term: November 17, 2009
Status: Independent director

With a Bachelor of Arts from the Université de Montréal and a Master's degree in Commerce from Université Laval, Michael Turcotte made a career for himself at the Royal Bank of Canada, where he held the position of Senior Vice President and General Manager, Québec. From 1999 to 2004, he was Chair of the Board of Management at the Canada Customs and Revenue Agency.

Thierry Vandal
President and Chief Executive Officer, Hydro-Québec
Appointment: April 6, 2005
Term: October 3, 2012
Status: Non-independent director

With a Bachelor of Engineering from the École Polytechnique de Montréal and an MBA from HEC Montréal, Thierry Vandal has worked in the energy sector for more than 25 years. In particular, he participated in the operations, marketing, and strategic planning aspects of the petroleum, petrochemical, and natural gas industries before joining Hydro-Québec in 1996. Mr. Vandal is Chairman of the Board of Collège Notre-Dame and is a director of The Conference Board of Canada, HEC Montréal and McGill University.

Normand Bergeron
Deputy Minister of Natural Resources and Wildlife, Gouvernement du Québec
Appointment: May 2, 2005 (indefinite term)
Status: Non-independent director

Normand Bergeron has a Bachelor's degree in Sociology from the Université de Montréal and studied at the Master's level at the École nationale d'administration publique. He has worked in the Québec public service since 1975. He joined the Ministère des Ressources naturelles in 2000 as Associate Deputy Minister responsible for Energy and Climatic Change and was named Deputy Minister of Natural Resources and Wildlife in 2002.

Gaston Blackburn
President, G. Blackburn Inc.
Appointment: September 10, 2003
Term: September 10, 2008
Status: Independent director

A merchant and businessman, Gaston Blackburn was elected MNA for Roberval in 1988. He was successively Parliamentary Secretary to the Premier, Minister for the Environment, and Minister of Recreation, Game and Fishing. He has served on the boards of companies in various sectors, including the food industry and natural resources.

Anik Brochu
General Manager, Chambre de commerce de Val-d'Or
Appointment: September 13, 2006
Term: September 13, 2010
Status: Independent director

With a law degree from the University of Ottawa, Anik Brochu is a member of the Québec Bar and practised law with the firm of Dufresne, Ferron, St-Julien. She joined the Chambre de commerce de Val-d'Or in 1997.

Carl Cassista
President, Axion Technologies Ltd.
Appointment: September 26, 2007
Term: September 26, 2011
Status: Independent director

A graduate of Université Laval and a member of the Ordre des ingénieurs du Québec, Carl Cassista has worked in electrical engineering and in R&D, mainly for Axion Technologies. He joined that company in 1982 and has served there as President since 1994.

Hélène F. Fortin
Partner, CGF CA, Chartered Accountants
Appointment: October 25, 2006
Term: October 25, 2009
Status: Independent director

Hélène F. Fortin holds a Bachelor of Administration specializing in Finance and Accounting from Concordia University, as well as a Graduate Diploma in Public Accountancy from McGill University, and is certified by the Institute of Corporate Directors. A member of the Ordre des comptables agréés du Québec, she formerly worked in acquisitions at Quebecor. Since 1990, she has been practising public accountancy as a partner in accounting firms. Ms. Fortin taught accounting at Montréal universities for over 20 years. She is active on various committees of the Canadian Institute of Chartered Accountants and sits on the board of CBC | Radio-Canada.

Bernard Gaudreault
Corporate Director
Appointment: December 5, 2001
Term: September 26, 2010
Status: Independent director

With a diploma in commerce from the Noranda Business School, Bernard Gaudreault has more than 30 years' experience in corporate management in real estate and the food industry. He is Chairman of the Board of the municipal housing bureau in Rouyn-Noranda.

Suzanne Gouin
President and Chief Executive Officer, TV5 Québec Canada
Appointment: September 26, 2007
Term: September 26, 2011
Status: Independent director

Suzanne Gouin has a Bachelor's degree in Political Science from Concordia University, where she also took graduate courses in media studies. She completed an MBA at the University of Western Ontario and has certification from the Institute of Corporate Directors. She has held several management positions in media companies and joined TV5 Québec Canada in 2002. Ms. Gouin sits on the boards of various not-for-profit organizations.

Louis Lagassé
Chairman of the Board, Lagassé Group
Appointment: September 10, 2003
Term: September 10, 2008
Status: Independent director

Louis Lagassé is a member of the Chambre des notaires du Québec. He completed a law degree at the Université de Montréal, an MBA at the University of Western Ontario and a German language diploma at the University of Salzburg in Austria. Mr. Lagassé heads an industrial group that is active on the Canadian and European markets, and he serves on the boards of several telecommunications companies as well as various not-for-profit organizations.

Jacques Leblanc
President, Gestion Jacques Leblanc inc.
Appointment: April 7, 2004
Term: September 26, 2010
Status: Independent director

A graduate of Université Laval in administration, Jacques Leblanc is a chartered accountant and a Fellow of the Ordre des comptables agréés du Québec. He was a partner in the firm of Leblanc Bourque Arsenault for 25 years.

Nathalie Le Prohon
Corporate Director
Appointment: September 26, 2007
Term: September 26, 2011
Status: Independent director

Nathalie Le Prohon has a Bachelor of Commerce from McGill University and an MBA from Concordia University. She has held numerous executive positions in high-technology companies, including President of Nokia Canada. She sits on the boards of various not-for-profit organizations.

Michel Plessis-Bélair
Vice-Chairman, Power Corporation of Canada
Appointment: April 7, 2004
Term: September 26, 2011
Status: Independent director
Other directorship: Power Corporation of Canada

Michel Plessis-Bélair holds a Bachelor of Arts from the Université de Montréal, a business and accounting degree from HEC Montréal and an MBA from Columbia University in New York. In 1986 he joined Power Corporation of Canada, where he served as Executive Vice-President and Chief Financial Officer and as Senior Vice-President, Finance and Administration, before being appointed Vice-Chairman and Chief Financial Officer. He retired as CFO in January 2008 but continues as Vice-Chairman. Mr. Plessis-Bélair also sits on the boards of various not-for-profit organizations.

Marie-France Poulin
Executive Vice President, Camada Group Inc.
Appointment: April 7, 2004
Term: September 26, 2011
Status: Independent director

Marie-France Poulin has a Bachelor of Business Administration with an option in Marketing from Université Laval, as well as certification from the Collège des administrateurs de sociétés. She has held several executive positions, including that of Vice-President, Sales and Marketing, of MAAX. Ms. Poulin sits on the boards of various not-for-profit organizations.

Marie-Anne Tawil
President and Chief Executive Officer,
Les Investissements Iron Hill Inc.
Appointment: December 7, 2005
Term: December 7, 2010
Status: Independent director

With a Licentiate in Civil Law and a Bachelor of Common Law from the University of Ottawa, Marie-Anne Tawil has earned certification from the Institute of Corporate Directors and is a member of the Québec Bar. She has practised law in two major law firms in Montréal, was Legal Counsel and Secretary of Quebecor and held management positions in various other companies. Ms. Tawil is Chairman of the SAAQ (Société d'assurance automobile du Québec).

Emmanuel Triassi
President, Groupe T.E.Q. Inc.
Appointment: September 26, 2007
Term: September 26, 2011
Status: Independent director

A member of the Ordre des ingénieurs du Québec, Emmanuel Triassi holds a Bachelor's degree from McGill University and a Master's degree in Building Engineering from Concordia University. He is the founding president of a general contracting company specializing in construction project management.

Gilles Vaillancourt
Mayor of the City of Laval
Appointment: September 26, 2007
Term: September 26, 2011
Status: Independent director

Following studies in pharmacology and business management, Gilles Vaillancourt launched his career in business. At the same time, he became involved in municipal affairs. He was elected Mayor of Laval in 1989 and serves in this capacity on the boards of various representational organizations at the local, regional, provincial and federal levels. He also sits on the boards of various not-for-profit organizations.

Activity Report of the Board of Directors and Board Committees

Adélard Godbout (1892–1956), Premier of Québec (1939–1944). Hydro-Québec was created in 1944 under his government.

Board of Directors

Hydro-Québec's Board of Directors is made up of 17 members, including the Chairman of the Board and the President and Chief Executive Officer. The directors' diverse professional backgrounds are a definite asset for the Board's seven committees: Executive, Audit, Governance and Ethics, Human Resources, Finance, Environment and Public Affairs, and Pension Plan Financial Management. The Board met 14 times and the committees a total of 45 times in 2007.

Following the adoption of the *Act respecting the governance of state-owned enterprises,* which amended several provisions of the *Hydro-Québec Act* dealing with the company's governance as well as the role and composition of the Board of Directors, among other things, the directors voted on several governance-related measures, including the reorganization of the Board's committees and the updating of their mandates. In particular, the Board abolished the Distribution, Generation and Transmission Committees. The issues handled by these committees are now submitted directly to the Board. It also replaced the Environment and Corporate Governance Committee with the Governance and Ethics Committee, and created the Environment and Public Affairs Committee. After this restructuring, the Board had the seven committees listed above. Committee members may, when necessary, consult independent experts to assist them in their deliberations.

In 2007, the Board of Directors approved the expertise and experience profiles developed for the appointment of new members to the Board. It updated its corporate governance bylaw as well as the bylaw setting out the functions and powers of the Chairman of the Board, the President and Chief Executive Officer and other senior executives. The Board approved the criteria for assessing its own performance and undertook such an assessment. It also approved the company's rules of governance and a financial disclosure policy. In addition, it monitored progress on the *Strategic Plan 2006–2010* and initiated the strategic planning process for 2009–2013. In this regard, the directors attended presentations on the company's business context and issues in power generation, transmission and distribution.

The Board's many decisions in 2007 included approving the Eastmain-1-A/Sarcelle/Rupert project, modifications to Saint-Maxime substation (increasing transformer capacity and rebuilding the 25-kV section) and construction of Vaudreuil-Soulanges and Mont-Tremblant substations. It also greenlighted continued rehabilitation of the Beauharnois generating units, modernization of Paugan generating station, the first phase in the expansion of solid radioactive waste storage facilities at Gentilly-2 nuclear generating station and rehabilitation of the spherical valves at Manic-5. Moreover, it approved construction of the 315-kV Chénier–Outaouais line as well as other work required to reinforce the future 1,250-MW interconnection with Ontario.

The Board's recurring deliberations dealt with the quarterly and annual objectives and financial results of the company and its wholly owned subsidiaries, capital projects and financial management of the pension plan. It also studied the enterprise risk management process and the portfolio of risks. It gave its prior approval to applications made to the Régie de l'énergie, the annual internal audit plan and the external auditors' plan and fees for the auditing of the financial statements of the company and its pension plan. In addition, the Board was regularly informed about the activities of its committees.

Director Attendance at Meetings of the Board of Directors and Board Committees in 2007

	Board of Directors and Existing Committees								Former Committee[a]
	Board	A[b]	B	C	D	E	F	G	H
Directors **Number of Meetings**	**14**		**18**	**6**	**12**	**2**	**2**	**2**	**2**
Michael L. Turcotte A B C D E F G H	14		18	6*	12**	2	2	2	2
Thierry Vandal A E F G H	13					2	2	2	0
Normand Bergeron	13								
Gaston Blackburn F H	11						2		1
Anik Brochu F	14						2		
Carl Cassista[c]	4								
Hélène F. Fortin B E	13		18			2			
Bernard Gaudreault B	13		17						
Suzanne Gouin[c] F	2								
Louis Lagassé A D E G	10				10**	2		2	
Jacques Leblanc B C	13		18	6*					
Nathalie Le Prohon[c]	4								
Michel Plessis-Bélair A C E G H	11			2		2		2	1
Marie-France Poulin C D	13			4	12				
Marie-Anne Tawil C D H	13			6	12				2
Emmanuel Triassi[c] B	4		1						
Gilles Vaillancourt[c]	4								
Outgoing Directors **Number of Meetings**	**4**		**7**	**3**	**8**		**1**	**1**	**2**
Norman E. Hébert Jr. B (end of term: 2007-03-31)	4		7						
Number of Meetings	**10**		**16**	**3**	**10**		**2**	**1**	**2**
Joseph Benarrosh D G H (end of term: 2007-09-26)	9				9			1	2
Andrée Corriveau B H (end of term: 2007-09-26)	10		8						2
Paul Larocque F (end of term: 2007-09-26)	10						2		

Board Commitees

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

** A joint meeting of the Audit Committee and the Governance and Ethics Committee was held on June 14, 2007. Michael Turcotte and Jacques Leblanc, who sit on both committees, were considered to have attended as members of the Audit Committee.*

*** A joint meeting of the Human Resources Committee and the Finance Committee was held on December 12, 2007. Michael Turcotte and Louis Lagassé, who sit on both committees, were considered to have attended as members of the Human Resources Committee.*

a) The Distribution, Generation and Transmission Committees were abolished on March 16, 2007. Only the Transmission Committee held a meeting in 2007. Also on March 16, 2007, the Environment and Corporate Governance Committee was replaced by the Governance and Ethics Committee.

b) The Executive Committee meets when necessary. It did not hold any meetings in 2007.

c) Carl Cassista, Suzanne Gouin, Nathalie Le Prohon, Emmanuel Triassi and Gilles Vaillancourt were appointed to the Board effective September 26, 2007.

Executive (A)

The Executive Committee is vested with all of the powers of the Board of Directors, except those powers that are expressly reserved for the Board by law and under the company's bylaws. The committee, which is chaired by Michael Turcotte, meets only when necessary and did not hold any meetings in 2007.

Audit (B)

The role of the Audit Committee is to recommend that the Board of Directors approve the financial statements of Hydro-Québec and of its pension plan. It ensures that the financial statements accurately reflect the company's financial position and changes therein, and that internal controls are adequate and effective. The committee recommends approval of the annual audit plan, supervises the internal audit process, ensures that the company has a plan to optimize the use of its resources and monitors this plan. It submits its recommendations on external auditors' fees to the Board and meets periodically with the auditors. In addition, it examines the integrated enterprise risk management process. It may also serve as the audit committee of any of the company's wholly owned subsidiaries.

The committee is made up exclusively of independent directors who have the necessary expertise, two of whom belong to the Ordre des comptables agréés du Québec. It is chaired by Jacques Leblanc.

The committee held seven regular meetings in 2007. In its recurring deliberations, it verified the independence of the external auditors. It examined internal and external audit results and internal audit reports on the control and optimization of the company's operations and resources as well as management of the related risks. It also examined the quarterly and annual financial statements of Hydro-Québec and the annual financial statements of its pension plan, of Hydro-Québec International and of Société d'énergie de la Baie James. The committee monitored the implementation of the project to attest to the effectiveness of internal controls related to financial information and the deployment of the Customer Information System. It also examined the 2008 internal audit plan and recommended that the Board approve it. The committee held additional meetings related to the mandate entrusted to the Auditor General of Québec regarding the sale of Hydro-Québec's investment in the Meiya Power Company.

Governance and Ethics (C)

The role of the Governance and Ethics Committee is to develop the rules of governance and codes of ethics applicable to directors, senior executives appointed by the company and employees of Hydro-Québec and its wholly owned subsidiaries; the expertise and experience profiles used in appointing Board members; the criteria for assessing the performance of directors and the Board; the induction and training program for directors; as well as measures to evaluate the company's efficiency and performance. It also makes recommendations to the Board regarding the company's policies and Strategic Plan. The committee is chaired by Michael Turcotte.

In 2007, the committee held six meetings, in addition to the two meetings held by the Environment and Corporate Governance Committee before the reorganization of the Board committees. Throughout the year, it closely monitored the application of the *Act respecting the governance of state-owned enterprises* and made several recommendations to the Board of Directors regarding, in particular, the corporate governance bylaw, the bylaw setting out the functions and powers of senior executives, the review of the terms of operation of the Board and the reorganization of its committees, the expertise and experience profiles of directors, as well as the criteria for assessing the performance of directors and the Board. It also enhanced the induction and training program for directors and examined the company's *Annual Report 2006*.

Human Resources (D)

The Human Resources Committee establishes human resources policies as well as standards and rate scales for the compensation of senior executives and employees of the company and its wholly owned subsidiaries. It is responsible for developing the expertise and experience profile to be applied in appointing the President and Chief Executive Officer and for proposing to the Board of Directors, for purposes of recommendation to the government, a candidate for this position. It also develops and suggests criteria for assessing the performance of the President and Chief Executive Officer and makes recommendations to the Board regarding his compensation. Furthermore, it participates in selecting the senior executives of the company and its subsidiaries and in developing a succession plan. The committee is chaired by Marie-France Poulin.

In 2007, the committee held 12 meetings, including a joint meeting with the Finance Committee in order to examine Hydro-Québec's Business Plan, objectives and enterprise risk management. It evaluated whether or not the company had met its annual performance objectives and assessed the overall compensation of its employees, its executives and the President and Chief Executive Officer; as well, it participated in optimizing the company's organizational structure, particularly in regard to information technology. In accordance with new legislative provisions relating to corporate governance, the committee also considered the reappointment of the President and Chief Executive Officer, updated his compensation and developed criteria for assessing his performance. It closely monitored the succession plan for Senior Management.

The committee studied the annual report on the application of the corporate policy *Our Human Resources,* which describes the action taken and results achieved in expertise management, working conditions, labor relations, and occupational health and safety. It also analyzed the results of the 2007 employee survey on job satisfaction and employee motivation, and discussed ways of tracking the main indicators.

Finance (E)

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

In 2007, the committee held two meetings, including a joint meeting with the Human Resources Committee for the purpose of analyzing the company's Business Plan, objectives and enterprise risk management. It also examined the various annual borrowing, guarantee, financial risk management, swap and sinking fund programs and monitored all capital projects with a value greater than $50 million.

Environment and Public Affairs (F)

The Environment and Public Affairs Committee provides opinions and makes recommendations to the Board of Directors on environmental and public affairs issues, particularly the following: environmental management, compliance with environmental legislation and integration of sustainable development principles; environmental incident reports, claims, opinions, investigations and lawsuits by government bodies or other parties; public health and safety; community relations; corporate citizenship and contribution to the community; as well as public image. The committee is chaired by Gaston Blackburn.

The committee held two meetings in 2007, in addition to the two meetings held by the former Environment and Corporate Governance Committee before the reorganization of the Board committees. Committee members examined environmental issues and considered requests for donations and sponsorships. The committee examined the *Sustainability Report 2006,* the annual report on environmental compliance and legislation, and the *Annual Report 2006* of the Fondation Hydro-Québec pour l'environnement. It also examined the 2006 regional profile of Hydro-Québec's activities and prepared a report on contributions to university research chairs in 2006. In addition, the committee reviewed the annual activity reports of the liaison committees established by the company with groups representing Québec agricultural producers and municipalities.

Pension Plan Financial Management (G)

The Pension Plan Financial Management Committee advises the Board on the directions, policies, strategies and overall objectives established for various aspects of Hydro-Québec's pension plan: the Pension Plan Funding Policy, the Pension Fund Investment Management Policy, actuarial valuations of the plan, choice of the benchmark portfolio, the plan's financial position, plan expenses and any other aspect of pension fund management. The committee is chaired by Louis Lagassé.

The committee met twice in 2007. It recommended that the Board approve the annual pension fund management and pension plan administration budgets, updating of the Pension Fund Investment Management Policy, the actuarial valuation for purposes of pension plan funding and solvency, and the reappointment of the current actuary for the next annual valuation. In addition, the committee reviewed the performance of the pension plan portfolio and specialized portfolio managers and closely monitored the pension plan's financial position.

Corporate Governance

Gallery of Presidents.

Hydro-Québec's Board of Directors complies with the requirements of the new corporate governance legislation applicable to state-owned enterprises. It also follows the guidelines set by the Canadian Securities Administrators to the extent that they apply to a government-owned utility like Hydro-Québec even though, legally speaking, it is not required to do so because the company is not publicly traded.

Mandate

The Board administers the company's business in accordance with the *Hydro-Québec Act,* the *Companies Act* and applicable regulations. Its main functions are set out in Hydro-Québec's incorporating act. The Board analyzes and adopts the Strategic Plan, which defines the company's main objectives, and the annual Business Plan, which establishes the budgets for each division and unit and sets the company's annual performance targets. Other Board functions include the monthly review of financial results, the cyclical review of integrated enterprise risk management, and the selection and evaluation of senior executives. It also approves major capital projects in generation, transmission and distribution as well as applications to the Régie de l'énergie.

Independence

A total of 15 of the 17 directors of Hydro-Québec, including the Chairman of the Board, are independent directors, that is, they have no direct or indirect relationships or interests, for example of a financial, commercial, professional or philanthropic nature, which are likely to interfere with the quality of their decisions concerning the company's interests. The only Board members who are not independent are Thierry Vandal, President and Chief Executive Officer, and Normand Bergeron, Deputy Minister of Natural Resources and Wildlife.

The government appoints the members of the Board based on the expertise and experience profiles established by the company. Directors are appointed for a term of up to four years and the Chairman for a term of up to five years; they may be reappointed twice, for successive or non-successive terms.

The Board ensures compliance at all times with the rules stated in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec,* which are based on the *Regulation respecting the ethics and professional conduct of public office holders.*

Compensation and other benefits paid to directors

Compensation for all independent directors, except the Chairman, is set out in Order in Council No. 610-2006, as amended by Order in Council No. 962-2006 and Order in Council No. 763-2007. Compensation consists of a basic annual retainer of $16,000, plus a meeting fee of $750 for each Board or committee meeting attended. In accordance with the Order in Council, a yearly supplement of $5,000 is paid to the chairs of Board committees. Pursuant to Order in Council No. 1099-2005, the Chairman of the Board receives annual compensation of $125,000. Board members are also entitled to reimbursement of travel expenses incurred in the performance of their duties.

Director training

In 2007, the Governance and Ethics Committee enhanced the induction and training program for directors. When Board members are first appointed, they receive training on their roles and responsibilities as well as Hydro-Québec's principal activities and business context. They are also informed about the company's legal and regulatory contexts, with particular emphasis on the governance of a government-owned utility. Board members

Board room.

Robert Bourassa (1933–1996), Premier of Québec (1970–1976 and 1985–1994) and the visionary to whom we owe the hydroelectric development of James Bay.

Compensation and Other Benefits Paid to the Company's Five Most Highly Compensated Officers in 2007

				Automobile		Life insurance and health insurance premiums paid by Hydro-Québec
	Base compensation	Variable compensation	Perquisites[a]	Description of benefit	Operating cost	
Vandal, Thierry President and Chief Executive Officer	$406,816	$113,553	$16,298	Executive vehicle	$6,077	$4,467
	Pension Plan and Supplementary Benefits Program					
	Basic Hydro-Québec Pension Plan (HQPP) - Usual contribution under the plan - Pension calculated in accordance with usual plan provisions **Supplementary Benefits Program** - Same terms as for senior executives (see below) *plus* - Pension calculated on the basis of average salary for the best three years (less pension payable under the HQPP) - Credit of 3% per contribution year (less pension credit under the HQPP) - Recognition of two years for each year of participation - Recognition of 100% of the maximum bonus as salary for purposes of the HQPP (less portion of bonus recognized under the HQPP) - Pension limited to 70% of the average base salary and variable compensation for the best three years					
Boulanger, André President, Hydro-Québec Distribution	$352,302	$94,324	$1,652	Vehicle and parking	$14,058	$8,501
Cacchione, Richard President, Hydro-Québec Production	$342,345	$96,196	$4,500		$11,570	$6,244
Garant, Daniel Executive Vice President, Finance and Chief Financial Officer	$339,626	$80,926	–		$10,840	$2,668
Saheb, Élie Executive Vice President, Technology	$312,958	$102,972	$4,099		$11,538	$20,965
	Pension Plan and Supplementary Benefits Program					
	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 bonus as salary for purposes of the HQPP **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					

a) Health assessment, financial and succession planning, sports clubs, professional memberships.

Compensation and Other Benefits Paid to the Five Most Highly Compensated Officers of the Company's Wholly Owned Subsidiaries in 2007

	Base compensation	Variable compensation	Perquisites[a]	Employee benefits
Kovacevic, Paul Director of Financial Transactions, HQ Energy Marketing Inc.	$155,000	$118,085[b]	$3,000	RRSP contribution: $9,474 Life insurance and health insurance premiums paid by the employer
Garant, Daniel President and Chief Executive Officer, Hydro-Québec International	–	$186,752[c]	–	Hydro-Québec Pension Plan and group insurance plans
Duchesne, Dany General Manager, TransÉnergie Technologies inc. and Cedars Rapids Transmission Company, Limited	$131,040	$24,981	$2,000	Hydro-Québec Pension Plan and group insurance plans
Derome, Caroline Director of Investment, Hydro-Québec CapiTech inc.	$117,867	$12,421	$3,000	Hydro-Québec Pension Plan and group insurance plans
Goyette, Benoît President and Chief Executive Officer, Hydro-Québec CapiTech inc.	$62,000[d]	$8,527	$11,779	Hydro-Québec Pension Plan and group insurance plans

a) These may include the following: health assessment, financial and succession planning, sports clubs, professional memberships, parking, automobile allowance.

b) The bonus was paid in 2007 by H.Q. Energy Services (U.S.) Inc. for 2006, at which time Mr. Kovacevic was Vice President, Marketing and Transactions at that subsidiary.

c) Mr. Garant receives base compensation only for the functions he performs for Hydro-Québec. In 2007, he received a special bonus from Hydro-Québec International for the sale of international assets in 2006.

d) This amount is in addition to the base compensation Mr. Goyette receives as Director, Legal and Regulatory Affairs – Wholesale Markets, at Hydro-Québec.

also receive a director's manual designed to help them in the performance of their duties. In addition, Board committee members receive manuals describing the committee's mandate and information documents so they will understand the issues involved in the matters the committee handles. The program also includes presentations on major files and projects, as well as tours of facilities. In 2007, Board members visited Gentilly-2 nuclear generating station, the Péribonka jobsite, the System Control Centre and the energy trading floor. External training programs are also available to complement directors' knowledge.

Deintegration

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

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

Hydro-Québec TransÉnergie abides by the *Transmission Provider Code of Conduct* approved by the Régie in 2004. This code governs the relations between Hydro-Québec TransÉnergie and other Hydro-Québec divisions, and its purpose is to prevent any form of preferential treatment or cross-subsidization. Violations of the code are made public on the OASIS (Open Access Same-Time Information System) Web site at **www.transenergie.com/oasis/hqt/en/entree.htmlx**, under the menu item *Code & Standards of conduct* and the heading *Violations*. To access them, one can simply register as a guest. In December 2007, the Régie de l'énergie approved the *Reliability Coordinator Code of Conduct* following the designation in August of Hydro-Québec TransÉnergie's Direction du contrôle des mouvements d'énergie (System Control) as Reliability Coordinator for Québec.

Access to documents and protection of personal information

Hydro-Québec is careful to protect the personal information it possesses on its customers, suppliers and employees, while respecting the public's right to information. Accordingly, it takes the necessary measures to ensure the confidentiality of this information, in accordance with the *Act respecting Access to documents held by public bodies and the Protection of personal information* (the *Act respecting Access*).

Hydro-Québec's Personal Information Protection Committee, which is chaired by the President and Chief Executive Officer, monitors the implementation of the access to information plan and the development of new computer systems containing personal information on employees and customers.

In 2007, Hydro-Québec published an enhanced version of its guide on access to documents and the protection of personal information. The guide explains the main concepts of the *Act respecting Access* and provides practical advice on how it applies to the company.

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

In 2007, Hydro-Québec received 383 requests under the *Act respecting Access;* it granted 89% of them. The others were denied mainly due to security issues or to opposition by a third party to the disclosure of information belonging to it.

Policy on the independence of external auditors

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

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

External auditors' fees

KPMG LLP and Ernst & Young LLP are the joint auditors for Hydro-Québec for 2007. Professional fees billed by external auditors in 2007 for services other than auditing and certification amounted to 5.8% of the total $4.6 million in fees billed.

Ethics

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

As a government-owned utility, Hydro-Québec must demonstrate exemplary probity. Loyalty, integrity, respect, discretion and fairness are fundamental values reflecting Hydro-Québec's social commitment to its customers and the entire community.

Ethical standards and rules resulting from these values are set out in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec* (see page 118 of this Annual Report) and in the *Code of Conduct* for employees. The latter document, which is available at **www.hydroquebec.com/profile**, is designed to fully explain the ethical principles approved by the Board of Directors and assist all employees in determining the conduct they should adopt in the performance of their duties.

Internal control system

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

Language guidelines

In 2007, Hydro-Québec continued its efforts to maintain the quality of the French used within the company. Several proficiency courses (grammar, business correspondence and specialized writing) were offered to employees. Six terminology bulletins and an office automation glossary were published on the intranet. The handbook entitled *Tours d'adresse et de rédaction* was entirely redesigned. The terminology bank was enhanced and its presentation improved. In addition, various promotional and awareness activities were organized to highlight Francofête, a celebration of French language and culture.

Sustainable development

Published simultaneously with this Annual Report, the *Sustainability Report 2007* describes Hydro-Québec's main sustainable development initiatives and reports on its sustainable energy choices and progress made in this area. This report is based on the Global Reporting Initiative Guidelines and can be consulted at **www.hydroquebec.com/sustainable-development**, where additional information is provided on the company's sustainable development performance.

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

Part I – Interpretation and application

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

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

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

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

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

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

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

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

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

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

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

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

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

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

n) **"Company"** means Hydro-Québec.

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

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

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

Part II – Ethical principles and general rules of professional conduct

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Prevention of conflicts of interest

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

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

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

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

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

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

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

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

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

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

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

12. A director, executive or controller who:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Waivers

20. This Code does not apply:

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

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

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

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

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

f) to a directors' liability insurance agreement; or

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

Attestation

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

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

Part IV – Remuneration

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

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

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

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

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

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

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

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

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

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

Part V – Application of the code

Competent authorities

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

b) the decision was submitted to the Board;

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

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

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

Penalties

28. Upon concluding that a provision of the law, the Regulation or this Code has been violated, the competent authority may impose either of the following penalties:

a) for an executive or a controller, the appropriate penalty, which can extend as far as termination of employment; and

b) for a director, reprimand, suspension without remuneration for a maximum of three months, or removal from the Board.

However, when the competent authority is the Associate Secretary General contemplated by section 20.9, the penalty is imposed by the Secretary General of the Conseil exécutif. If the penalty proposed consists of the removal of a public office holder appointed or designated by the Government, it can only be imposed by the latter; in this case, the Secretary General of the Conseil exécutif may immediately suspend the public office holder without remuneration for a period not exceeding 30 days.

Any penalty imposed on a director and the decision to temporarily relieve him of his duties must be in writing and give the reasons therefor.

29. In the case of a violation of section 10, the competent authority records in writing the forfeiture of office of the violator.

30. The director, executive or controller shall render an account and restore to the Company any profits earned or benefits received as a result of or on the occasion of a violation of the provisions of this Code.

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

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

Generating and Transmission Facilities *as at December 31, 2007*

Generation *Installed capacity in MW*

Hydroelectric generating stations

The installed capacity of a hydroelectric generating station is equivalent to that of its generating units operating in winter conditions (water temperature 5°C).

Robert-Bourassa	5,616
La Grande-4	2,779
La Grande-3	2,417
La Grande-2-A	2,106
Beauharnois	1,755
Manic-5	1,528
La Grande-1	1,436
Manic-3	1,244
Bersimis-1	1,125
Manic-5-PA	1,064
Manic-2	1,041
Outardes-3	1,026
Sainte-Marguerite-3	884
Laforge-1	878
Bersimis-2	845
Carillon	752
Outardes-4	746
Toulnustouc	553
Eastmain-1	507
Outardes-2	472
Brisay	469
Laforge-2	319
Trenche	303
Beaumont	270
La Tuque	263
Rocher-de-Grand-Mère	230
Rapide-Blanc	204
Paugan	202
Shawinigan-2	200
Manic-1	184
Shawinigan-3	184
Rapides-des-Îles	176
Chelsea	153
Péribonka	135
Première-Chute	130
La Gabelle	129
Les Cèdres	126
Grand-Mère	105
Other (19 generating stations rated less than 100 MW)	749

Nuclear generating station

Gentilly-2	675

Conventional thermal generating stations

Tracy	660
Bécancour, La Citière and Cadillac (gas turbine)	881
Other (24 diesel plants)	124

Wind farm

Saint-Ulric (3 wind turbines)	2

Installed capacity *MW*

Hydroelectric (57)	33,305
Nuclear (1)	675
Conventional thermal (28)	1,665
Wind (1)	2
Total	**35,647**

Other sources of supply *MW*

Churchill Falls generating station—Churchill Falls (Labrador) Corporation Limited[a]	5,428
Seven privately owned wind farms[b]	420
Agreements with other independent power producers[c]	1,222

a) Hydro-Québec has access to almost all the output.
b) Hydro-Québec purchases all the output.
c) Hydro-Québec has access to this output.

Hydroelectric generating stations under construction *MW*

Eastmain-1-A and Sarcelle	893
Péribonka (1st unit commissioned in 2007)	250
Chute-Allard and Rapides-des-Cœurs	139

Transmission

Voltage	Lines (km)	Substations (number)
765 and 735 kV	11,422	38
450 kV DC	1,218	2
315 kV	5,127	63
230 kV	3,038	50
161 kV	2,013	41
120 kV	6,584	212
69 kV or less	3,606	103
Total	**33,008**	**509**

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Hydro-Québec International (HQI)
is responsible for investment and the sale of professional services outside Canada and the U.S.

Since HQI has entrusted Hydro-Québec with the management of its operations, each Hydro-Québec division is responsible for foreign operations in its spheres of competence.

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Hydro-Québec IndusTech
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Société d'énergie de la Baie James
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Units of measure

¢/kWh	cents ($0.01) per kilowatthour
$M	millions of dollars
$B	billions of dollars
kV	kilovolt (one thousand volts)
kW	kilowatt (one thousand watts)
MW	megawatt (one million watts)
GW	gigawatt (one million kilowatts)
kWh	kilowatthour (one thousand watthours)
MWh	megawatthour (one million watthours)
GWh	gigawatthour (one million kilowatthours)
TWh	terawatthour (one billion kilowatthours)
km	kilometre
m²	square metre

The following publications may be obtained from our Web site **www.hydroquebec.com** or by calling 1 800 ENERGIE (363-7443):

Annual Report 2007
(this document)

Sustainability Report 2007

Financial Profile 2007–2008

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

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