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ANNUAL REPORT 2017

hydro quebec .com

COVER

Left: Employees prepare to deploy the LineRanger, an innovative robot developed by IREQ to inspect conductor bundles on transmission lines. It can inspect several kilometres of line in a day. Top right: Energy traders at work on Hydro-Québec's trading floor. Bottom right: A researcher characterizes samples for an R&D project on battery materials at IREQ.

All significant events up to February 16, 2018, are reflected in this report.

2017 HIGHLIGHTS

The employee awareness campaign on **jobsite safety** was launched in April.

Our net exports reached a **record volume** of 34.4 TWh.

We introduced a new **training program** to ensure continuous development for all employees who are in contact with customers.

The **bill for residential customers** was revamped.

Customers can now track their **hourly consumption** online.

For the third year in a row, we upheld **our commitment** that rate increases would not exceed forecast inflation.

More than 40 **data centers** are now established in Québec.

We launched a new advertising campaign with the theme "**You can count ON us**," highlighting our intent to serve customers better and better.

We successfully completed a pilot project using a **visual inspection drone** on a live 735-kV line.

Our **Centraide** campaign yielded $5,919,936 in donations.

An **energy storage system** designed by our joint venture Technologies Esstalion was connected to a feeder line at Hemmingford substation in the Montérégie region.

Romaine-3 generating station went into service in September, adding 395 MW to our installed capacity.

Work on the **Chamouchouane–Bout-de-l'Île** project advanced rapidly and should be completed in 2018.

We replaced 208 **PK circuit breakers** installed on the power system between 1967 and 1983.

After five years of operation, the **Electric Circuit** now has 1,289 public charging stations.

There was a marked increase in the number of **new hires** from target groups.

We deployed several new **information and communication technologies** that simplify customer interaction with us.

Net income

$2,846 million

in 2017

Electricity sales

205.6 TWh

including 34.9 TWh in exports

Residential rate

7.07¢/kWh

the lowest in North America

Capital investments

$3,754 million

in Québec in 2017

Workforce

19,786

permanent and temporary employees

Generating capacity

37,309 MW

from 87 generating stations operated by Hydro-Québec

Purchases of goods and services

$2,902 million

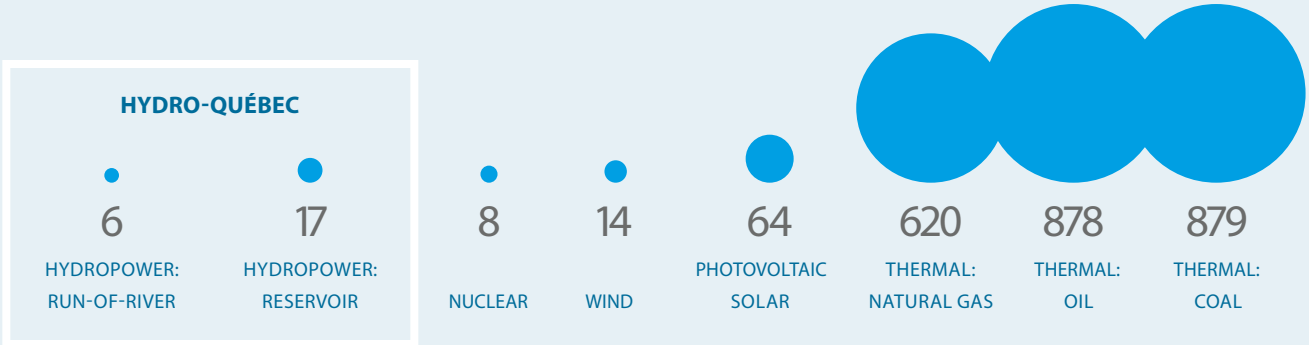
in Québec in 2017

More than 99% of Hydro-Québec's power output is clean and renewable.

The hydropower generated by our reservoir and run-of-river facilities offers an ideal solution for North America in its efforts to reduce GHG emissions while ensuring a secure supply of electricity. As shown in the figure below, the GHG emissions rate of our generating fleet is among the lowest of the main generating options, whether continuous- or intermittent-output.

GHG EMISSIONS BY GENERATING OPTION (g CO_2 eq./kWh)

Illustration adapted from a study by the Centre universitaire de recherché sur le cycle de vie des produits, procedés et services (CIRAIG), 2014



MESSAGE FROM THE CHAIRMAN OF THE BOARD

Michael D. Penner
Chairman of the Board

The company ended the year with outstanding financial results. Also noteworthy is customer satisfaction, which rose to 92% in 2017. One of the primary reasons for this improvement is the company's new offering of convenient, user-friendly online tools such as the one that shows customers an hour-by-hour breakdown of their electricity use. And of course, the Board of Directors commends Hydro-Québec for having honored its commitment that rate increases would not exceed inflation.

The Board invested considerable efforts during the year in overseeing the implementation of the highest possible standards of occupational health and safety. To this end, the special Board committee set up in 2016 was mandated to evaluate the company's practices in this regard and ensure that the most stringent standards are met. To obtain an independent opinion, the committee turned to an outside firm, which submitted its report in December 2017. In light of the recommendations laid out in the report, Management drew up an action plan designed to make Hydro-Québec a model in workplace safety.

The Board and the management team place the utmost importance on health and safety for all employees of Hydro-Québec and its contractors. In 2018, we will therefore carefully monitor the implementation of the company's Health and Safety Action Plan 2017–2020.

During the past year, the Board paid close attention to the company's progress in carrying out the *Strategic Plan 2016–2020*. We had extended discussions with Management on the execution of the company's growth strategy, with particular focus on the energy transition.

The Board also authorized bids in response to two major requests for proposals for supplying power to the states of Massachusetts and New York. It similarly approved numerous capital projects in power generation, transmission and distribution, authorized investments to optimize the processes and systems of Hydro-Québec Innovation, équipement et services partagés, and agreed to the updating of the employee Code of Conduct.

As in previous years, the Board conducted an evaluation of its own performance in order to continue improving its governance methods.

Two of our members—Marie-Anne Tawil and Isabelle Hudon—left the Board during the year. We thank them for their dedication and invaluable contribution. They were replaced by Geneviève Brouillette and François Lafortune. Hydro-Québec's Board of Directors therefore remains at 16 members, eight of whom are women.

Through the energy and commitment of all of Hydro-Québec's employees and pensioners, our 41st Centraide campaign raised a total of $5,919,936.

On behalf of the Board, I extend sincere thanks to the management team and all of Hydro-Québec's employees for the indispensable role they play in the company's success.

MESSAGE FROM THE PRESIDENT AND CHIEF EXECUTIVE OFFICER

Éric Martel
President and Chief Executive Officer

With net income of $2,846 million in 2017, Hydro-Québec will be able to pay a dividend of more than $2 billion to its shareholder, the Québec government, for the fifth consecutive year. Thanks to an effective sales strategy, smooth operation of our generating and transmission facilities, and high runoff, our net electricity exports reached a historic volume of 34.4 TWh and contributed $780 million to net income.

Our hydroelectricity—clean, renewable power—has been publicly recognized by Massachusetts as a strategic energy source in the effort to reduce GHG emissions in the U.S. Northeast. By selecting the bid we submitted in 2017 in response to a request for proposals for 9.45 TWh of renewable energy, Massachusetts has confirmed the advantages of our hydropower for our neighbors south of the border. It's becoming increasingly clear that having green electricity available at low prices is good not only for the environment but for the economy, too.

Of course, a number of steps remain to be completed before construction can begin, in particular signing the contract and obtaining the necessary permit.

The commissioning of Romaine-3 generating station in September boosted the total installed capacity of our generating fleet by 395 MW. Romaine-4, currently under construction and scheduled to come onstream around 2020, will add a further 245 MW to our hydropower capacity, which today stands at 37,309 MW. I'm proud to say that over 99% of the electricity we produce comes from clean, renewable sources.

For the third year in a row, we upheld our commitment to keep rate increases no higher than forecast inflation. That, coupled with the fact that our residential rates are the lowest in North America and lower than any electric utility rate in the European Union, is of definite benefit to all Quebecers.

Our efforts to continuously improve our services and the many tools we use to communicate with customers—including online self-services and social media—helped raise overall customer satisfaction to 92% in 2017.

Over the past several months, we've worked with the Special Committee on Workplace Health and Safety to institute concrete measures to increase safety on our jobsites, with the aim of becoming a model in this regard. Change agents have been trained to raise employee awareness about the importance of safety and inform managers about workers' concerns. The safety campaign *Je m'engage dans le virage de la sécurité* [I'm on board with workplace safety], under way since April 2017, attests to our commitment to eliminate risks at source, as does our recently implemented Health and Safety Action Plan 2017–2020.

As a result of our undeniable competitive advantages, especially our rates, we've been able to bring a number of data centers to Québec, including several global cloud-computing services. I've been focusing particular attention on attracting this industry, because it's another excellent way to capitalize on our electricity rates, both now and down the road.

Our employees' commitment is a cornerstone of our many achievements. Their consistently high level of motivation and the quality of their work are key to our success. I'm also grateful to the members of the Board for their careful study of the various matters brought to their attention in 2017, in particular those concerning our Strategic Plan objectives.

Net income totaled
$2,846 million

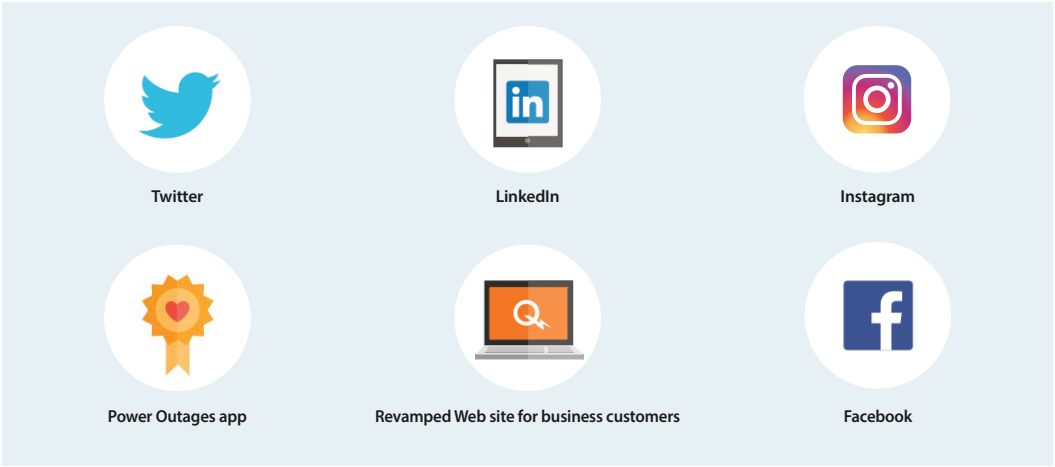
Net electricity exports reached a historic volume of
34.4 TWh

Customer satisfaction rose to
92%

OUR MANAGEMENT TEAM

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

As a power utility, Hydro-Québec has to maintain its customers' **trust** at all times. That's why **we're continually improving our customer services**, by introducing more and more user-friendly online tools, for instance. My Consumption Profile is a good example. Our "Why be energy wise?" Web page is another. The corporate advertising campaign launched last fall, built around the phrase "**You can count ON us**," highlights our intent to serve our customers better and better, as evidenced by a variety of recent measures such as expanding customer service hours and introducing rapid power restoration responses. The constant challenge of providing the best customer services motivates us to keep working better. For that reason, we're doing everything we can to **develop the skills of all employees in contact with customers**—not just customer service representatives, but field crews, too.

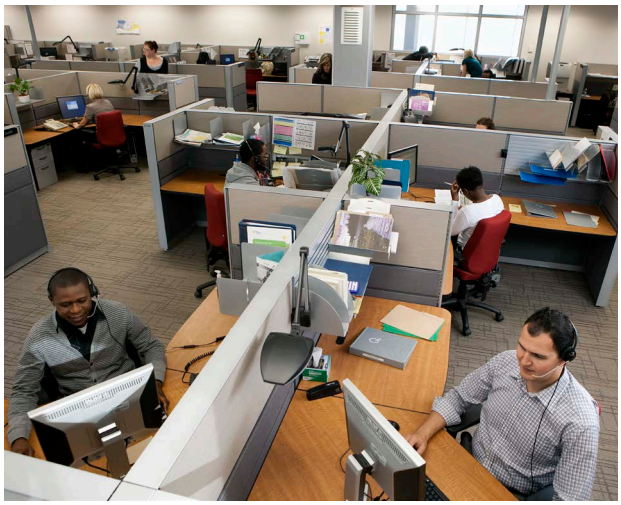


Social media, mobile app, Web site, self-service options available online and by telephone—these are some of the tools that help us communicate better with customers on an ongoing basis.

Customer-centered training

Hydro-Québec has undertaken to upgrade the skills of all employees in contact with customers. Customer service representatives will become more familiar with our online offering, while field crews such as line and cable workers will receive training in customer relations. This will continuously improve our service delivery and help us focus more on customer needs.

Our engineering technicians, who are constantly interacting with customers, received training to improve their communications. Tools for written and telephone communication were also introduced. This initiative and many others will help us stand out, both for our top-notch operations and for the quality of our customer services.



Handling of complaints

Hydro-Québec is seeking to improve the complaint-handling process and reduce response times. For each complaint, we bring in the respondents best suited to solve the problem at the source. There were 24% fewer complaints in 2017 than in 2016, reflecting improvements in interactions with customers.

Streamlined bills

Simplifying bills for residential and business customers is one of our priorities. We introduced an entirely revamped residential bill in January 2018, after holding many focus groups with customers and consumer associations to ensure that the redesigned bill met their needs.

Low-income households

In 2017, more than 100,000 arrangements were made with low-income customers. Close to half of these arrangements included support for paying arrears and current consumption.

Our 2017 and 2018 initiatives for low-income households are aimed at developing personalized payment arrangements that match their ability to pay. In 2018, we'll set up an in-house support center that will offer these households improved payment arrangement services as of the spring, then easier access to energy efficiency programs starting in the fall.

Dynamic pricing

Hydro-Québec continues to develop new rate options in response to economic and energy market conditions. We'll be submitting proposals for opt-in dynamic rates to the Régie de l'énergie in spring 2018. These options will offer customers more choice and encourage them to help us better manage energy supplies, for example by using smart house technology. Dynamic pricing reflects the fact that supply costs vary over time depending on demand.

92%	91%	84 seconds	99 seconds	87%	83%
2017	2016	2017	2016	2017	2016

OVERALL PUBLIC SATISFACTION INDEX

In 2017, 92% of customers said they were "very satisfied" or "quite satisfied" with Hydro-Québec, compared to 82% in 2015 and 91% in 2016. This progression reflects efforts to meet customer expectations better by enhancing our services and improving our ways of communicating.

AVERAGE CALL WAIT TIME AT CUSTOMER RELATIONS CENTERS

Average call wait time improved in 2017. The 15% reduction from the previous year can be credited to measures taken to improve customer service and confirms our efficiency gains in this area.

CALL SERVICE LEVEL AT CUSTOMER RELATIONS CENTERS

The proportion of calls answered in less than 180 seconds rose from 83% in 2016 to 87% in 2017.

Technical services for customers

Consolidation of the organizational changes begun in 2016 at the center that manages customer technical services has enabled us to better meet promised customer connection dates and shorten average lead times. After many meetings and discussions with representatives of various associations, the customer technical services teams decided to set up a one-stop service for handling requests from customers with large or complex projects. This approach, implemented in June 2017, gives us greater flexibility by assigning each project of this type to a specific team member. Customers enjoy personalized support at every stage, while the company benefits from better coordination of connection projects with the planning of its own initiatives in distribution infrastructure sustainment.

Meetings with advocates and developers

Our proactive communications include meetings with various organizations and consumer associations such as: Association québécoise des consommateurs industriels d'électricité, Fédération québécoise des municipalités, Union des municipalités du Québec, Les Producteurs en serre du Québec, Association des stations de ski du Québec, Union des producteurs agricoles, Corporation des maîtres électriciens du Québec, and Association des professionnels de la construction et de l'habitation du Québec, as well as low-income family coalitions, municipalities, and major developers and contractors. The purpose of the meetings is to engage in a constructive dialogue focusing on the needs and expectations of various types of customers and to strengthen our ties with them.

Treatment of earnings variances

The earnings-sharing mechanism was applied for the first time in 2017. Any positive earnings variance—in other words, earnings above those authorized by the Régie—is shared with customers, while any negative variance is absorbed by Hydro-Québec. As at December 31, 2017, $45 million to be shared with customers was recognized in this connection. This amount will have a positive impact on the 2019–2020 rate adjustment.

Grid self-restoration

We continued with our pilot projects involving two self-restoration schemes that will be rolled out on a larger scale as we update our grid control system. On February 8, 2017, one of the schemes restored power to 478 customers in the Magog area in about ten seconds.

OCTAS awards

In the prestigious OCTAS competition, which is organized by Réseau ACTION TI and has run for over 30 years, Hydro-Québec garnered two awards:

- The award in the Government Departments and Corporations category for an interactive analytical solution implemented for distribution system planning, as part of the CISRI project focusing on the concept of semantic interoperability for the smart grid. This innovative analytical platform, based on artificial intelligence and advanced mathematics, enables our engineers to better plan the maintenance and development of our distribution system. They're able to quickly identify possible grid optimizations and apply the corrections needed to maintain reliable service.
- The People's Choice award for the second year in a row, this time for My Consumption Profile. This online tool enables customers to track their electricity use down to the specific day, thanks to data transmitted by their smart meters, and to gain a better understanding of variations in their electricity bills.

2,914	3,836	92%	90%	85%	NOT MEASURED IN 2016
2017	2016	2017	2016	2017	

NUMBER OF COMPLAINTS

There were 24% fewer complaints in 2017, reflecting improved interactions with customers.

SIMPLE SERVICE CONNECTIONS

Percentage of simple service connections completed within 10 business days. This indicator is up for the second consecutive year, rising from 83% in 2015 to 92% in 2017.

MULTIPLE-PARTY SERVICE CONNECTIONS

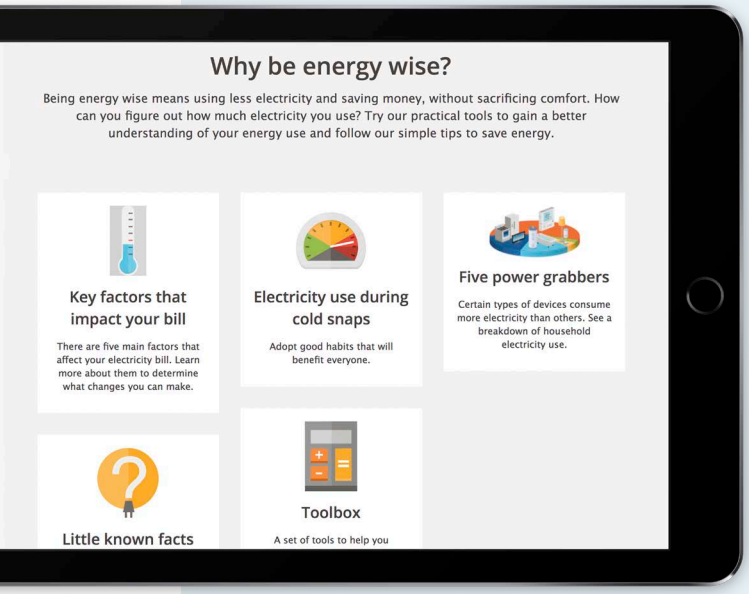
Percentage of cases in which technical services involving multiple parties were provided on schedule (a new indicator). Our 2017 performance, at 85%, exceeds the target of 80% set a year ago.

Web site

The Consumption Profile is now available for business customers, who can track their energy consumption and power demand more easily than ever.

The version for residential customers was also improved in 2017. Customers can now see an hour-by-hour breakdown of their electricity use and a projection of the electricity costs they can expect on their next bill, based on their consumption so far. What's more, the residential Customer space section and the entire business Web site have been revamped to give customers the online services they expect.

Our Web site gives all kinds of tips to help customers understand and manage their electricity use. The Why be energy wise? page describes the ways electricity is used in the home, gives a breakdown by appliance, and explains the factors that influence electricity bills.



It features an interactive house that provides little-known facts about the most common home appliances and electronic devices.

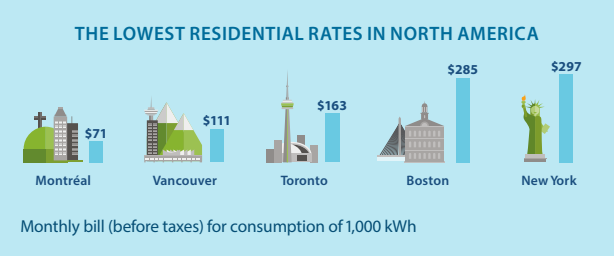
Special promotions boosted the use of our online tools. For the second year running, customers have been able to report their change of address online free of charge between April 1 and October 31.

And from the beginning of September until December 6, the *Simplify Your Life and Win!* contest was an incentive to sign up for Online Billing. Newly enrolled customers, as well as those already signed up for the service, won prizes in October (five iPad tablets) and December (five iPad tablets and a Chevrolet Volt). Every time someone new signed up, Hydro-Québec donated $3 to Centraide, for a total of $276,378.

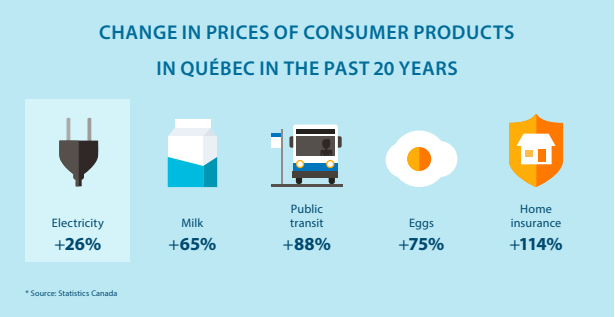
In January 2018, Hydro-Québec added chatting to its Web site to respond even more quickly to customer requests. This is one more of the many communication channels in use, including social media.

2017–2018 rate increase

For the 2017–2018 rate year, the Régie de l'énergie approved a 0.7% increase for all residential customers and most business customers, which was below inflation. Quebecers continue to enjoy electricity rates that rank among the lowest in North America: for example, households in Toronto pay twice as much, and New Yorkers four times as much.



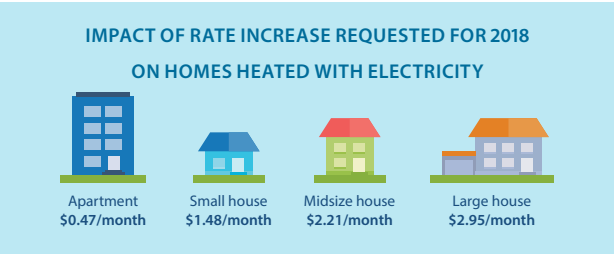
It's also worth noting that over the last 20 years, electricity prices have increased much more slowly than the prices of many consumer products, such as milk, eggs, public transit and insurance.



2018–2019 rate increase

For the third year running, Hydro-Québec upheld its commitment to Quebecers to keep rate increases no higher than forecast inflation. The application filed with the Régie de l'énergie seeks a rate adjustment of 1.1%, effective April 1, 2018, for all residential customers and most business customers.

If the Régie approves the application, the result will be an increase of $0.47 per month for an apartment heated with electricity and $2.21 for a midsize house.



Industrial greenhouses

Hydro-Québec has hired an outside firm to assess the potential for additional electricity sales to industrial greenhouses growing fruits and vegetables, ornamental flowers, and other crops. We plan to develop an integrated offer to attract this type of business to Québec, leveraging the availability of clean power at highly competitive rates.

Continuous improvement management system

Aiming to serve its customers better and better, Hydro-Québec is implementing a continuous improvement management system. We're seeking to stimulate employee engagement and strengthen managers' support role. Managers meet with employees on the ground at set times of the day, which means that problems and issues are resolved more quickly. For instance, we're optimizing the process for connecting energy-intensive industrial companies and providing them with high-voltage supply. A dozen employees from Hydro-Québec Innovation, équipement et services partagés, Hydro-Québec TransÉnergie and Hydro-Québec Distribution have come up with ways to significantly cut wait times and the cost of handling this type of request. The planned changes will shorten connection wait times for data centers to 12 months, which is in line with market expectations.

Revised Conditions of Service

In November, the Régie de l'énergie issued its ruling on the revised Conditions of Service, accepting the vast majority of Hydro-Québec's proposals. Customers and employees will benefit from the clearer language, and the document's structure now parallels customers' usual interactions throughout their contractual relationship with Hydro-Québec. The revised Conditions of Service will also increase customer autonomy by encouraging the use of self-service options that simplify access to our services. The new approach promotes efficient management of customer requests and more predictable costs. Moreover, wait times and costs will be reduced, which will help improve customer satisfaction.

Two communications awards

The *Infopresse* Boomerang 2017 awards jury, composed of communication and marketing industry peers, gave Hydro-Québec the "Constant Presence" award (Social Media Strategy) for its Facebook strategy. We also took the award in the B2C Site or App – Big Business category, for our Consumption Profile.

Data centers

Leveraging both its reliable, renewable power and its low rates, Hydro-Québec has stepped up its efforts to attract data centers. These are some of the advantages we offer:

- Extremely competitive rates, especially the Economic Development Rate
- A portfolio of over 7.6 million square metres (81.8 million square feet) of possible sites in strategic locations
- Support to get projects up and running quickly
- Expertise in energy efficiency measures

Our efforts are paying off, judging by the arrival of many global suppliers of cloud-computing services, such as Microsoft, Amazon Web Services and Google. Developing the industry in Québec is an excellent way to profit from our surplus power. Data centers that locate here benefit from extremely competitive rates—in California, for instance, they would pay up to three times as much for power. What's more, cooling systems don't need to be used as much in our climate, so operating costs are lower.

More than 40 data centers are now established in Québec. Their installed load is expected to total more than 350 MW by 2020, and there's no end in sight. Québec has many assets to offer this booming market.

OUR COMPETITIVE ADVANTAGES FOR ATTRACTING DATA CENTERS TO QUÉBEC

- RENEWABLE ENERGY WITH A SMALL CARBON FOOTPRINT
- EXTREMELY COMPETITIVE RATES
- COLD CLIMATE THAT LOWERS COOLING COSTS
- HIGHLY QUALIFIED ENGINEERING WORKFORCE
- ONE OF THE WORLD'S MOST ADVANCED TELECOMMUNICATIONS NETWORKS

Vegetation control

When we filed our rate application with the Régie de l'énergie in July 2017, we requested an increase in the vegetation control budget, given that vegetation-related outages account for more than 40% of all power failures and have been on the rise over the past five years. The requested budget increase will help reduce the number of outages and improve system reliability over the long term.

In line with our action plan, we're taking practical measures to ensure public and employee safety while working to meet customer expectations better. For instance, we've solicited the cooperation of some fifty municipalities to facilitate acceptance of our vegetation control operations and make it easier to obtain the necessary permits.

Spring floods

Hydro-Québec took extraordinary measures to assist the victims of flooding caused by exceptional high waters in spring 2017. A 24/7 telephone hotline handled more than 8,000 calls, and we held over a dozen meetings with civil security authorities. Our crews' efforts and dedication ensured the success of this large-scale operation in demanding circumstances. At the 2017 awards of the Société québécoise des professionnels en relations publiques, Hydro-Québec received the Silver in the Issue Management and Crisis Communications category.

Solar Decathlon

Hydro-Québec is TeamMTL's lead sponsor for the international Solar Decathlon China 2018, being held in Dezhou. With the support of the Ministère de l'Énergie et des Ressources naturelles du Québec, we're lending our expertise to the team and providing $250,000 to build a net-zero-energy prototype home. This partnership underscores both our leadership in the energy transition and our desire to be active in the market for technologies of the future.

TeamMTL's "deep-performance dwelling" combines a typical Montréal row house with some features of the *siheyuan*, a traditional Chinese residence with an inner courtyard.

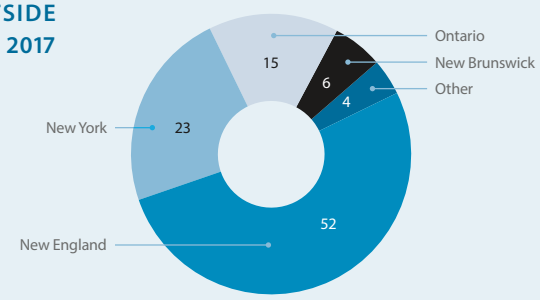
A new ad campaign was launched last fall. Focused on customer services, it revolved around the word *on*, this time in the phrase "You can count ON us," which highlights our intent to serve customers better and better.

In September 2017, no fewer than 125 Hydro-Québec employees lent a hand in Georgia, which was shaken by Hurricane Irma. Some fifty line crews and a number of support teams took part in the mission, organized under power utility mutual assistance agreements. The public could follow the progress of the operation on our corporate Twitter and Facebook pages. In October 2017, we received an award from the North Atlantic Mutual Assistance Group (NAMAG) recognizing our commitment to provide support to member companies during widespread power failures in the U.S. and Canada.

The search for **new sources of revenue** is an absolute imperative for Hydro-Québec, reflecting our commitment to maintain high levels of profitability so we can actively contribute to the prosperity of Québec. With this in mind, we're **seizing growth opportunities** and are increasingly present in the **export markets** of northeastern North America. In 2017, we stepped up our wholesaling operations and **responded to requests for proposals** by the states of New York and Massachusetts. We also intend to **participate in the energy transition** in certain regions of the globe by purchasing **assets or stakes** in companies involved in hydroelectric generation and power transmission. In addition, using our expertise in **innovation**, we develop products that can be **commercialized** to increase our revenue. On the domestic front, we want to launch a **new era of electrification in Québec** with the electrification of ground transportation, the conversion of off-grid systems and the integration of energy options such as solar. Finally, our future growth will also be ensured by **new facilities** (generating stations and lines) and by programs to ensure the **long-term operability** of our generation and transmission assets.

SALES OUTSIDE QUÉBEC IN 2017

%



Our export markets generated profits of $780 million in 2017, or 27% of the company's net income. This was a record year for net export volume, which totaled 34.4 TWh.

Our business positioning

As stated in its *Strategic Plan 2016–2020*, Hydro-Québec intends to double its revenue by 2030, with a view to increasing its net income. We're focusing on **three main growth avenues**: export markets, investing outside Québec and commercializing our innovations.

Greater integration of North American grids

Hydro-Québec's generating fleet is unparalleled on this continent. Our clean power offers a solution to the major energy challenges facing northeastern North America, namely, reducing GHG emissions and ensuring a secure supply of electricity at stable prices.

Greater integration between the Québec and U.S. grids is a key component of the energy transition. Interconnected markets benefit from reduced generation and management costs through access to diversified energy sources across extensive geographic areas.

That's why, in 2017, Hydro-Québec responded to two requests for proposals (RFPs) by neighboring markets for renewable energy.

The March 2017 Massachusetts RFP was for 9.45 TWh of firm clean energy, to be delivered for 20 years. Hydro-Québec's proposal consisted of hydropower and three possible transmission scenarios developed in conjunction with its American partners: one through New Hampshire, one through Maine, and one through Vermont.

We also responded to an RFP from the New York Power Authority (NYPA) for 1 TWh or more of renewable energy. Two proposals were presented to help New York State reach its target of 50% renewable energy by 2030. NYPA will make its selection known in the first half of 2018.

With the U.S. Northeast largely dependent on natural gas for power generation, Hydro-Québec offers an alternative—electricity from clean, renewable sources—making it a natural ally in the fight against climate change.

An international player

Hydro-Québec also plans to participate in the energy transition by purchasing assets or stakes in companies involved in hydroelectric generation and power transmission, two fields at the core of our expertise. For these acquisitions, we're focusing on regions where the energy transition is in full swing, such as North America, Europe and certain Latin American countries.

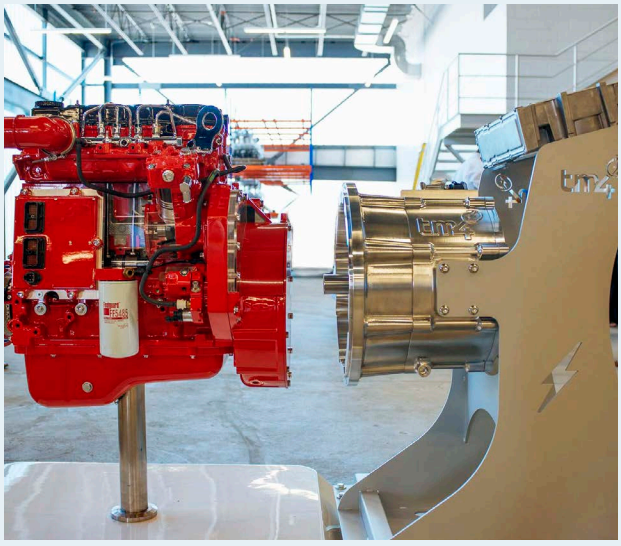
Because of our excellent reputation, we're highly solicited. However, we rigorously assess every business opportunity that arises, using very specific criteria. In the past several months, we've conducted analyses and due diligence reviews on numerous projects. We're continuing with this process, taking the time to make choices that are aligned with our investment principles and values and that are sure to benefit Quebecers.

Our advantages on export markets

- Power from clean, renewable sources
- Large volumes of available electricity
- Predictable operating costs allowing long-term supply at competitive rates
- Firming capacity for variable renewables
- Reliability guaranteed by our extensive generating fleet and robust transmission system
- Long-standing local presence

Hydro-Québec subsidiary TM4 expanded its offering of SUMO powertrains with the launch of the SUMO HP line for high-power applications. Included in the new line is the SUMO HP HV900, an innovative motor-generator and inverter combination that can be coupled to a combustion engine to increase the range of hybrid trucks and buses.

Prestolite E-Propulsion Systems (PEPS), a joint venture between TM4 and Prestolite Electric Beijing, continued to develop, manufacture and sell electric and hybrid powertrain systems for the Chinese market. Intent on offering solutions catered to the needs of its clientele, TM4 also entered into a number of important partnerships. It will be working alongside Cummins and the Société de transport de Laval to develop an electric bus equipped with a range extender. With AxleTech International, it will design an electric axle featuring a built-in powertrain for heavy-duty vehicles—a solution that will make it possible to electrify vehicles without adding to their bulk.



Innovation in motion

All aspects of tomorrow's power grid will incorporate digital technologies, enabling interactive features that promote customer participation. That's why our research institute, the **Institut de recherche d'Hydro-Québec (IREQ)**, has proposed a corporate vision for **technological progress by 2035** based on three major priorities: customers, assets and the grid of the future.

Our R&D teams will join forces with partners from our ecosystem and with the company's own business units to adapt and develop cutting-edge technologies designed to speed up electrification and enrich our offering of integrated energy services. Targeted technologies include distributed generation, energy storage and microgrids.

We'll also work to improve methods for predictive maintenance, optimal asset use and facility design and commissioning. Digital technologies will be leveraged to roll out a smart, integrated and flexible power grid that reacts in real time to equipment status and customer needs.

New expertise project with NYPA

In March 2017, IREQ was awarded a large research contract by the New York Power Authority (NYPA) and its R&D department, the New York State Energy Research and Development Authority. The study's focus is on investigating the potential for dynamic behavior improvement of the New York State grid, operated mainly by NYPA, by means of advanced-control technologies developed at IREQ. These technologies either have been or are currently being rolled out on Hydro-Québec's transmission system, and we already know that a number of them can be integrated into the U.S. Northeast power grid.

Drones for visual inspection of transmission lines

In July 2017, IREQ carried out a pilot project involving the use of a drone to visually inspect a live 735-kV line north of Saint-Hyacinthe. Detailed video data was captured and transmitted to the ground in real time, allowing the experts on site to confirm the quality of the inspection and diagnostics. It was the first time in Québec that a drone was used near a live line of such high voltage—a feat made possible by the work of IREQ teams to ensure superior resistance to magnetic fields.

Integrating renewables into off-grid systems

At the request of Hydro-Québec Distribution, our researchers conducted a study on bringing renewable generation into a dozen diesel-powered off-grid systems. The goal was to determine the best combination of renewables and storage systems to reduce diesel consumption. The study used the operation simulator OPERA and the optimizer ExploRA, tools developed by IREQ specifically for the project.

Partnership with Korea Electric Power Research Institute

IREQ and the Korea Electric Power Research Institute (KEPRI), managed by Korea Electric Power Corporation, signed an agreement to conduct R&D in cybersecurity, digital integration of substations, high-voltage direct current, and performance testing of magneto-optic current sensors.

A Hydro-Québec/MuRata joint venture continued its R&D work on battery materials and large-scale energy storage systems. After a prototype was successfully tested, the teams connected a 2.4-MWh storage system to a feeder line at Hemmingford substation in the Montérégie region (photo). In addition, a center of excellence in transportation electrification and energy storage was created in 2017, combining the R&D work on battery materials previously carried out by IREQ, Technologies Esstalion and SCE France. This world-class technological hub has signed a licensing agreement with Belgian company Solvay and a contract with the U.S. Department of Energy's Lawrence Berkeley National Laboratory (Berkeley Lab) for industrial-scale manufacturing technologies. This contract will lead to the creation of a Québec-Berkley joint research center (QUBE) in the San Francisco area.

Platform for testing energy services and technologies

To assess the energy uses and services of the future, anticipate their impact on the grid and help customers make technological choices, we built two identical constructions similar to many houses in Québec. Located at our energy technologies laboratory in Shawinigan, this test facility was first used to develop very sophisticated thermal and energy models, which for decades have informed many of the energy efficiency programs offered by Hydro-Québec. Today, we've adapted these "homes of the future" into net-zero-energy houses to understand the issues related to the growing popularity of advanced smart houses, electric vehicles—including vehicle-to-grid (V2G) and vehicle-to-home (V2H) applications—and distributed generation. Technologies being tested on these houses include a smart home system, a bidirectional EV charging station, and photovoltaic solar panels.

A better grid for Gaspésie

In the Gaspésie region, a special protection system was deployed to prevent instabilities on the transmission grid along with the resulting equipment failures and power outages. The new SPS uses innovative concepts in signal processing and artificial intelligence to detect imminent instability and take action to prevent it. In this region, the grid is particularly exposed to fluctuations due to load variations, energy interchanges with New Brunswick, and wind power integration.

Investing to serve our customers

By **investing** in new facilities, generating station **refurbishment** and transmission line and substation **maintenance**, we ensure power system reliability and improved service continuity for our customers.

Upgrading our generating fleet

We continued with the rehabilitation of our most powerful hydro-electric facility, Robert-Bourassa generating station in the Baie-James region, where a third generating unit underwent the same overhaul as the previous two. Similar work began or continued at the 55-year-old Carillon facility and at Rapides-des-Quinze, which at nearly 95 is one of the "old-timers" in our fleet.

On October 19, 2017, the Québec government and Hydro-Québec inaugurated Romaine-3 generating station, adding 395 MW of clean, renewable power to our total installed capacity. Our crews are now working to complete Romaine-4 (245 MW), some thirty kilometres further north. The commissioning of this final generating station, slated for the 2020 horizon, will mark the end of work on the 1,550-MW Romaine complex, which began in 2009.

Chamouchouane–Bout-de-l'Île project: installation of the first tower in section 3, at Réservoir Taureau in Saint-Zénon (Mauricie region). Completion is slated for 2018.

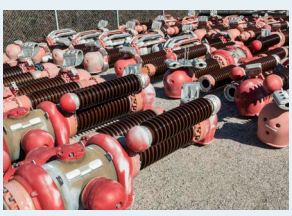
Chamouchouane–Bout-de-l'Île project

Work on Chamouchouane–Bout-de-l'Île was stepped up during the year. This project, which was the subject of numerous public consultations, has two components: first, the construction of about 400 km of 735-kV lines between Chamouchouane substation, in Saguenay–Lac-Saint-Jean, and the Montréal metropolitan loop, along with the rerouting of a short segment of 735-kV line to Bout-de-l'Île substation in Montréal; and second, the construction of Judith-Jasmin substation at Terrebonne in the Lanaudière region. This project will improve the reliability of the main transmission system, reinforce supply to the Montréal area, and help meet strong demand growth in Montréal's north shore suburbs. The work is progressing well in all the regions concerned and should be completed in 2018.

Focus on safety

Hydro-Québec is working to improve safety throughout the company, especially on its jobsites, and hopes to become a model for Québec's construction industry. At the Romaine complex, workers and contractors participated in determining the best ways to identify and manage risks. We trained change agents whose role is to raise awareness among personnel about the importance of safety and to inform managers about workers' concerns. We also took steps to make the pre-shift "toolbox talks" more dynamic in order to heighten workers' vigilance toward risks and their knowledge about protection measures. The campaign *Je m'engage dans le virage de la sécurité* [I'm on board with workplace safety] has been under way since April 2017.

To ensure employee and public safety, we continued with the replacement of the PK circuit breakers installed on our system between 1967 and 1983. In 2017, as part of a capital project authorized by the Régie, we replaced 165 735-kV breakers, 35 315-kV breakers and eight 230-kV breakers, for a total of 208. Through detailed planning and careful management at every step (procurement, removal, installation), we reduced the project's anticipated cost by over $150 million and significantly shortened its duration.



In the first phase of a broader deployment, anti-icing spiral rods were installed on transmission lines crossing major intersections in the cities of Québec and Lévis. The spiral rods prevent ice accumulation on high-voltage line conductors during use of the de-icing system at Lévis substation.

In 2018, we'll continue to roll out our action plan, which covers all our generation and transmission jobsites. From now on, bids from suppliers will need to include a risk analysis and a description of the measures they will implement to manage these risks for the entire term of the contract. We're also applying a hierarchy of controls that prioritizes the elimination of hazards at source.

Transmission system maintenance

Most of our transmission substation equipment is more than halfway through its service life. Given our sustainment strategy, which calls for tight control over asset replacement expenditure, the average age of our equipment can be expected to increase over the coming years. However, since our maintenance plans take aging into account, maintenance efforts were intensified in 2017 to counter the rise in forced outages linked to older equipment.

In 2017, some 50% (588) of the 1,183 workers at the Romaine jobsites came from Côte-Nord municipalities and 11% (130) were Innu. Significant sums continued to be invested in the region, in procurement of goods and services, salaries, and contributions to the different funds established under agreements with local communities. As a result of construction expenditure going to Côte-Nord companies and regional subcontractors since the start of the project, Hydro-Québec has become a leading economic player in the region.

Electrification in action

Hydro-Québec plans to launch a new electrification era by maintaining its active participation in ground transportation electrification, contributing to the conversion of off-grid systems and exploring generating options such as solar power.

Off-grid systems

As part of Québec's energy transition, Hydro-Québec is considering projects for complete or partial conversion of off-grid systems to renewable sources, in order to reduce its fuel costs and environmental footprint.

Discussions on the conversion of our largest off-grid system, Îles-de-la-Madeleine, were held in 2017 between the municipality and Hydro-Québec. In October we opened the three bids submitted in response to our 2015 RFP for 6 MW of wind power generated within the municipality. Hydro-Québec will make its selection known during the first quarter of 2018.

Complete or partial conversion of off-grid systems remains one of our priorities. We intend to continue our efforts in this regard and create winning conditions for the energy transition of these systems.

Photovoltaic generation

Hydro-Québec has started building a pilot solar fleet to develop expertise in centralized solar generation and exploit the commercial potential of this energy source in Québec. In late November, our teams installed 69 panels totaling 20 kW in Quaqtaq, Nunavik. We'll be using this experimental setup to study the viability of solar power in northern off-grid systems. Once the project is up and running, it should decrease fuel consumption at our thermal generating station by 5,000 litres per year, replacing 2% of its capacity. A battery bank for storing the power is scheduled to be installed in the next few months.

In addition, a preliminary study for a photovoltaic solar power plant was completed during the year. In the draft-design phase, currently under way, we'll confirm the location, conduct environmental and technical studies, and obtain the government permits required for commissioning in 2020.

The Electric Circuit

The year saw strong growth in the Electric Circuit. The network expanded beyond the boundaries of Québec, with 10 fast chargers and 8 standard stations installed in Ontario along highways 401, 416, 417 and 17, and in Ottawa. After five years of existence, the Electric Circuit installed its 1,000th charging station, in Ragueneau, Côte-Nord—the first fast charger in the region.

In addition, the superstation concept was unveiled at the end of the year. Each superstation will be equipped with several fast chargers, allowing more than one vehicle to fill up at the same time. Thanks to the success of the Electric Circuit, Hydro-Québec received the Tom Mitchell Vehicle Leadership Award presented by Plug'n Drive and the Canadian Electricity Association to a power company that led an electric vehicle or charging station program.

Public transit

Following amendments made in December 2016 to the *Hydro-Québec Act* and the *Act respecting the Régie de l'énergie*, Hydro-Québec can now finance the infrastructure required for the electrification of public transit. To this end, we'll be signing a financing agreement with CDPQ Infra, a subsidiary of the Caisse de dépôt et placement du Québec, to support the Réseau électrique métropolitain (REM). The REM driverless light rail project calls for the installation of 67 km of electrified railway tracks made up of four branches converging downtown from Montréal's south shore, Deux-Montagnes, the West Island and Pierre-Elliott-Trudeau International Airport. Hydro-Québec is actively involved in the planning process, particularly since parts of our distribution and transmission systems will need to be moved in order to connect the REM to our grid.

Electric Circuit

1,289 charging stations (including 106 fast chargers)

Serving **16 regions** of Québec

252 partners

19,153 members

Hydro-Québec operates in a business environment that's constantly changing, at the same time as its various customer classes are demanding ever greater efficiency. As a result, our **resources** and **processes** must be more **efficient** in every way. To meet the many **challenges** we're currently facing, as well as those on the horizon, we're relying on continuous **improvement**, proximity **management** that's more flexible than ever, and a unifying **culture** ensuring that all our employees are active participants in our success. In the area of information and communication technologies (ICT), we've developed **strategies** that will help us maintain excellent **performance** and high-quality **services** while reducing our operational expenditure and prioritizing increasingly vigilant **cybersecurity**. Year after year, we allocate large amounts to the purchase of **goods** and **services**. To get the most out of these purchases, we recently overhauled our **procurement** activities by adopting a strategy that will very soon provide us with a **world-calibre process**.

Hydro-Québec has always met very high standards for occupational **health and safety**. However, recent events and a report on our safety practices have revealed opportunities for improvement. These have prompted us to review our work methods so that we can do more than simply apply current standards.

We want to adopt a more proactive approach to managing health and safety in the workplace. Concrete initiatives have already been launched and will continue in the coming years. Their aim is to establish a safety culture based on:

- the engagement and accountability of all of the company's units and stakeholders
- sound behaviors and shared values in occupational health and safety
- a unifying leadership and increased manager presence on the ground
- improving the ability to identify risks, implement effective means of control, and learn from any safety-related incidents

Hydro-Québec's evolving organization

A changing business environment and growing customer demands are prompting the company to make major shifts. Various initiatives under way are contributing to this transformation, which has four main thrusts:

1. Phase in a corporate management system based on continuous improvement and proximity management.
2. Encourage employees to adopt key behaviors that will enable them to meet our new challenges.
3. Make certain management practices more flexible in order to increase efficiency.
4. Establish a unifying culture focused on performance.

Employee engagement

Hydro-Québec creates conditions that encourage active contribution by employees to the company's success. Engaged employees support the company's performance and development by supplying the effort needed to achieve its objectives. Every year, we conduct a survey to gather input from our employees and determine areas for improvement. In 2017, 15,643 employees responded to the survey, a 77% participation rate.

In addition, we devoted 3.1% of total payroll to developing our human resources. Specifically, 158 managers received leadership development training: 135 newly appointed supervisory and middle managers, and 23 executive managers.

Integrated workforce planning

Hydro-Québec takes great care to structure its workforce plan according to its ever-evolving operations, in order to have an integrated vision of its needs. In 2017, we focused on certain key jobs in several of Québec's regions. Integrated planning enables us to be proactive in implementing our staffing strategy, for example through closer coordination of employee recruitment and training, with a view to supporting the company's performance.

Partnership to fund and manage the IEPE

As a founding partner of the Institute of Electrical Power Engineering (IEPE), Hydro-Québec is involved in phase three of the IEPE's business plan, which we're supporting with a major pedagogical and financial contribution ($1,975,000 for 2014–2018). The company also plays a leading role in developing the training program and improving the employability of IEPE students and graduates.

A changing workforce

At the end of 2017, Hydro-Québec had a workforce of 19,786 permanent and temporary employees, comparable to the 2016 figure.

During the year, 877 employees retired, while 335 permanent employees and 1,304 temporary employees were hired.

Workforce mobility and renewal

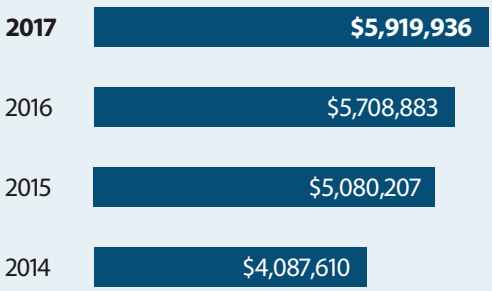
At the end of 2017, 43,050 LinkedIn subscribers were receiving company news and had access to our job offers. During the year, we welcomed 1,639 new hires, 1,437 people were promoted within the company, and 12,561 employees took part in at least one training activity.

Sharp increase in the number of recruits from target groups

In 2017, Hydro-Québec adopted a declaration on diversity and inclusion, and took concrete steps to promote the integration of people belonging to groups targeted by the *Act respecting equal access to employment in public bodies*. Internships for students with disabilities and a professional mentorship program geared to new immigrants are among the initiatives. We also formed our first cohort of line workers from diversity groups. What's more, we hold talks and forums to increase employee awareness of the benefits of openness and diversity.

In 2017, the Hydro-Québec Board of Directors had an equal number of men and women, while the percentage of women on the Management Committee rose from 23% to 33%. In addition, when applicants from target groups expressed an interest in our jobs, we were able to hire them in 50% of cases.

2017 Hydro-Québec employees' and pensioners' Centraide campaign: $5,919,936 in total donations



Our five-year ICT vision

The transformation of our **information and communication technologies (ICT)** continued in 2017. We concentrated our efforts on the objectives of **performance**, **productivity** and increased **value creation** within Hydro-Québec, and also prioritized **cybersecurity**. During the year, our strategies translated into some twenty high-priority mandates. We continued implementing our plan for reducing operational expenditure, while making sure to maintain the outstanding stability and reliability of our services.

Integrated investment portfolio and target architecture

The reorganization of our ICT activities meant that investment planning in 2017 was grounded in an overall assessment of Hydro-Québec's needs. The first integrated project portfolio to emerge from this planning is guided by the principles of the target ICT architecture. During the year, we defined the telecommunications component of this architecture, which will steer our technological choices and will ultimately lead us to simplify the overall architecture of our systems, integrate changes in technology and cybersecurity more easily and speed up value creation.

Improving productivity

Hydro-Québec relies on ICT to increase productivity, in particular by automating processes and adding advanced functionalities to systems and applications. Here are some of the initiatives carried out with this in mind:

- Functionalities were added to the geographic information system for determining the inventory, positioning and characteristics of distribution system structures and equipment.
- Real-time dashboards went into operation, allowing viewing on a computer or mobile device and facilitating monitoring of indicators established by the company's units.
- Rollout continued on wireless network access, allowing greater employee mobility.
- A solution was developed for analyzing pole reliability using information from previous inspections.
- We installed an app that allows all employees to easily monitor the progress of requests related to their computer and telecommunications tools.
- Tools for planning work on Hydro-Québec Production assets were installed.

In addition to contributing to the company's productivity, technologies are central to our customer service improvement strategy. Several new features were introduced in 2017 and early 2018 to make customers' lives easier in their interactions with us and in understanding and managing their electricity consumption.

Prioritizing cybersecurity

We're maintaining our efforts to protect our facilities and data, as well as customer information. An action plan aimed at improving the company's ICT security posture and an awareness program for our employees and suppliers informed the measures we took during the year. These included bolstering the security of our perimeter and access to corporate systems.

Cooperation by our employees and the acquisition of new, more powerful systems and tools have enabled us to increase our monitoring and detection capability. We're also working on upgrading our ICT architecture so that it will better support the company in fulfilling its core mission.

Telecommunications links supporting power system operations

Hydro-Québec operates an extensive telecommunications network to manage, monitor and run its facilities. In 2017, we laid the groundwork for integrating a number of components into the system, including our new data center, Nicolas-Riou wind farm and the links for the Chamouchouane–Bout-de-l'Île project. Additionally, rollout of the IP/MPLS backbone was extended to the Baie-James region, and some services migrated onto that network. Eventually, a single secure and powerful IP network will serve the entire company. Our telecommunications architecture teams are also working on the digital integration of transmission substations and modernization of power system operation tools.

To maximize the value provided by the goods and services it acquires from its suppliers, Hydro-Québec recently overhauled its procurement activities. We introduced a **strategic procurement** process and management of goods and services grouped by category in order to consolidate and plan recurring purchases. Strategic procurement and management by category also allow us to set up a supply chain structure based on the company's future needs.

The recent formation of the Direction principale – Approvisionnement stratégique was accompanied by a deliberation exercise that enabled us to define a business model, specify the role this team would play in dealing with its internal contacts and benchmark the company's processes against best practices in strategic procurement. This exercise resulted in a transformation plan based on three components: trained, qualified employees, effective tools and optimized processes that create value. The plan should enable us to attain the ambitious yet realistic objective of having a world-class strategic procurement process by 2019.

Support for municipalities and regions

Under our Integrated Enhancement Program (IEP), established in 1985, communities that host new transmission infrastructure receive funding equal to 1% of the initially authorized value of the project. This funding is earmarked for local or regional initiatives related to municipal, community or recreational infrastructure, community development or the environment.

In 2017, the IEP supported 27 initiatives, for a total of $4.2 million invested directly in communities. The city of Terrebonne, for instance, received $490,599 as part of the Lachenaie substation project. This funding was used to build a gymnasium inside a community center.

The Fondation Hydro-Québec pour l'environnement, for its part, granted $738,250 to various Québec organizations, thereby contributing to 16 initiatives in 9 administrative regions of Québec for the protection and enhancement of natural areas and education about local environmental issues.

For example, the $66,500 it gave to Éco-Nature will go to such projects as a digital boat rally on the Rivière des Mille-Îles. A special app will be downloadable from the organization's Web site and from interactive terminals set up in the monitoring room at the new visitor center. The project is intended to make visitors more aware of the natural bounty of Parc de la Rivière-des-Mille-Îles by leading them to discover the river, its habitats, and protective measures to limit environmental degradation.

For more information on the Foundation's activities, go to: www.hydroquebec.com/foundation-environment.

Our sustainability efforts between now and 2020

As part of our contribution to Québec's *Government Sustainable Development Strategy 2015–2020*, we published our third *Sustainable Development Action Plan* in July 2015. The 12 actions laid out in it encapsulate our intention to participate in this strategy, as well as the government's 2011–2016 strategy to ensure the occupancy and vitality of territories (renewed in 2017) and its *Agenda 21 for Culture*. A detailed account of our performance with respect to the Action Plan is presented in the *Sustainability Report 2017*.

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

Hydro-Québec ranked fourth among "Best 50 Corporate Citizens in Canada"

In its 2017 report, *Corporate Knights* magazine ranked the company fourth out of the 50 best corporate citizens in Canada. What's more, Hydro-Québec stands solidly in first place among the electric utilities and energy companies that made it onto the list.

The "Best 50" ranks companies on their sustainability performance—responsible use of resources, improving energy efficiency and reducing GHG emissions, for example. It's based on 14 wide-ranging criteria, including R&D expenditure, safety performance, and representation of women in executive positions.

Host of the 26th Global Sustainable Electricity Partnership Summit

Hydro-Québec hosted the 26th Global Sustainable Electricity Partnership (GSEP) Summit on May 29 and 30, 2017, in Montréal. This event brought together the heads of the world's leading power utilities, who discussed measures for making electricity an important vector of decarbonization.

GSEP members pledged to institute concrete solutions for tackling climate-related issues, including low- or zero-emission energy technologies, energy efficiency and the replacement of fossil fuels.

In October, Hydro-Québec, in collaboration with the Italian company Enel, completed a feasibility study for a pilot project for integrating two electric buses into Lima's public transit system in the summer of 2018. The study was part of the company's GSEP activities.

Donations and sponsorships

Hydro-Québec contributes to Québec society and culture. In the past year, we were active in community assistance, education and health, and also supported cultural, environmental, socioeconomic, scientific and sports events.

We proudly supported a wide range of organizations in every region of the province, including the Québec Aboriginal Science and Engineering Association, the Fondation de l'Institut universitaire en santé mentale de Montréal, Fondation Tel-Jeunes, Fondation de l'Université du Québec à Rimouski, the Special Olympics Québec organization, Culture pour tous and Maison du développement durable (Center for Sustainable Development). Altogether, over 600 organizations received $19.4 million.

Further details are available at www.hydroquebec.com/donations-sponsorships.

The Société de conservation des Îles-de-la-Madeleine received $25,000 from the Fondation Hydro-Québec pour l'environnement to ensure the long-term conservation of a property located in an area of great ecological interest in Fatima, on Île de Cap-aux-Meules.

This Management's Discussion and Analysis should be read in conjunction with the consolidated financial statements of Hydro-Québec and the notes thereto. The financial information and tabular amounts presented herein are expressed in Canadian dollars, unless otherwise indicated. The consolidated financial statements take into account the decisions handed down by the Régie de l'énergie with respect to the transmission and distribution of electricity.

This analysis, and especially the Outlook section, contains statements based on estimates and assumptions concerning future results and the course of events. Given the risks and uncertainties inherent in any forward-looking statements, Hydro-Québec's actual future results could differ from those anticipated. Finally, the information contained herein takes into account any significant event that occurred on or before February 16, 2018, the date of approval of this Annual Report by Hydro-Québec's Board of Directors.

FINANCIAL REVIEW

2017 at a Glance

In 2017, Hydro-Québec posted net income of $2,846 million. Because the earnings-sharing mechanism came into effect in 2017, the company took into account the surplus realized during the year over and above the authorized rates of return for its regulated activities, recognizing $45 million payable to customers in this regard, in accordance with the terms established by the Régie de l'énergie. For purposes of comparison with 2016 net income, which totaled $2,861 million, adjusted net income excluding this first-time item was $2,891 million in 2017, an increase of $30 million compared to the previous year. This strong result is mainly due to net electricity exports of more than 34 TWh—a record volume in the company's history.

On the Québec market, sales volume reached 170.7 TWh, compared to 169.3 TWh in 2016. This 1.4-TWh rise is partly attributable to greater demand by residential customers as well as commercial and institutional customers. The increased demand was primarily met by wind power purchases from independent producers. In addition, December temperatures averaged 4°C colder than normal; consequently, Hydro-Québec Production provided Hydro-Québec Distribution with additional peak supplies.

For a fifth consecutive year, Hydro-Québec will thus be able to pay a dividend of more than $2 billion to its shareholder, the Québec government. For 2017, the dividend amounts to $2,135 million.

UNPRECEDENTED EXPORTS

In 2017, net electricity exports reached a historic volume of 34.4 TWh and contributed $780 million to net income. As a result of an effective sales strategy, smooth operation of generating and transmission facilities and high runoff, net exports increased by 1.8 TWh over the previous record, set in 2016. Monthly records for net exports were also set in the first quarter of 2017: 3.5 TWh in January, 3.1 TWh in February and 3.5 TWh in March. As for reservoir storage, it stood at the historic level of 140.5 TWh as at December 31, 2017.

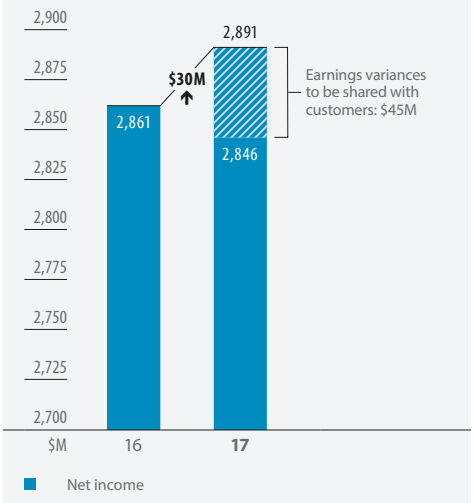
MAJOR INVESTMENTS IN ASSET GROWTH AND SUSTAINMENT

Hydro-Québec's investment program totaled $3,754 million in 2017. This high amount is mainly attributable to the continuation of major development projects in the generation and transmission segments, as well as increased investment in maintaining and improving the quality of the company's assets.

At the Romaine hydroelectric complex, in the Côte-Nord region, Hydro-Québec reached an important milestone in September with the commissioning of the two units at Romaine-3 generating station (395 MW) and the connection of the station to the grid. The facility was put to good use very shortly thereafter, both to help meet Québec demand during peak consumption periods in winter 2017–2018 and for export purposes. Two of the four generating stations in this 1,550-MW project—Romaine-2 (640 MW) and Romaine-1 (270 MW)—were brought onstream in 2014 and 2015, respectively, and Romaine-4 (245 MW) should follow around 2020.

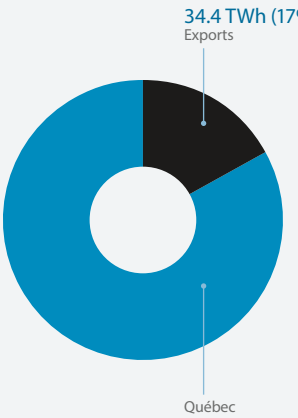
In 2017, net exports accounted for 17% of sales volume, but generated 27% of the company's net income.

Adjusted Net Income



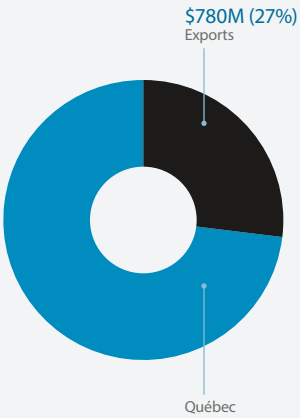
Net Electricity Sales in 2017

205.1 TWh



Net Income in 2017

$2,846M



In addition, work was stepped up in 2017 on the 735-kV Chamouchouane–Bout-de-l'Île project, which will enhance the reliability of the main transmission system, reinforce energy supply to the Montréal region and meet demand growth in the city's north shore suburbs. The project has two components: first, deployment of 735-kV lines extending approximately 400 km between Chamouchouane substation, in the Saguenay–Lac-Saint-Jean region, and the Montréal metropolitan loop, as well as the rerouting of a short segment of 735-kV line to Bout-de-l'Île substation, in Montréal; and, second, construction of 735/120/25-kV Judith-Jasmin substation in Terrebonne, in the Lanaudière region. Line construction is proceeding simultaneously in the Saguenay–Lac-Saint-Jean, Mauricie and Lanaudière regions, with the goal of commissioning all the facilities at the end of 2018.

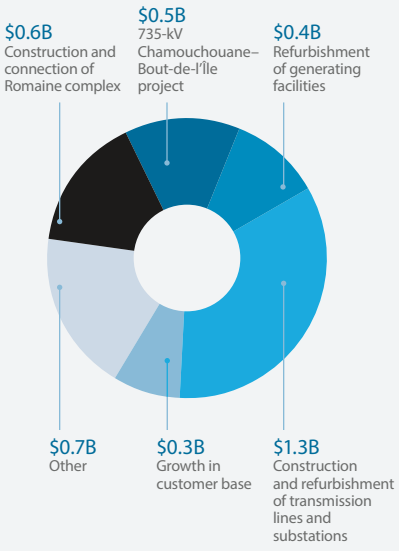
The company also carried out several projects to ensure the long-term operability of its facilities and optimize their performance, in all its business segments.

A MAJOR CONTRIBUTION TO THE QUÉBEC GOVERNMENT'S REVENUE

For a fifth consecutive year, Hydro-Québec's contribution to the Québec government's revenue has exceeded $4 billion. This significant contribution, which includes the company's net income, water-power royalties, the public utilities tax and guarantee fees related to debt securities, combined with the economic spinoffs of the company's operations throughout the province, will benefit all Quebecers.

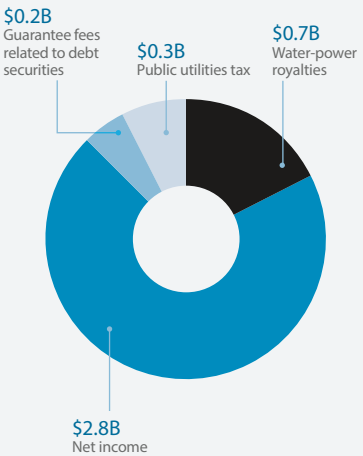
Investments in Québec in 2017

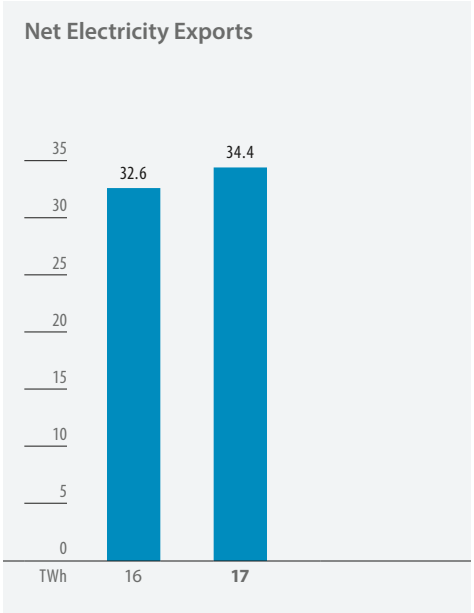
$3.8B

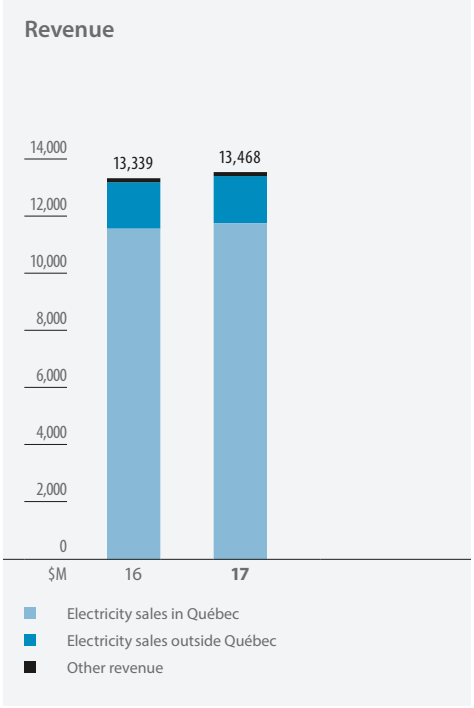


Hydro-Québec's Contribution to the Québec Government's Revenue for 2017

More than **$4B**







NET INCOME

Hydro-Québec recorded net income of $2,846 million in 2017. Due to the earnings-sharing mechanism, which applied for the first time in 2017, the company recognized $45 million payable to customers, in accordance with the terms established by the Régie de l'énergie. For purposes of comparison with 2016 net income, which totaled $2,861 million, adjusted net income excluding this new item was $2,891 million in 2017, an increase of $30 million compared to the previous year.

On markets outside Québec, net electricity exports rose by $7 million, primarily because of a 1.8-TWh volume increase that brought net exports to a historic high of 34.4 TWh. On the Québec market, supplies provided by Hydro-Québec Production to Hydro-Québec Distribution increased by $37 million compared to 2016, mainly as a result of temperature variances.

REVENUE

Revenue totaled $13,468 million, compared to $13,339 million in 2016. Revenue from electricity sales increased by $215 million to $13,414 million. Sales in Québec generated $11,763 million, or $190 million more than the $11,573 million recorded in 2016. On markets outside Québec, revenue from electricity sales was $1,651 million, an increase of $25 million. Other revenue amounted to $54 million, compared to $140 million in 2016.

The $190-million increase in electricity sales in Québec is attributable to three main factors. First, temperature variances, most pronounced in April and December, led to growth of $53 million in sales revenue. In 2016, April temperatures were 3°C below climate normals, giving rise to additional sales of $63 million, whereas they were closer to normal in 2017. Conversely, December temperatures were exceptionally cold in 2017, resulting in additional sales of $97 million. Second, demand growth in Québec led to a $123-million increase in revenue, partly offset by a $41-million decrease because 2016 was a leap year. Third, the April 1, 2016 and 2017 rate adjustments resulted in a $70-million increase in revenue. Rates are determined by the Régie de l'énergie on a basis that allows for recovery of the cost of service plus a reasonable return on the rate base.

Revenue from electricity sales on markets outside Québec amounted to $1,651 million, compared to $1,626 million in 2016. The $25-million increase was mainly due to volume growth in electricity exports by Hydro-Québec Production. The impact of this volume increase was partially offset, however, by the effect of the risk management strategy, which was less favorable in 2017 than in 2016.

Other revenue decreased by $86 million to $54 million in 2017, mainly because of the change in the net amounts that Hydro-Québec is entitled to receive from customers or is required to pay to them. Under the earnings-sharing mechanism implemented in 2017, Hydro-Québec TransÉnergie and Hydro-Québec Distribution share with customers any surplus over and above the rate of return authorized by the Régie de l'énergie for a given year. An amount of $45 million was therefore recognized in this regard in 2017; it will have a positive impact on the rate adjustment that will take effect on April 1, 2019.

EXPENDITURE

Total expenditure was $8,109 million in 2017, compared to $7,946 million in 2016.

Operational expenditure totaled $2,664 million, a $7-million decrease from the $2,671 million recorded in 2016. This decrease is the result of careful management, which enabled the company to fully absorb the impacts of inflation, salary indexing and growth in activities.

Following the adoption of an amendment to an accounting standard, certain items related to employee future benefits that were previously presented in operational expenditure are now presented as a separate line item, Other components of employee future benefit cost, in the consolidated statements of operations. A credit amount of $322 million is presented in this line item for 2017, compared to a credit amount of $233 million for 2016. This positive change of $89 million is primarily due to an increase in the amount recognized for the expected return on pension plan assets, mainly on account of an increase in the value of the underlying assets.

Electricity and fuel purchases totaled $2,005 million, a $139-million increase compared to $1,866 million in 2016. This change is essentially due to a $131-million, or 1.3-TWh, increase in Hydro-Québec Distribution's wind power purchases from third parties, mainly as a result of the commissioning of three new wind farms at the end of 2016.

Depreciation and amortization expense amounted to $2,686 million, an $89-million increase compared to 2016. The depreciation of property, plant and equipment increased by $17 million, partly because of the commissioning of the two units at Romaine-3 generating station in September. Furthermore, the amortization expense related to regulatory assets and liabilities increased by $56 million, mainly because a liability related to the changeover to U.S. generally accepted accounting principles was fully amortized in 2016.

Taxes were $1,076 million, compared to $1,045 million in 2016, mainly as a result of a $28-million increase in water-power royalties on account of higher output and the indexing of the applicable rate.

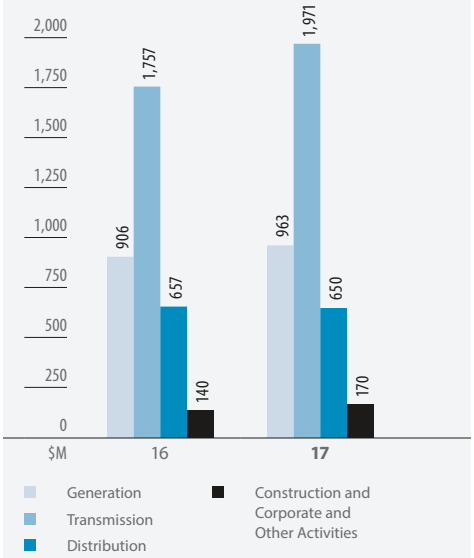
Financial expenses totaled $2,513 million in 2017, compared to $2,532 million in 2016. This decrease is partly due to the impact on working capital denominated in U.S. dollars of hedging operations carried out by the company to manage risks related to exchange rates.

	2017	2016
OPERATIONS AND DIVIDEND ($M)		
Revenue	**13,468**	13,339
Income before financial expenses	**5,359**	5,393
Net income	**2,846**	2,861
Dividend	**2,135**	2,146
BALANCE SHEETS ($M)		
Total assets	**75,730**	75,167
Property, plant and equipment	**63,990**	62,691
Long-term debt, including current portion and perpetual debt	**45,259**	45,909
Equity	**19,755**	19,704
FINANCIAL RATIOS		
Return on equity (%)[a]	**12.9**	13.4
Capitalization (%)[b]	**30.7**	30.5
Profit margin (%)[c]	**21.1**	21.4
Interest coverage[d]	**2.13**	2.16
Self-financing (%)[e]	**66.6**	58.8

a) Net income divided by average equity for the year less average accumulated other comprehensive income for the year.
b) Equity divided by the sum of equity, long-term debt, current portion of long-term debt, perpetual debt, borrowings and derivative instrument liabilities, less derivative instrument assets and sinking fund.
c) Net income divided by revenue.
d) Sum of income before financial expenses and net investment income divided by interest on debt securities.
e) Cash flows from operating activities less dividend paid, divided by the sum of cash flows from investing activities, excluding net change in short-term investments and sinking fund, and repayment of long-term debt.

Cash and Capital Management

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



OPERATING ACTIVITIES

Cash flows from operating activities totaled $5.6 billion in 2017, compared to $5.5 billion in 2016. These funds were used to pay the dividend for 2016 and to finance a large portion of the investment program, among other things.

INVESTING ACTIVITIES

In 2017, Hydro-Québec invested $3.8 billion in property, plant and equipment and intangible assets, compared to $3.5 billion in 2016. Of the total, $1.5 billion was invested in development projects and $2.3 billion in maintaining or improving the quality of assets.

Hydro-Québec Production's investments totaled $963 million. Over half of this amount, $561 million, went to development activities, mainly the ongoing construction of the Romaine hydroelectric complex. The amounts allocated to ongoing asset maintenance and improvement totaled $402 million. Work included refurbishment at Robert-Bourassa, Beauharnois, Carillon and Rapides-des-Quinze generating stations.

Capital spending at Hydro-Québec TransÉnergie totaled $1,971 million. Of this amount, $569 million was used to connect new hydroelectric and wind power facilities to the grid and increase transmission capacity. In this regard, the main active jobsites are related to the ongoing 735-kV Chamouchouane–Bout-de-l'Île project and the work to connect the Romaine complex, which represented investments of $485 million and $39 million, respectively, in 2017. Another $1,402 million was allocated to projects designed to maximize transmission asset reliability and sustainment, which mainly involved replacing equipment and modernizing facilities. In particular, the division allocated $279 million to the replacement of PK type circuit breakers.

Hydro-Québec Distribution invested $650 million, mainly to handle its growing customer base and ensure the long-term operability of the distribution system.

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

FINANCING ACTIVITIES

In 2017, Hydro-Québec made two bond issues maturing in 2055 on the Canadian capital market, at an average cost of 3.20%.

These issues raised $1.2 billion. The proceeds were used to support part of the investment program and to refinance maturing debt.

SOURCES OF FINANCING

Type of financing	Amount authorized by the Board of Directors	Market	Outstanding as at December 31, 2017
Operating credit lines	C$ or US$1,000 million[a]		C$1.5 million
Credit facility[b]	US$2,000 million[c]		–
Commercial paper[b]	US$3,500 million or equivalent in C$	United States or Canada	C$8.1 million
Medium-term notes[b]	US$3,000 million or equivalent in other currencies C$20,000 million or equivalent in US$	United States Canada	US$340 million[d] C$14,224 million[d]

a) Of this amount, available balances of US$200 million and $243 million in Canadian or U.S. dollars are covered by operating credit line agreements with the financial institutions concerned.
b) Guaranteed by the Québec government.
c) Includes a US$750-million swing loan.
d) Corresponds to net proceeds from the issuance of medium-term notes.

CREDIT RATINGS

	2017			2016		
	Commercial paper	Long-term debt	Outlook/ Trend	Commercial paper	Long-term debt	Outlook/ Trend
U.S. agencies						
Moody's	**P-1**	**Aa2**	**Stable**	P-1	Aa2	Stable
S&P Global Ratings	**A-1+**	**AA–**	**N/A**[a]	A-1+	A+	N/A[a]
Fitch Ratings	**F1+**	**AA–**	**Stable**	F1+	AA–	Stable
Canadian agency						
DBRS	**R-1 (middle)**	**A (high)**	**Stable**	R-1 (middle)	A (high)	Stable

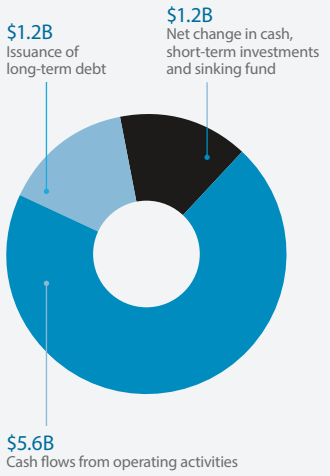
a) S&P Global Ratings does not provide an outlook for Hydro-Québec's credit rating. However, it has given a "stable" outlook to the Québec government, Hydro-Québec's shareholder and guarantor, after upgrading the government's credit rating from A+ to AA– in 2017.

DIVIDEND AND CAPITALIZATION

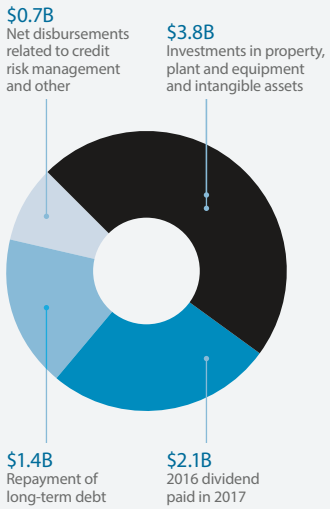
The dividend payable to the Québec government for 2017 is $2,135 million. Once this dividend is factored in, the capitalization rate was 30.7% as at December 31, 2017.

Under the *Hydro-Québec Act*, the dividend cannot exceed 75% of net income. Furthermore, the Québec government may not declare, in respect of a given year, a dividend in an amount that would have the effect of reducing the capitalization rate to less than 25% at the end of the year.

Sources of Funds in 2017



Uses of Funds in 2017

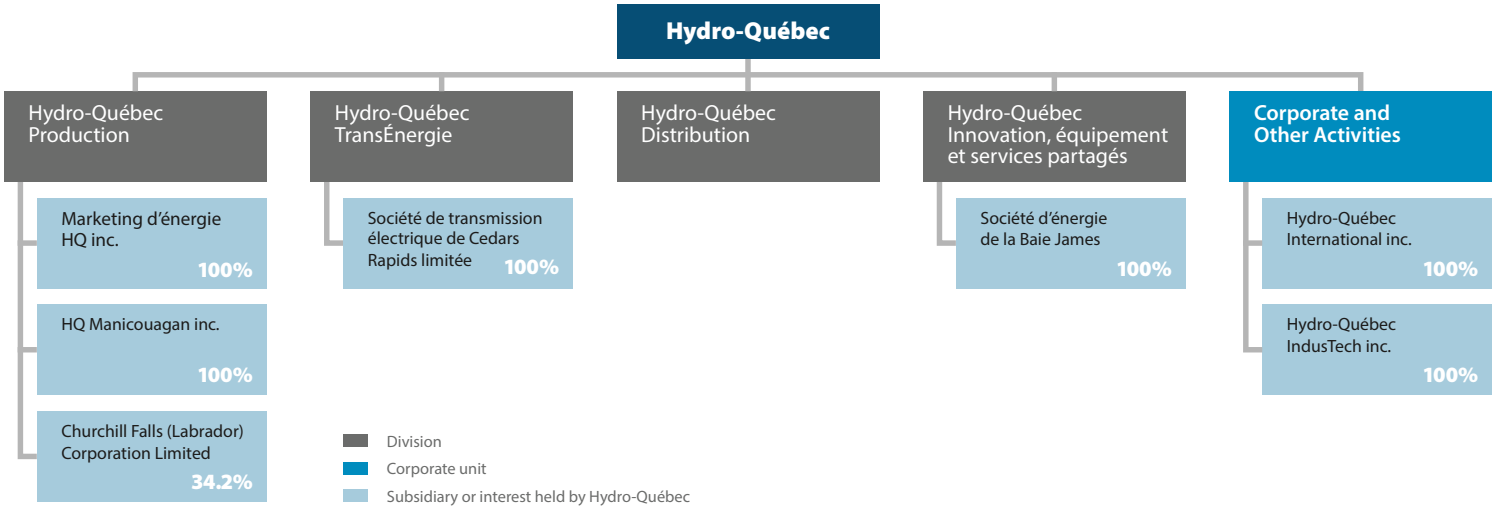


Segmented Results

OPERATING SEGMENTS

As in 2016, Hydro-Québec had four operating segments in 2017, namely Generation, Transmission, Distribution and Construction, as well as activities grouped under Corporate and Other Activities.

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



GENERATION

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

TRANSMISSION

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

DISTRIBUTION

Hydro-Québec Distribution operates and develops Hydro-Québec's distribution system and ensures the supply of electricity to the Québec market. It also carries on activities related to electricity sales in Québec, provides customer services and promotes energy efficiency.

CONSTRUCTION

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

The following tables present information on segment results and assets:

						2017
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec
Revenue[a]	**6,516**	**3,307**	**11,701**	**2,480**	**1,757**	**13,468**
Net income	**1,948**	**554**	**333**	**–**	**11**	**2,846**
Total assets	**32,944**	**22,494**	**13,639**	**39**	**6,768**	**75,730**[b]

						2016
Segmented financial information ($M)	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Hydro-Québec
Revenue[a]	6,482	3,215	11,514	2,225	1,819	13,339
Net income	1,870	561	342	1	87	2,861
Total assets	32,773	21,476	13,546	59	7,499	75,167[b]

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

b) This figure reflects the intersegment eliminations and adjustments presented in Note 20 to the consolidated financial statements.

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

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

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

OPERATING RESULTS

Hydro-Québec Production posted net income of $1,948 million in 2017, a $78-million increase compared to the previous year. Net electricity exports rose by $7 million to $1,575 million—one of the division's best-ever performances in this regard. As a result of an effective sales strategy, optimal management of generating and transmission facilities, and high runoff, the division recorded net exports of 34.4 TWh, a historic high and a 1.8-TWh increase over the previous record, set in 2016. Net electricity sales to Hydro-Québec Distribution amounted to $4,857 million, a $37-million increase that was mainly due to temperature variances. Taxes increased by $28 million, whereas financial expenses decreased by $32 million.

ELECTRICITY SALES IN QUÉBEC

SALES TO HYDRO-QUÉBEC DISTRIBUTION

The total volume of electricity sales to Hydro-Québec Distribution was 159.2 TWh in 2017, compared to 159.1 TWh in 2016. Revenue from these sales increased by $37 million from the $4,820 million posted in 2016, mainly because of very cold temperatures in December 2017, which on average were 4°C below the climate normals, and also because of the indexing of heritage pool electricity.

ELECTRICITY SALES OUTSIDE QUÉBEC

Electricity sales outside Québec amounted to $1,651 million, compared to $1,626 million the previous year.

Net electricity exports, which factor in short-term electricity purchases, generated $1,575 million in 2017, a $7-million increase compared to $1,568 million in 2016. They rose by 1.8 TWh to a historic volume of 34.4 TWh. The impact of this volume increase was partly offset, however, by the effect of the risk management strategy, which was less favorable in 2017 than in 2016.

Reservoir storage also reached a record level: 140.5 TWh as at December 31, 2017, compared to 138.2 TWh a year earlier. The energy reserve fully meets the criteria set for management of risks related to the security of the energy supply.

ELECTRICITY AND FUEL PURCHASES

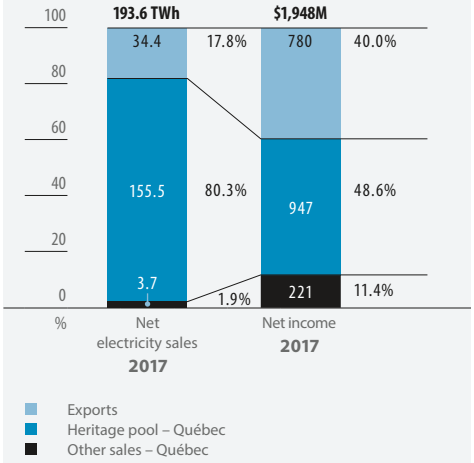
Electricity and fuel purchases totaled $970 million, comparable to the $960 million recorded in 2016.

DEPRECIATION AND AMORTIZATION

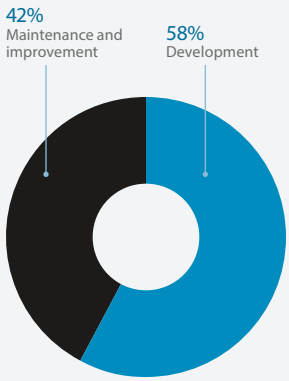
Depreciation and amortization expense stood at $805 million in 2017, compared to $775 million the previous year. This $30-million increase is mainly due to the commissioning of property, plant and equipment, in particular the two units at Romaine-3 generating station in September 2017.

2017 AT A GLANCE	
Revenue	**$6.5B**
Net income	**$1,948M**
Contribution of net exports to net income	**$780M**
Customers (% of revenue from electricity sales)	
Hydro-Québec Distribution	**74%**
Other	**26%**
Sales volume	
Hydro-Québec Distribution	**159.2 TWh**
Other	**34.9 TWh**
Property, plant and equipment as at December 31 (including work in progress)	**$31.1B**
Investments in property, plant and equipment and intangible assets	**$963M**
Reservoir storage as at December 31	**140.5 TWh**

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



Breakdown of 2017 Investments by Hydro-Québec Production



TAXES

Taxes were $876 million in 2017, compared to $848 million in 2016, as a result of a $28-million increase in water-power royalties on account of higher output and the indexing of the applicable rate.

FINANCIAL EXPENSES

Financial expenses totaled $1,173 million in 2017, compared to $1,205 million the previous year. This decrease is partly due to the impact on working capital denominated in U.S. dollars of hedging operations carried out by the company to manage risks related to exchange rates.

INVESTING ACTIVITIES

Investments in property, plant and equipment and intangible assets totaled $963 million in 2017. Of this amount, $561 million went toward development activities, mainly the continued construction of the Romaine hydroelectric complex, which reached another milestone in September with the commissioning of Romaine-3 generating station (395 MW).

Hydro-Québec Production also invested $402 million in asset sustainment and optimization. Ongoing work included refurbishment at Robert-Bourassa, Beauharnois, Carillon and Rapides-des-Quinze generating stations.

Transmission

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

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

RATE CASES

For 2017, the revenue authorized by the Régie de l'énergie for transmission rate-setting purposes totaled $3,248 million, namely $2,859 million for native-load transmission and $389 million for short- and long-term point-to-point transmission services. These amounts represent increases of $115 million and $20 million, respectively, compared to 2016.

For 2018, Hydro-Québec TransÉnergie filed an application with the Régie de l'énergie requesting revenue of $3,364 million, namely $2,960 million for native-load transmission and $404 million for short- and long-term point-to-point transmission services. The Régie's decision regarding this application is expected in the first quarter of 2018.

OPERATING RESULTS

Hydro-Québec TransÉnergie's net income amounted to $554 million in 2017. Excluding the $27 million payable to customers under the earnings-sharing mechanism, the division's adjusted net income was $581 million, compared to $561 million in 2016. The $115-million increase in revenue from native-load transmission service was partly offset by two main factors: an $81-million increase in depreciation and amortization expense related to the amortization of regulatory assets and liabilities in accordance with the terms approved by the Régie de l'énergie, and a $24-million increase in financial expenses.

INVESTING ACTIVITIES

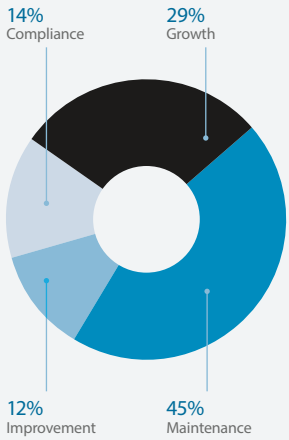
In 2017, Hydro-Québec TransÉnergie invested $1,971 million in property, plant and equipment and intangible assets, namely $569 million for growth projects and $1,402 million for asset sustainment and reliability projects. The purpose of growth projects is to connect new generating facilities to the grid and to increase transmission capacity in response to higher load demand or new customer requests. Asset sustainment and reliability projects involve keeping facilities in good operating condition, maintaining and improving service quality and complying with the legal and regulatory requirements for operating a power transmission system.

In the growth category, Hydro-Québec TransÉnergie invested $485 million in continuing the Chamouchouane–Bout-de-l'Île project: $407 million for the deployment of 735-kV lines extending approximately 400 km between Chamouchouane substation, in the Saguenay–Lac-Saint-Jean region, and the Montréal metropolitan loop, and $78 million for the construction of 735/120/25-kV Judith-Jasmin substation in the Lanaudière region (these amounts also include the project component related to transmission system sustainment and reliability). The division allocated a further $39 million to ongoing work to connect the Romaine complex as part of the expansion of the transmission system in the Minganie region, primarily construction of the line between the future Romaine-4 substation and Montagnais substation. In September 2017, the division also reached an important milestone in the project with the connection of Romaine-3 generating station (395 MW) to the grid. Finally, it continued to integrate the output from wind farms built in response to the calls for tenders issued by Hydro-Québec Distribution, for a total investment of $40 million.

In the asset sustainment and reliability category, Hydro-Québec TransÉnergie invested $279 million to complete the replacement of PK circuit breakers, begun in 2016. In 2017, it replaced a total of 208 such breakers at 32 transmission substations. In addition, it allocated $86 million (including the project's growth component) to rebuilding De Lorimier substation and installing new tap lines for it, as well as $54 million (including the growth component) to rebuilding Gracefield substation and the 120-kV Paugan–Maniwaki line.

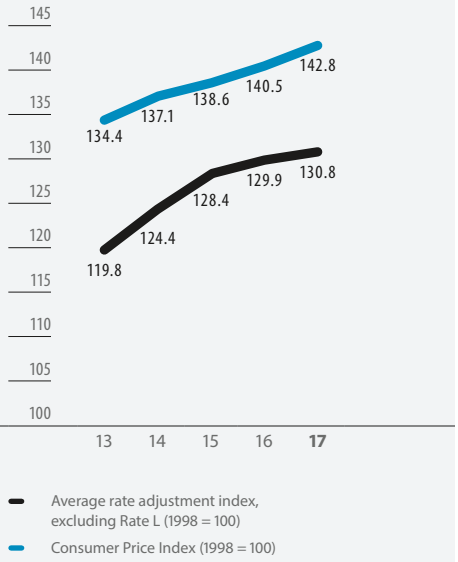
2017 AT A GLANCE	
Revenue	$3.3B
Net income	$554M
Customers (% of revenue)	
Hydro-Québec Distribution *(native-load transmission service)*	87%
Hydro-Québec Production and other North American wholesalers *(point-to-point transmission services)*	12%
Other	1%
Property, plant and equipment as at December 31 (including work in progress)	$22.3B
Investments in property, plant and equipment and intangible assets	$1,971M

Breakdown of 2017 Investments by Hydro-Québec TransÉnergie



2017 AT A GLANCE	
Revenue	$11.7B
Net income	$333M
Segments (% of revenue from electricity sales)	
Residential	45%
Commercial, institutional and small industrial	33%
Large industrial	19%
Other	3%
Property, plant and equipment as at December 31 (including work in progress)	$10.0B
Investments in property, plant and equipment and intangible assets	$650M
Rate increase effective April 1, 2017 (excluding Rate L)	0.7%

Average Rate Adjustment Index and Consumer Price Index



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

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

RATE CASES

In March 2017, the Régie de l'énergie authorized an average increase of 0.7% in all Hydro-Québec electricity rates except the large-power industrial rate (Rate L), for which the increase was set at 0.2%. In accordance with the *Act respecting the Régie de l'énergie*, the indexing of the price of heritage pool electricity does not apply to Rate L customers, which explains the smaller increase. The new rates went into effect on April 1, 2017.

In July, Hydro-Québec Distribution filed an application with the Régie for a 1.1% rate adjustment for all customers except those at Rate L, for which the requested adjustment was 0.8%. The new rates would take effect on April 1, 2018. The main reasons for the 1.1% adjustment are the financial impact of the commissioning of high-voltage transmission facilities to provide secure, reliable service; the increase in certain distribution costs, particularly amounts allocated for vegetation control to prevent outages; and the higher cost of electricity purchases. Other factors, such as sales growth resulting partly from the strategy to attract data centers to Québec, as well as the impact of milder temperatures in the winters of 2015–2016 and 2016–2017, limited the requested increase.

The cumulative average rate adjustment index for 1998 to 2017 is 130.8, while the Consumer Price Index for the same period is 142.8.

The Régie de l'énergie's ruling on the rate application is expected in March 2018.

SUPPLYING THE QUÉBEC MARKET

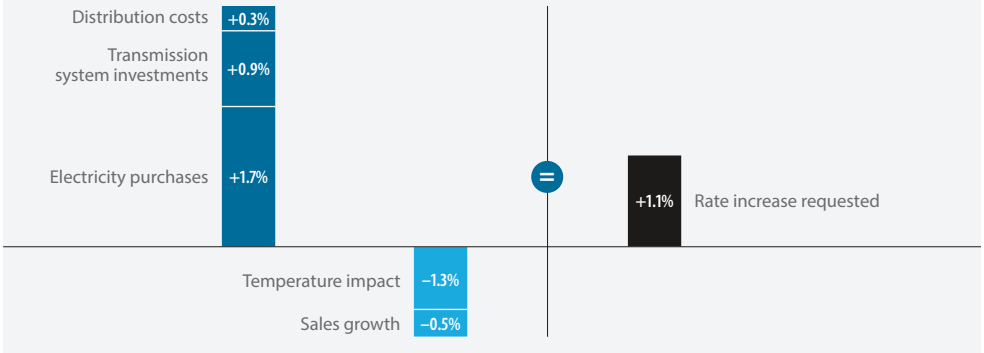
Hydro-Québec Distribution depends on various sources to supply the Québec market, mainly the heritage pool of 165 TWh, which it purchases from Hydro-Québec Production. It also issues short- and long-term calls for tenders.

For requirements of less than three months, the division may also buy electricity directly on the market, without tendering, under an authorization granted by the Régie de l'énergie. For unforeseen needs that cannot be met otherwise, it relies on a framework agreement with Hydro-Québec Production that covers the period from January 1, 2017, to December 31, 2019. The Régie de l'énergie approved this agreement in September 2016.

In October 2017, Hydro-Québec Distribution filed a first progress report on the Electricity Supply Plan 2017–2026 with the Régie de l'énergie. This follow-up provided an updated demand forecast for the Québec market and outlined the events that have influenced supply planning and the division's actions since the plan was filed in November 2016.

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

2018–2019 Rate Adjustment Application



OPERATING RESULTS

Hydro-Québec Distribution recorded net income of $333 million in 2017. Excluding the $18 million payable to customers recognized under the earnings-sharing mechanism, the division's adjusted net income was $351 million, compared to $342 million in 2016. Revenue from electricity sales increased by $190 million on account of three main factors: lower temperatures in December 2017 than in December 2016; higher baseload demand; and the rate adjustments of April 1, 2016 and 2017. In addition, the change in the net amounts that Hydro-Québec is entitled to receive from customers or is required to pay to them in connection with temperatures had a positive impact of $50 million on other revenue. Electricity purchases, the related transmission costs and fuel purchases were $290 million higher because of an increase in supplies purchased from Hydro-Québec Production and from third parties, and transmission costs incurred with Hydro-Québec TransÉnergie were higher as well. Depreciation and amortization expense decreased by $27 million.

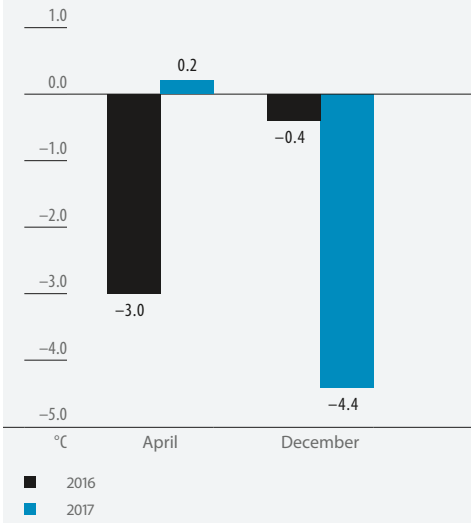
ELECTRICITY SALES IN QUÉBEC BY SEGMENT

	Sales volume			Sales revenue		
	2017	2017–2016 change		**2017**	2017–2016 change	
Market segment	TWh	TWh	%	$M	$M	%
Residential	**66.1**	1.0	1.5	**5,285**	130	2.5
Commercial, institutional and small industrial	**45.8**	0.3	0.7	**3,873**	31	0.8
Large industrial	**53.7**	0.1	0.2	**2,288**	23	1.0
Other	**5.1**	–	–	**317**	6	1.9
Total	**170.7**	1.4	0.8	**11,763**	190	1.6

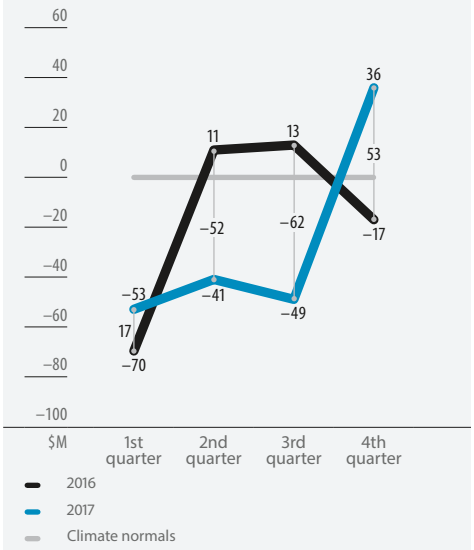
FACTORS IN THE 2017–2016 CHANGE IN SALES BY SEGMENT

	Volume effects							Price effects			**Total**
	Baseload demand		Temperatures		February 29		**Total**	Rate adjustments	Other	**Total**	
Market segment	TWh	$M	TWh	$M	TWh	$M	$M	$M	$M	$M	$M
Residential	0.8	73	0.5	45	(0.3)	(22)	**96**	38	(4)	**34**	**130**
Commercial, institutional and small industrial	0.4	30	0.1	7	(0.2)	(12)	**25**	26	(20)	**6**	**31**
Large industrial	0.2	19	–	–	(0.1)	(6)	**13**	2	8	**10**	**23**
Other	–	1	–	1	–	(1)	**1**	4	1	**5**	**6**
Total	1.4	123	0.6	53	(0.6)	(41)	**135**	70	(15)	**55**	**190**

Variances from Climate Normals—Montréal and Québec



Cumulative Impact of Temperatures Compared to Normals



ELECTRICITY SALES IN QUÉBEC

Electricity sales revenue reached $11,763 million, a $190-million increase over 2016 that was mainly due to temperature variances, higher baseload demand and the rate adjustments of April 1, 2016 and 2017.

Sales volume totaled 170.7 TWh, compared to 169.3 TWh in 2016, an increase of 1.4 TWh. First, temperature variances, most pronounced in April and December, led to a 0.6-TWh, or $53-million, increase in electricity sales. In 2016, April temperatures were 3°C below climate normals, giving rise to additional sales of $63 million, whereas they were closer to normal in 2017. Conversely, December temperatures were exceptionally cold in 2017, resulting in additional sales of $97 million. Second, baseload demand grew by 1.4 TWh, or $123 million, particularly in the residential segment, where it increased by 0.8 TWh, mainly because of the larger number of customer accounts. However, these factors were partly offset by the fact that 2016 was a leap year, and sales of 0.6 TWh, or $41 million, were made on February 29.

OTHER REVENUE

The change in the net amounts that Hydro-Québec is entitled to receive from customers or is required to pay to them, recognized as other revenue, was $15 million in 2017. This positive change results mainly from temperature variances net of amortization; that is, revenue variances related to climate conditions and electricity supply cost variances, which had an overall positive impact of $50 million in 2017 compared to 2016.

Moreover, 2017 was the first year of implementation of the earnings-sharing mechanism approved by the Régie de l'énergie, under which Hydro-Québec shares with customers the excess earnings realized during the year over and above the authorized rate of return. Hydro-Québec Distribution therefore recognized an amount of $18 million payable to customers.

ELECTRICITY PURCHASES, TRANSMISSION COSTS AND FUEL PURCHASES

Electricity purchases, the related transmission costs and fuel purchases increased by $290 million compared to 2016. Supplies from Hydro-Québec Production increased by $37 million under the combined effect of temperatures and the indexing of the heritage pool price in accordance with the *Act respecting the Régie de l'énergie*. Supplies from third parties rose by $154 million, on account of a $131-million, or 1.3-TWh, increase in wind power purchases, mainly due to the commissioning of three new wind farms at the end of 2016. Finally, native-load transmission costs incurred with Hydro-Québec TransÉnergie increased by $115 million.

DEPRECIATION AND AMORTIZATION

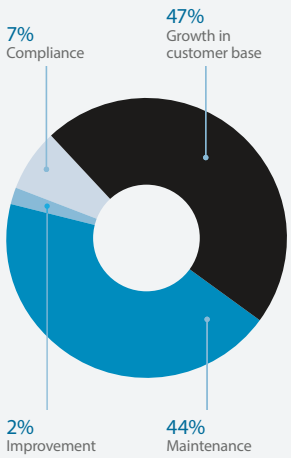
Depreciation and amortization expense totaled $752 million, compared to $779 million in 2016. This $27-million difference is mainly due to a reduction in the amounts recognized for asset retirement and a decrease in amortization of costs related to energy efficiency initiatives.

INVESTING ACTIVITIES

In 2017, Hydro-Québec Distribution's investments in property, plant and equipment and intangible assets totaled $650 million.

Of this amount, $305 million was allocated to handling growth in the Québec customer base, including $189 million for customer connections. The division also invested $283 million in asset sustainment.

Breakdown of 2017 Investments by Hydro-Québec Distribution



Construction

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

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

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

VOLUME OF ACTIVITY

Hydro-Québec Innovation, équipement et services partagés and SEBJ carried out projects worth a total of $2,480 million in 2017, compared to $2,225 million the previous year. The high volume is attributable to several large-scale projects. Work done for Hydro-Québec Production totaled $744 million, compared to $746 million in 2016, while work done for Hydro-Québec TransÉnergie totaled $1,671 million, compared to $1,419 million.

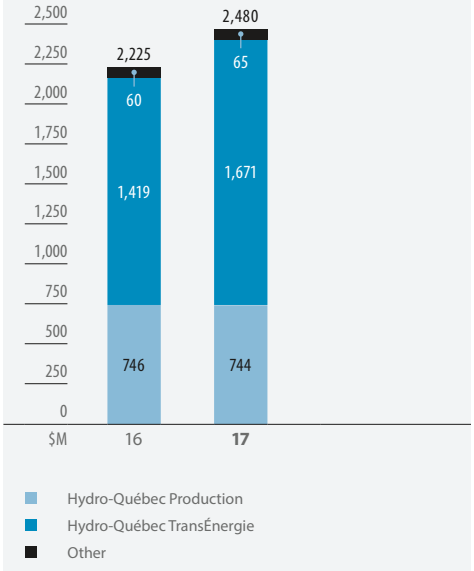
MAIN PROJECTS

In the area of power generation, Hydro-Québec Innovation, équipement et services partagés continued construction of the Romaine hydroelectric complex and refurbishment of the structures at Beauharnois generating station. The division also completed refurbishment of a unit at Robert-Bourassa generating station. For Hydro-Québec TransÉnergie, ongoing mandates included the connection of the Romaine complex, completing the construction of Romaine-3 substation and carrying on work at Montagnais substation and the future Romaine-4 substation. It also continued replacing transformers at Manicouagan substation, as well as rebuilding De Lorimier and Saint-Patrick substations and deploying related lines. Construction of Judith-Jasmin substation and the lines that will connect Chamouchouane substation to the Montréal metropolitan loop under the 735-kV Chamouchouane–Bout-de-l'Île project continued to advance as well. In the asset sustainment and reliability category, Hydro-Québec TransÉnergie completed the replacement of PK circuit breakers. Finally, the division worked on upgrading various facilities in the main transmission system while pursuing other projects to increase transmission system capacity.

2017 AT A GLANCE

Volume of activity	**$2.5B**
Main customers	
Hydro-Québec Production	**30%**
Hydro-Québec TransÉnergie	**67%**

Breakdown of Construction Segment Activities



1. The operations of the Direction principale – Institut de recherche d'Hydro Québec, Centre d'excellence en électrification des transports et en stockage d'énergie, Direction principale – Centre de services partagés and Direction principale – Approvisionnement stratégique are included under Corporate and Other Activities.

Corporate and Other Activities

The Corporate and Other Activities heading includes all corporate activities, as well as the Vice-présidence – Technologies de l'information et des communications, Vice-présidence – Développement des affaires, Direction principale – Centre de services partagés, Direction principale – Approvisionnement stratégique, Direction principale – Institut de recherche d'Hydro-Québec, and Centre d'excellence en électrification des transports et en stockage d'énergie.

RESULTS

Corporate and Other Activities recorded net income of $11 million in 2017.

CORPORATE ACTIVITIES

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

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

The Vice-présidence – Affaires corporatives et secrétariat général provides administrative support to the company's Board of Directors and the boards of Hydro-Québec subsidiaries. It also develops strategies and guidelines and provides advisory services in the areas of corporate affairs, ethics, access to information, governance, the environment and sustainable development, as well as document management.

The Vice-présidence – Affaires juridiques provides legal services, advice and opinions to Hydro-Québec and its subsidiaries. It negotiates, drafts and reviews the contracts and agreements they require in the course of their operations and protects their interests in business matters and disputes, including court cases and matters involving regulators such as the Régie de l'énergie.

The Vice-présidence – Communications et affaires gouvernementales develops strategies and provides support and advisory services in the areas of communications and public affairs, as well as relations with governments, communities and partner organizations. It is also tasked with monitoring Hydro-Québec's corporate image and reputation.

The Vice-présidence – Financement, trésorerie et caisse de retraite is in charge of meeting the company's financing requirements, managing its treasury and maintaining relations with Hydro-Québec bondholders and rating agencies. It also acts as trustee of Hydro-Québec's pension fund. In 2017, the pension fund's rate of return was 10.7%, driven in particular by the strong performance of the stock portfolio. Over the past 10 years, it has posted an average annual return of 7.6%, placing it in the first quartile of Canadian pension funds of comparable size. As at December 31, 2016, the date of the most recent actuarial valuation, the pension plan showed a funding surplus of $5.2 billion, which means that the assets held on that date were sufficient to cover future pension costs as well as the stabilization provision established under the requirements of the *Act to amend the Supplemental Pension Plans Act mainly with respect to the funding of defined benefit pension plans*. The pension plan's funding ratio was 129.1% at that time.

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

The Vice-présidence – Transformation, santé et sécurité is responsible for spearheading efforts to transform the corporate culture and improve performance, as well as overseeing occupational health and safety. In this regard, it develops strategies and objectives and provides advisory services pertaining to the prevention of absenteeism and occupational illness and accidents, and promotes measures and behaviors that help to ensure worker health and safety.

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

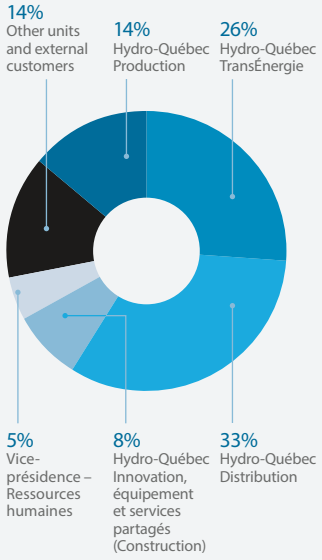
The mandate of the Vice-présidence – Technologies de l'information et des communications is to design, build, deploy, operate and evolve the company's information and telecommunications networks, systems, applications and infrastructure. With this in mind, it continues to implement an integrated vision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

In 2017, this unit posted revenue of $644 million, compared to $666 million in 2016.

INVESTING ACTIVITIES

In 2017, the investments made by the Vice-présidence – Technologies de l'information et des communications totaled $115 million and were allocated to maintaining asset quality.

Breakdown of 2017 Revenue: Vice-présidence – Technologies de l'information et des communications



VICE-PRÉSIDENCE – DÉVELOPPEMENT DES AFFAIRES

The mandate of the Vice-présidence – Développement des affaires is to prospect for business opportunities and act on them so that Hydro-Québec can not only increase its operating revenue and income from markets outside Québec, but also play a leading role in the global energy transition. In concrete terms, the unit is constantly on the lookout for potential international investments in the form of acquisitions, stakes or long-term partnerships that will leverage the company's expertise in hydroelectric generation and power transmission. In addition, it is actively involved in developing the company's export markets by highlighting the benefits of Québec hydropower and orchestrating the marketing of Hydro-Québec's technological innovations. Finally, it supports Hydro-Québec's initiatives in transportation electrification while piloting the expansion of the Electric Circuit in Québec and neighboring markets.

DIRECTION PRINCIPALE – INSTITUT DE RECHERCHE D'HYDRO-QUÉBEC

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

CENTRE D'EXCELLENCE EN ÉLECTRIFICATION DES TRANSPORTS ET EN STOCKAGE D'ÉNERGIE

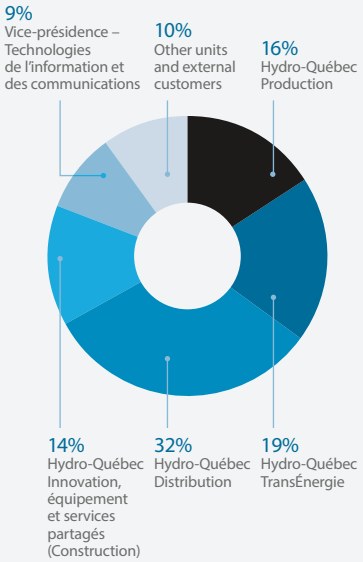
The Centre d'excellence en électrification des transports et en stockage d'énergie, which is part of Hydro-Québec Innovation, équipement et services partagés, was set up in 2017. It conducts research and development on battery materials.

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

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

The revenue of these two units totaled $480 million in 2017, compared to $481 million in 2016.

Breakdown of 2017 Revenue: Direction principale – Centre de services partagés and Direction principale – Approvisionnement stratégique



Outlook

In keeping with the objective stated in the *Strategic Plan 2016–2020*, Hydro-Québec is targeting net income of $2,475 million in 2018 despite a business environment that is more difficult than expected, mainly on account of lower energy prices on markets outside Québec and a reduction in electricity demand in Québec.

The company plans to invest on the order of $3.6 billion in 2018, most of which will be allocated to the operations of Hydro-Québec TransÉnergie ($1.8 billion) and Hydro-Québec Production ($1.0 billion). Almost 60% of Hydro-Québec's investments will be earmarked for facility maintenance and improvements. The remainder will go toward growth and development activities.

Hydro-Québec Production will continue its work on the Romaine complex jobsites in the course of developing Québec's hydroelectric potential. Three of the four generating stations in this major project, namely Romaine-2, Romaine-1 and Romaine-3, were commissioned in 2014, 2015 and 2017, respectively, and Romaine-4 should follow around 2020. At the same time, the division will continue investing to ensure the long-term operability of its facilities and optimize their output. For instance, refurbishment is under way at Robert-Bourassa and Beauharnois generating stations.

Hydro-Québec TransÉnergie will devote a large part of its investments to erecting transmission lines, in particular some 400 km of lines that will connect Chamouchouane substation to the Montréal metropolitan loop as part of the 735-kV Chamouchouane–Bout-de-l'Île project and the 120-kV Grand-Brûlé–Saint-Sauveur supply line. In addition, it will continue connecting wind farms built in response to Hydro-Québec Distribution's calls for tenders, working on Judith-Jasmin substation and connecting the Romaine complex as part of the project to expand the transmission system in the Minganie region. The division will also continue to invest in upgrading and modernizing its facilities to ensure the reliability and long-term operability of its transmission assets and enhance service quality. Some examples of this include the upgrading of transmission grid control systems and continued work on the architecture development plan for the 315-kV system on the island of Montréal.

Hydro-Québec Distribution will continue to deliver reliable power and high-quality services to all Québec customers. It will make further investments to handle the growth of the customer base and to maintain and improve the quality of its facilities. Its growth projects include connecting Judith-Jasmin substation, as well as the communities of La Romaine and Unamen Shipu, currently served by an off-grid system, to the distribution system.

Integrated Business Risk Management

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

The company's divisions and corporate units are central to the process. As part of their ongoing activities, they manage the risks to which they are exposed and reassess them on a regular basis, daily in some cases. In concrete terms, each division and corporate unit must identify and assess its main risks and then develop and apply mitigation measures to ensure that residual risks are at a level acceptable to Hydro-Québec. The divisions and corporate units report monthly on their risk management activities and follow-up to the Management Committee, which then acts as a risk management committee to provide overall monitoring of business risks. This approach makes it possible to create a consolidated portfolio of residual business risks during the annual planning process. The consolidated portfolio is presented to the Board of Directors with the Business Plan, which includes a sensitivity analysis indicating the impact of certain risks on projected net income.

INTEGRATED BUSINESS RISK MANAGEMENT PROCESS

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

a) Acting as the risk management committee with the President and Chief Executive Officer as Chief Risk Officer.

FINANCIAL RISKS

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

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

MARKET RISK

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

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

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

LIQUIDITY RISK

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with its financial liabilities. This type of risk may translate into difficulties accessing sources of financing for its investment program.

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

CREDIT RISK

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

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

REGULATORY RISKS

Hydro-Québec is exposed to regulatory risks because, under the *Act respecting the Régie de l'énergie*, its activities related to electricity transmission and distribution are regulated. The decisions handed down by the Régie may therefore affect the results of Hydro-Québec TransÉnergie and Hydro-Québec Distribution. The Act also stipulates that rates are determined on a basis that allows for recovery of the cost of service and provides a reasonable return on the rate base.

Various measures have been put in place to reduce the impact of regulatory risks on these two divisions' results. These measures include submitting complete and convincing files to the Régie de l'énergie and maintaining a constructive dialogue with the Régie and other intervenors, particularly in the context of work sessions.

OPERATIONAL RISKS

GENERATION

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

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

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

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

TRANSMISSION

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

Hydro-Québec TransÉnergie must provide adequate transmission capacity to supply Hydro-Québec Distribution and other customers, while also ensuring transmission system security and reliability. To do so, the division relies, among other things, on a transmission asset management model and on a process for optimal management of annual peak load.

DISTRIBUTION

The continuity of power distribution is the main risk to which Hydro-Québec Distribution is exposed. To maintain power quality, the division makes ongoing investments in its system to modernize and automate it and enhance its security. It also relies on vegetation control, the implementation of an asset maintenance program and a strategy for asset renewal, as well as compliance with applicable standards for overhead and underground systems. To reduce the length of service interruptions, the vast majority of which are caused by adverse weather conditions, the division has adopted new technologies for rapid detection of outages, remote management of certain incidents and faster service restoration.

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

CONSTRUCTION

One of the key risks that Hydro-Québec Innovation, équipement et services partagés must deal with is occupational health and safety in construction. In 2017, the division moved to increase jobsite safety, with the ambition of becoming a model in Québec. With this goal in mind, it reviewed all its practices, particularly concerning the prevention of serious or fatal accidents, and deployed an action plan at all its jobsites. This new approach led to the introduction of effective ways to identify and manage health and safety risks and will be monitored in 2018 and subsequent years.

Pressure on construction project costs is another risk to which the division is constantly exposed. This pressure is due to such factors as the rising cost of labor in the construction industry, higher prices for certain materials or products, and events that affect project schedules (late deliveries, poor quality, work stoppages).

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

Finally, trade agreements between Québec and Ontario and between Canada and the European Union may affect Hydro-Québec's procurement processes, particularly regarding security, confidentiality of information and how requirements are defined.

CORPORATE AND OTHER ACTIVITIES

HEALTH AND SAFETY

The safety of individuals (employees, suppliers and the public) and the security of the company's assets, including information and communication technologies (ICT), are key concerns for Hydro-Québec. To manage this issue, the company relies on a multidisciplinary team of experts who continuously monitor its facilities, anticipate and analyze threats, maintain a close watch on related risks, regularly assess the mitigation measures in place and deploy new strategies based on changes in the social and business environment as well as emerging trends in security. Hydro-Québec's security model is based on anticipation, detection, dissuasion, intervention and restoration. It is also rooted in an integrated security culture that relies on cooperation and awareness on the part of the company's managers, employees and internal and external partners.

Hydro-Québec has also always maintained high occupational health and safety standards. However, certain recent events and the results of an analysis of its health and safety practices conducted by a consulting firm in 2017 revealed areas for improvement that led the company to review its procedures and strive to do more than simply apply the standards in effect, both on jobsites and throughout the company.

To ensure more proactive management in this area, Hydro-Québec launched concrete initiatives that will continue over the coming years. These initiatives are intended to build a health and safety culture based on the engagement and accountability of all the company's units and stakeholders, sound behaviors and shared values, unifying leadership and increased manager presence on the ground, and improving the company's ability to identify risks, implement effective means of control and learn from any health and safety–related incidents.

The protection of information, ICT systems and intellectual property is another major issue. The creation, in 2016, of a corporate ICT security monitoring center enabled Hydro-Québec to improve its capacity and fine-tune its methods for monitoring and detecting malicious behavior directed at the power system or at corporate systems and information.

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

BUSINESS DEVELOPMENT AND INVESTMENT OUTSIDE QUÉBEC

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

ENVIRONMENT

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

MANAGEMENT'S REPORT ON FINANCIAL INFORMATION

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

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

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

The 2017 and 2016 consolidated financial statements have been audited jointly by the Auditor General of Québec, KPMG LLP and Ernst & Young LLP.

/s/ Michael D. Penner
Chairman of the Board

/s/ Éric Martel
President and Chief Executive Officer

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

Montréal, Québec
February 16, 2018

INDEPENDENT AUDITORS' REPORT

To the Minister of Finance of Québec:

REPORT ON CONSOLIDATED FINANCIAL STATEMENTS

We have audited the accompanying consolidated financial statements of Hydro-Québec, which comprise the consolidated balance sheets as at December 31, 2017 and 2016, the consolidated statements of operations, comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

MANAGEMENT'S RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

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

AUDITORS' RESPONSIBILITY

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

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

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

OPINION

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Hydro-Québec as at December 31, 2017 and 2016, and its consolidated results of operations and its consolidated cash flows for the years then ended in accordance with United States generally accepted accounting principles.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the *Auditor General Act* (CQLR, c. V-5.01), we report that, in our opinion, except for the changes in accounting policies described in Note 2 to the consolidated financial statements, these principles have been applied for the year ended December 31, 2017, on a basis consistent with the previous year.

/s/ KPMG LLP[1]

/s/ Ernst & Young LLP[2]

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

Montréal, Québec
February 16, 2018

1. FCPA auditor, FCA, public accountancy permit No. A110618
2. CPA auditor, CA, public accountancy permit No. A129122

CONSOLIDATED STATEMENTS OF OPERATIONS

Years ended December 31 In millions of Canadian dollars	Notes	2017	2016
Revenue		**13,468**	13,339
Expenditure			
Operations		**2,664**	2,671
Other components of employee future benefit cost	2, 18	**(322)**	(233)
Electricity and fuel purchases		**2,005**	1,866
Depreciation and amortization	4	**2,686**	2,597
Taxes	5	**1,076**	1,045
		8,109	7,946
Income before financial expenses		**5,359**	5,393
Financial expenses	6	**2,513**	2,532
Net income		**2,846**	2,861

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years ended December 31 In millions of Canadian dollars	Notes	2017	2016
Net income		**2,846**	2,861
Other comprehensive income	16		
Net change in items designated as cash flow hedges	15	**(271)**	(368)
Net change in employee future benefits	18	**(387)**	(121)
Translation differences in financial statements of foreign operations		**(2)**	3
		(660)	(486)
Comprehensive income		**2,186**	2,375

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	2017	2016
ASSETS			
Current assets			
Cash and cash equivalents		**537**	1,243
Short-term investments		**1,112**	2,184
Accounts receivable and other receivables	15	**2,486**	2,049
Derivative instruments	15	**69**	100
Regulatory assets	3	**124**	123
Materials, fuel and supplies		**228**	219
		4,556	5,918
Property, plant and equipment	7	**63,990**	62,691
Intangible assets	8	**871**	938
Investments	9	**890**	884
Derivative instruments	15	**19**	284
Regulatory assets	3	**4,717**	4,237
Other assets	10	**687**	215
		75,730	75,167
LIABILITIES			
Current liabilities			
Borrowings		**8**	7
Accounts payable and accrued liabilities		**2,508**	2,199
Dividend payable	16	**2,135**	2,146
Accrued interest		**895**	894
Asset retirement obligations	11	**65**	86
Derivative instruments	15	**187**	152
Current portion of long-term debt	12	**1,183**	1,398
		6,981	6,882
Long-term debt	12	**43,825**	44,218
Asset retirement obligations	11	**799**	774
Derivative instruments	15	**22**	13
Regulatory liabilities	3	**366**	381
Other liabilities	13	**3,731**	2,902
Perpetual debt	14	**251**	293
		55,975	55,463
EQUITY	16		
Share capital		**4,374**	4,374
Retained earnings		**17,972**	17,261
Accumulated other comprehensive income		**(2,591)**	(1,931)
		19,755	19,704
		75,730	75,167
Commitments and contingencies	19		

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

On behalf of the Board of Directors,

/s/ Michelle Cormier
Chair of the Audit Committee

/s/ Michael D. Penner
Chairman of the Board

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

Years ended December 31 In millions of Canadian dollars	Note	Share capital	Retained earnings	Accumulated other comprehensive income	Total equity
Balance as at January 1, 2017		**4,374**	**17,261**	**(1,931)**	**19,704**
Net income		**–**	**2,846**	**–**	**2,846**
Other comprehensive income	16	**–**	**–**	**(660)**	**(660)**
Dividend	16	**–**	**(2,135)**	**–**	**(2,135)**
Balance as at December 31, 2017		**4,374**	**17,972**	**(2,591)**	**19,755**
Balance as at January 1, 2016		4,374	16,546	(1,445)	19,475
Net income		–	2,861	–	2,861
Other comprehensive income	16	–	–	(486)	(486)
Dividend	16	–	(2,146)	–	(2,146)
Balance as at December 31, 2016		4,374	17,261	(1,931)	19,704

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31 In millions of Canadian dollars	Notes	2017	2016
Operating activities			
Net income		**2,846**	2,861
Adjustments to determine net cash flows from operating activities			
Depreciation and amortization	4	**2,686**	2,597
Amortization of premiums, discounts and issue expenses related to debt securities		**190**	173
Deficit of net cost recognized with respect to amounts paid for employee future benefits		**(200)**	(146)
Other		**470**	299
Regulatory assets and liabilities		**(175)**	(301)
Change in non-cash working capital items	17	**(239)**	21
		5,578	5,504
Investing activities			
Additions to property, plant and equipment		**(3,647)**	(3,363)
Additions to intangible assets		**(107)**	(97)
Net change in short-term investments and sinking fund	10	**492**	(272)
Other		**15**	39
		(3,247)	(3,693)
Financing activities			
Issuance of long-term debt		**1,207**	2,011
Repayment of long-term debt		**(1,417)**	(1,927)
Cash receipts arising from credit risk management		**4,964**	10,312
Cash payments arising from credit risk management		**(5,596)**	(11,093)
Net change in borrowings		**(8)**	(6)
Dividend paid		**(2,146)**	(2,360)
Other		**(31)**	(137)
		(3,027)	(3,200)
Foreign currency effect on cash and cash equivalents		**(10)**	(16)
Net change in cash and cash equivalents		**(706)**	(1,405)
Cash and cash equivalents, beginning of year		**1,243**	2,648
Cash and cash equivalents, end of year		**537**	1,243
Supplementary cash flow information	17		

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

Years ended December 31, 2017 and 2016

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

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

Note 1 Significant Accounting Policies

Hydro-Québec's consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP").

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

Management has reviewed events occurring until February 16, 2018, the date of approval of these consolidated financial statements by the Board of Directors, to determine whether circumstances warranted consideration of events subsequent to the balance sheet date.

REGULATION

The *Act respecting the Régie de l'énergie* grants the Régie de l'énergie (the "Régie") exclusive authority to determine or modify the rates and conditions under which electricity is transmitted and distributed by Hydro-Québec. Hydro-Québec's electricity transmission and distribution activities in Québec are therefore regulated. Under this legislation, rates are set by reasoned decision of three commissioners after public hearings. Moreover, the Act stipulates that rates are determined on a basis that allows for recovery of the cost of service and provides a reasonable return on the rate base. Under an earnings-sharing mechanism applied since 2017, any return in excess of the authorized returns of the Transmission Provider and the Distributor is shared equally with customers for the first 100 basis points and is split 75/25 in their favor for any portion of the variance exceeding 100 basis points.

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

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

SCOPE OF CONSOLIDATION

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

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

USE OF ESTIMATES

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

REVENUE

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

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

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

FOREIGN CURRENCY TRANSLATION

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

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

FINANCIAL INSTRUMENTS

CASH AND CASH EQUIVALENTS

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

SHORT-TERM INVESTMENTS

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

RECEIVABLES – ACCOUNTS RECEIVABLE

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

OTHER RECEIVABLES AND FINANCIAL LIABILITIES

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

DERIVATIVE INSTRUMENTS

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

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

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

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

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

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

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

FAIR VALUE

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

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

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

MATERIALS, FUEL AND SUPPLIES

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

PROPERTY, PLANT AND EQUIPMENT

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

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

Hydraulic generation	40–120 years
Thermal generation	15–50 years
Transmission substations and lines	30–85 years
Distribution substations and lines	25–70 years
Other property, plant and equipment	5–50 years

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

Maintenance and repair costs are recognized in results when incurred.

LEASES

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

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

INTANGIBLE ASSETS

Intangible assets are recognized at cost.

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

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

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

Software and licences	3–10 years
Patents	20 years

CAPITALIZED FINANCIAL EXPENSES

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

IMPAIRMENT OF LONG-LIVED ASSETS

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

EMPLOYEE FUTURE BENEFITS

Hydro-Québec offers all its employees a contributory defined-benefit pension plan based on final pay (the "Pension Plan"), as well as other post-retirement benefits and post-employment benefits (collectively, the "Other plans").

PENSION PLAN AND OTHER POST-RETIREMENT BENEFITS

Hydro-Québec accounts for its obligations under the Pension Plan and other post-retirement benefits after deducting the fair value of their respective assets.

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

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

- Discount rates used are based on the interest rate curve on the measurement date, namely December 31, of high-quality Canadian corporate bonds and take into account the amount and different payment maturity dates of the projected benefit obligations for each plan.
- Actuarial gains and losses are initially recognized in Other comprehensive income. Thereafter, amortization of actuarial gains or losses is recognized under Other components of employee future benefit cost if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the value of the projected benefit obligations or 10% of the market-related value of the plan assets, whichever is greater. The amortization corresponds to the excess divided by active employees' average remaining years of service.

- Past service costs (credits) arising from amendments to the Pension Plan and other post-retirement benefits are initially recognized in Other comprehensive income, and thereafter are amortized under Other components of employee future benefit cost using the straight-line method over periods not exceeding active employees' average remaining years of service.
- The expected return on Pension Plan assets is based on a market-related value determined by using a five-year moving average value for equity securities and by measuring other asset classes at fair value.

The current service cost component of net plan costs for the year is recognized under Operational expenditure, net of the amount capitalized in assets.

Interest on obligations, expected return on plan assets, amortization of net actuarial loss and amortization of past service costs (credits) are recognized under Other components of employee future benefit cost. Since January 1, 2017, these components are no longer capitalized in assets.

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

POST-EMPLOYMENT BENEFITS

Post-employment benefits include, in particular, a long-term disability plan that provides for the payment of long-term defined benefits.

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

ASSET RETIREMENT OBLIGATIONS

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

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

AGREEMENTS WITH LOCAL COMMUNITIES

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

RELATED PARTY TRANSACTIONS

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

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

Note 2 Changes to Accounting Policies

RECENT CHANGES

EMPLOYEE FUTURE BENEFITS

On January 1, 2017, Hydro-Québec early adopted Accounting Standards Update (ASU) 2017-07, *Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, as issued by the Financial Accounting Standards Board (the "FASB"). This ASU states that current service cost is the only component of net employee future benefit cost that is eligible for capitalization in assets and can be presented in Operational expenditure.

ASU 2017-07 was applied prospectively for the capitalization of related costs in assets. For 2017, this amendment resulted in a $98-million increase in property, plant and equipment, offset by a $45-million increase in net income and a $53-million increase in financial liabilities related to rate-regulated activities.

The ASU was applied on a modified retrospective basis for the separate presentation of the other components of employee future benefit cost in the consolidated statements of operations. Using the allowed practical expedient, Hydro-Québec applied the amounts disclosed in the "Employee Future Benefits" note to the 2016 consolidated financial statements for the restatement of comparative information. For 2017, $(322) million is presented in Other components of employee future benefit cost. For 2016, the new presentation led to the reclassification of $(233) million from Operational expenditure to Other components of employee future benefit cost.

INVESTMENTS

On January 1, 2017, Hydro-Québec adopted ASU 2016-07, *Investments—Equity Method and Joint Ventures (Topic 323): Simplifying the Transition to the Equity Method of Accounting*, as issued by the FASB. This ASU simplifies the application of the equity method of accounting in the case where a reporting entity increases its level of investment in another entity or its degree of influence over such an entity. It was applied prospectively and has not had any impact on Hydro-Québec's consolidated financial statements.

STANDARDS ISSUED BUT NOT YET ADOPTED

HEDGE ACCOUNTING

In August 2017, the FASB issued ASU 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. This ASU amends the requirements related to hedging relationships in order to simplify the application of hedge accounting and to improve the transparency of information provided in the financial statements regarding an entity's risk management activities. It will be applied on a modified retrospective basis to interim and annual financial statements for annual periods beginning on or after January 1, 2019, and will be early adopted by Hydro-Québec on January 1, 2018, but will not have any significant impact on its consolidated financial statements.

STATEMENT OF CASH FLOWS

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

LEASES

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

FINANCIAL INSTRUMENTS

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

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*. This ASU provides new guidance on the impairment of financial assets that are not accounted for at fair value through net income. It will be applied on a modified retrospective basis to the consolidated financial statements for annual periods beginning on or after January 1, 2021. Hydro-Québec is currently examining the impact of this ASU on its consolidated financial statements.

REVENUE

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU provides guidance on the recognition of revenue at the time that goods or services are transferred to a client, for an amount that reflects the payment which the entity expects to receive in exchange for the goods or services.

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

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

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

These ASUs will apply on a modified retrospective basis to consolidated financial statements for annual periods beginning on or after January 1, 2018. Hydro-Québec is completing its analysis and, to date, has not identified any significant impact on its consolidated financial statements.

Note 3 Regulation

RATES

TRANSMISSION

Hydro-Québec's power transmission rates for 2017 and 2016 were determined in Régie decisions D-2017-049 and D-2016-046, effective January 1, 2017, and January 1, 2016, respectively. The authorized return on the rate base was set at 6.80% in 2017 and 6.85% in 2016, assuming a capitalization with 30% equity.

DISTRIBUTION

Hydro-Québec's electricity rates for the rate years beginning on April 1, 2017, and April 1, 2016, respectively, were determined in decisions D-2017-034 and D-2016-047, in which the Régie authorized increases of 0.7% for all rates except Rate L, for which an increase of 0.2% was authorized in 2017, but which remained unchanged in 2016. The authorized return on the rate base was set at 6.90% in 2017 and 6.95% in 2016, assuming a capitalization with 35% equity.

CHANGEOVER TO U.S. GAAP

In decisions D-2015-189 and D-2016-003, the Régie authorized changes, effective July 10, 2015, to accounting policies applied by the Transmission Provider and the Distributor for rate-setting purposes, given the application of U.S. GAAP to Hydro-Québec's rate-regulated power transmission and distribution activities as of that date.

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

REGULATORY ASSETS

COSTS RELATED TO ENERGY EFFICIENCY INITIATIVES

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

COSTS RELATED TO A SUSPENSION AGREEMENT

The Régie authorized an agreement regarding the temporary suspension of deliveries from a generating station in 2014. The offsetting entry for the financial liability recorded for this agreement was recognized as a non-interest-bearing regulatory asset, and the adjustments related to subsequent changes in this liability are also recognized in this asset. The costs related to the suspension agreement are recovered in the rates on an annual basis, according to the amounts billed. This accounting practice was authorized by the Régie in decision D-2014-086, which relates to Hydro-Québec's power distribution activities. In decision D-2016-105, the Régie revoked decisions D-2015-179 and D-2016-069, under which it had approved an agreement regarding use of the generating station during peak demand periods.

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

The eligible expenses incurred as of April 11, 2016, as part of the project involving the replacement of PK type circuit breakers are recognized as a regulatory asset and amortized over a five-year period in accordance with the terms established by the Régie. These expenses bear interest at the rates prescribed by the Régie. This accounting practice was authorized by the Régie in decisions D-2016-077, D-2016-174 and D-2017-021, which relate to Hydro-Québec's power transmission activities.

DEVELOPMENT COSTS

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

EMPLOYEE FUTURE BENEFITS

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

REGULATORY ASSETS

	Expected years of amortization	**2017**	2016
Costs related to energy efficiency initiatives	2018–2027	**572**	684
Costs related to a suspension agreement	2018–2021	**482**	482
Costs related to the project involving the replacement of PK type circuit breakers	2018–2021	**99**	51
Development costs	2018–2022	**16**	16
Employee future benefits	As of 2018	**3,667**	3,122
Other	2018–2047	**5**	5
		4,841	4,360
Current regulatory assets		**124**	123
Long-term regulatory assets		**4,717**	4,237

REGULATORY LIABILITIES

DEPRECIATION OF PROPERTY, PLANT AND EQUIPMENT

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

PAST SERVICE COSTS UNDER THE PENSION PLAN

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

REGULATORY LIABILITIES

	Expected years of amortization	**2017**	2016
Depreciation of property, plant and equipment	2018–2115	**351**	361
Past service costs under the Pension Plan	2018–2022	**15**	20
Long-term regulatory liabilities		**366**	381

Regulatory assets and liabilities are not included in the rate base, except in the case of costs related to energy efficiency initiatives and development costs.

RISKS AND UNCERTAINTIES

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

OTHER REGULATORY PRACTICES

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

In decisions D-2002-95 and D-2004-47, the Régie prescribed capitalizing financial expenses in property, plant and equipment under construction related to rate-regulated activities, according to the authorized rates of return on the rate bases. Set using methods approved by the Régie, these rates take into account a component associated with the cost of the debt and a component associated with the return on equity. The component associated with return on equity totaled $53 million in 2017 and $49 million in 2016.

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

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

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

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

FINANCIAL ASSETS AND LIABILITIES

	Note	**2017**	2016
Variances in electricity supply costs		**(40)**	(20)
Revenue variances related to climate conditions		**(1)**	176
Variances in pension cost		**(38)**	(45)
Variances in the expense related to the activities of Transition énergétique Québec		**–**	19
Earnings variances to be shared with customers		**(45)**	–
Variances related to amendments to ASC 715, *Compensation—Retirement Benefits*		**(42)**	–
Other		**14**	32
		(152)	162
Presented as follows:			
Accounts receivable and other receivables		**–**	29
Other assets	10	**–**	133
Accounts payable and accrued liabilities		**(69)**	–
Other liabilities		**(83)**	–

Financial assets and liabilities are not included in the rate base.

Note 4 Depreciation and Amortization

	2017	2016
Property, plant and equipment	**2,226**	2,209
Intangible assets[a]	**175**	178
Regulatory assets and liabilities	**176**	120
Retirement of capital assets	**109**	90
	2,686	2,597

a) For the period from 2018 to 2022, amortization of intangible assets that have already been recognized should be as follows: $109 million in 2018, $77 million in 2019, $49 million in 2020, $29 million in 2021 and $12 million in 2022.

Note 5 Taxes

	2017	2016
Water-power royalties[a]	**701**	673
Public utilities tax[b]	**284**	284
Municipal, school and other taxes[c]	**91**	88
	1,076	1,045

a) Water-power royalties payable to the Québec government totaled $695 million in 2017 ($667 million in 2016), including a balance due of $83 million as at December 31, 2017 ($68 million as at December 31, 2016).

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

c) Including two amounts payable to the Québec government in 2017, namely $36 million under the *Act respecting Transition énergétique Québec* ($36 million under the *Act respecting energy efficiency and innovation* in 2016), of which no balance was outstanding as at December 31, 2017 and 2016, and $15 million under the *Act to establish the Northern Plan Fund* ($15 million in 2016), which was outstanding as at December 31, 2017 and 2016.

Note 6 Financial Expenses

	2017	2016
Interest on debt securities	**2,532**	2,510
Net exchange loss	**10**	32
Guarantee fees related to debt securities[a]	**217**	218
	2,759	2,760
Less		
Capitalized financial expenses	**203**	194
Net investment income	**43**	34
	246	228
	2,513	2,532

a) Guarantee fees related to debt securities are charged at a rate of 0.5% and are paid to the Québec government.

Note 7 Property, Plant and Equipment

	2017			
	In service	Accumulated depreciation	Under construction	Net carrying amount
Generation				
Hydraulic	47,957	18,154	917	**30,720**
Thermal	380	368	4	**16**
Other	827	494	19	**352**
	49,164	19,016	940	**31,088**
Transmission				
Substations and lines	31,587	12,172	1,699	**21,114**
Other	2,557	1,485	98	**1,170**
	34,144	13,657	1,797	**22,284**
Distribution				
Substations and lines	14,612	6,760	361	**8,213**
Other	3,490	1,822	100	**1,768**
	18,102	8,582	461	**9,981**
Construction	43	23	2	**22**
Corporate and Other Activities	1,332	845	128	**615**
	102,785[a]	42,123[a]	3,328	**63,990**

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

a) As at December 31, 2017, the cost and accumulated depreciation of property, plant and equipment in service under capital leases amounted to $896 million and $205 million, respectively ($885 million and $163 million as at December 31, 2016).

Note 8 Intangible Assets

	2017			2016		
	Cost	Accumulated amortization	Net carrying amount	Cost	Accumulated amortization	Net carrying amount
Subject to amortization						
Software and licences	1,944	1,553	**391**	1,897	1,421	476
Patents	28	18	**10**	26	17	9
	1,972	1,571	**401**	1,923	1,438	485
Not subject to amortization						
Servitudes			**457**			442
Rights			**13**			11
			470			453
			871			938

Additions corresponding to internally developed software totaled $87 million in 2017 ($81 million in 2016).

Note 9 Investments

	2017	2016
At equity		
Churchill Falls (Labrador) Corporation Limited (34.2%)	**264**	249
Société en commandite Hydroélectrique Manicouagan (60.0%)[a]	**601**	613
	865	862
Other	**25**	22
	890	884

a) This investment includes the unamortized excess of the purchase price over the underlying net carrying amount of the assets of Société en commandite Hydroélectrique Manicouagan as at the acquisition date, which is composed of unamortizable intangible assets of $282 million and amortizable assets of $252 million as at December 31, 2017 (respectively, $282 million and $262 million as at December 31, 2016).

In 2017, electricity purchases from Churchill Falls (Labrador) Corporation Limited [CF(L)Co] and Société en commandite Hydroélectrique Manicouagan totaled $96 million and $81 million, respectively ($103 million and $81 million in 2016).

Note 10 Other Assets

	Note	2017	2016
Sinking fund[a]	12	**605**	–
Government reimbursement for the 1998 ice storm[b]		**66**	66
Receivables[c]		**–**	133
Other		**16**	16
		687	215

a) The sinking fund consists of bonds issued by the Québec government and allocated to repaying the long-term debt. As at December 31, 2017, it was composed of long-term bonds in the amount of $605 million (nil as at December 31, 2016), which replaced short-term investments during the year, as well as an amount of $126 million presented in Short-term investments ($729 million as at December 31, 2016).The long-term bonds, which mature in 2026, have an effective rate of 2.50%.

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

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

Note 11 Asset Retirement Obligations

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

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

				2017
	Dismantling of Gentilly-2 facilities[a]	Removal of spent nuclear fuel[a]	Dismantling of other assets	Total
Balance, beginning of year	468	248	144	**860**
Liabilities incurred	–	–	14	**14**
Accretion expense	25	15	4	**44**
Liabilities settled	(30)	(2)	(24)	**(56)**
Revision of estimated cash flows and expected timing of payments	–	–	2	**2**
Balance, end of year	463	261	140	**864**
Less				
Current portion	41	8	16	**65**
	422	253	124	**799**

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

a) The Canadian Nuclear Safety Commission approved a consolidated financial guarantee of $835 million to secure performance of Hydro-Québec's obligations with regard to the cost of dismantling the Gentilly-2 facilities and the removal of spent nuclear fuel. The Québec government provided an irrevocable financial guarantee of up to $685 million to that effect, and the balance will be obtained from investments held by the Hydro-Québec Trust for Management of Nuclear Fuel Waste.

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

%	Dismantling of Gentilly-2 facilities	Removal of spent nuclear fuel	Dismantling of other assets
Initial recognition of obligations	6.4	6.4	Between 1.1 and 6.4
Subsequent recognition of obligations	Between 4.3 and 5.7	Between 3.6 and 5.7	Between 0.8 and 4.6

HYDRO-QUÉBEC TRUST FOR MANAGEMENT OF NUCLEAR FUEL WASTE

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

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

Hydro-Québec has made all the payments required under the NFWA. As at December 31, 2017, the investments held in the Hydro-Québec trust fund were composed of debt securities issued by Hydro-Québec, the fair value of which totaled $163 million ($161 million as at December 31, 2016).

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

Note 12 Long-Term Debt

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

	2017				2016			
			At time of issue	At time of repayment			At time of issue	At time of repayment
	In Canadian dollars and other currencies	At closing exchange rates as at the balance sheet date	%	%	In Canadian dollars and other currencies	At closing exchange rates as at the balance sheet date	%	%
Canadian dollars[a, b]	37,607	**37,607**	**84**	**100**	36,232	36,232	80	100
U.S. dollars	5,704	**7,142**	**16**	**–**	6,701	9,000	20	–
Yen	–	**–**	**–**	**–**	1,000	12	–	–
		44,749	**100**	**100**		45,244	100	100
Plus								
Adjustment for fair value hedged risk		**259**				372		
		45,008				45,616		
Less								
Current portion		**1,183**				1,398		
		43,825				44,218		

a) Including non-interest-bearing debts other than bonds and medium-term notes whose present value was $1,482 million as at December 31, 2017 ($1,466 million as at December 31, 2016).

b) Certain debts carry sinking fund requirements. This fund, presented in Short-term investments and Other assets, totaled $731 million as at December 31, 2017 ($729 million as at December 31, 2016).

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

2018	1,183
2019	3,146
2020	2,602
2021	2,297
2022	3,283

INTEREST RATES

The following table presents interest rates on bonds and medium-term notes, which take into account contractual rates, premiums, discounts and issue expenses, as well as the effect of forward contracts and swaps traded to manage long-term risks related to debt. As at December 31, 2017, the variable rate portion of the bonds and notes totaled 12.0% (15.2% as at December 31, 2016).

%			2017	2016
Maturity	Canadian dollars	U.S. dollars	Weighted average	Weighted average
1–5 years	8.03	9.06	**8.29**	7.09
6–10 years	4.51	8.34	**8.24**	8.53
11–15 years	3.74	9.91	**7.62**	7.61
16–20 years	5.63	–	**5.63**	5.59
21–25 years	5.11	–	**5.11**	5.11
26–30 years	4.89	–	**4.89**	4.89
31–35 years	4.47	–	**4.47**	4.47
36–40 years	3.46	–	**3.46**	3.98
41–45 years	6.53	–	**6.53**	6.53
Weighted average	4.93	9.25	**5.22**	5.35

CREDIT FACILITY AND LINES OF CREDIT

Hydro-Québec has an undrawn credit facility of US$2,000 million, including a US$750-million swing loan, which will expire in 2022. Any related debt securities will bear interest at a rate based on the London Interbank Offered Rate (LIBOR), except for the swing loan, which is at the U.S. base rate. Hydro-Québec also has access to operating lines of credit, which are renewed automatically in the absence of notice to the contrary and bear interest at the prime rate. As at December 31, 2017, the available balances on these lines of credit were US$200 million and $243 million in Canadian or U.S. dollars (US$200 million and $232 million in Canadian or U.S. dollars as at December 31, 2016).

Note 13 Other Liabilities

	Note	2017	2016
Employee future benefit liabilities	18	**3,127**	2,395
Accounts payable		**604**	507
		3,731	2,902

Accounts payable include a $358-million financial liability ($359 million as at December 31, 2016) related to an agreement regarding the temporary suspension of deliveries from a generating station, which was approved by the Régie in 2014. The current portion, presented under Accounts payable and accrued liabilities, totaled $124 million as at December 31, 2017 ($123 million as at December 31, 2016). This financial liability, including the current portion, represented a discounted amount of $482 million as at December 31, 2017 and 2016. It included an outstanding amount, payable in U.S. dollars, of $24 million (US$20 million) as at December 31, 2017 ($32 million, or US$24 million, as at December 31, 2016). As at December 31, 2017, the effective rate of this liability was 1.35% (1.22% as at December 31, 2016).

Note 14 Perpetual Debt

Perpetual notes in the amount of $251 million (US$201 million) as at December 31, 2017, and of $293 million (US$218 million) as at December 31, 2016, bear interest at LIBOR, plus 0.0625%, as calculated semiannually. As at December 31, 2017 and 2016, the rates applicable to the perpetual notes were 1.6% and 1.3%, respectively.

The perpetual notes are redeemable at Hydro-Québec's option. In 2017, portions totaling $23 million (US$17 million) were repurchased on the secondary market and then canceled ($10 million, or US$7 million, in 2016). Forward contracts are used to mitigate the currency risk associated with the perpetual debt.

Note 15 Financial Instruments

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

MARKET RISK

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

MANAGEMENT OF LONG-TERM RISK

MANAGEMENT OF RISK ASSOCIATED WITH DEBT

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

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

	2017[a]	2016[a]
Forward contracts		
Canadian dollars	**(70)**	–
U.S. dollars	**202**	1,223
Swaps		
Canadian dollars	**(6,938)**	(7,969)
U.S. dollars	**5,730**	5,730
Yen	**–**	1,000

a) Figures in parentheses represent amounts to be paid.

MANAGEMENT OF SHORT-TERM RISK

Currency risk – Hydro-Québec uses forward contracts to manage its foreign currency risk exposure over the short term. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact of currency risk hedging transactions on results is recognized in the line item affected by the hedged item, namely Revenue, Electricity and fuel purchases, or Financial expenses. In this context, Hydro-Québec has traded foreign currency sales contracts for which the notional amount of open positions as at December 31, 2017, totaled US$885 million (US$1,175 million as at December 31, 2016).

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

Price risk – Hydro-Québec uses mainly commodity futures and swaps to manage risk resulting from fluctuations in energy and aluminum prices. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact on results of transactions to hedge the risk related to energy and aluminum prices is recognized in the line item affected by the hedged item, namely Revenue or Electricity and fuel purchases. In this context, Hydro-Québec has traded electricity futures and swaps for which open positions as at December 31, 2017, totaled 22.5 TWh (19.9 TWh as at December 31, 2016), natural gas futures for which open positions as at December 31, 2017 and 2016, totaled 0.5 million MMBtu, petroleum product swaps for which there were no open positions as at December 31, 2017 (2.6 million litres as at December 31, 2016), as well as aluminum swaps for which open positions as at December 31, 2017, totaled 410,125 tonnes (254,050 tonnes as at December 31, 2016).

LIQUIDITY RISK

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with its financial liabilities.

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

Moreover, as at December 31, 2017, $42,942 million in long-term debt, perpetual debt and borrowings, net of the sinking fund, was guaranteed by the Québec government ($43,491 million as at December 31, 2016).

CREDIT RISK

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

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

ACCOUNTS RECEIVABLE AND OTHER RECEIVABLES

Exposure to credit risk from electricity sales is limited due to Hydro-Québec's large and diverse customer base. Management believes that Hydro-Québec is not exposed to a significant credit risk, particularly because sales in Québec are billed at rates that allow for recovery of costs based on the terms and conditions set by the Régie. Moreover, Hydro-Québec holds as collateral customer deposits totaling $124 million ($119 million as at December 31, 2016), of which $35 million ($32 million as at December 31, 2016) is recognized in Accounts payable and accrued liabilities and $89 million ($87 million as at December 31, 2016) in Other liabilities.

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

	2017	2016
Accounts receivable[a]	**2,030**	1,684
Other receivables[b]	**456**	365
	2,486[c]	2,049[c]

a) Including unbilled electricity deliveries, which totaled $1,496 million as at December 31, 2017 ($1,206 million as at December 31, 2016).

b) Including a $118-million financial guarantee ($104 million in 2016) covering certain derivative instruments held at year end.

c) Including US$284 million (US$159 million in 2016) translated at the exchange rate in effect at the balance sheet date.

The allowance for doubtful accounts amounted to $239 million as at December 31, 2017 ($250 million as at December 31, 2016).

OTHER FINANCIAL ASSETS

In order to reduce its exposure to credit risk associated with cash and cash equivalents, short-term investments, the sinking fund and derivative instruments, Hydro-Québec deals with a number of issuers and financial institutions with high credit ratings, most of which are Canadian. In addition, it applies policies to limit risk concentration as well as various monitoring programs and sets credit limits for each counterparty. Through prior agreements, it can also limit the market value of the main derivative instrument portfolios. Any variation in market value beyond the agreed-upon limit results in a cash receipt or payment. As at December 31, 2017, substantially all counterparties dealing with Hydro-Québec had a credit rating of A or higher, and none of them had defaulted on their obligations to Hydro-Québec.

FAIR VALUE

FAIR VALUE OF DERIVATIVE INSTRUMENTS

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

	2017			
	Derivatives designated as fair value hedges	Derivatives designated as cash flow hedges	Derivatives not designated as hedges[a]	Gross amounts of derivatives recognized[b]
Assets				
Contracts – Currency risk	–	769	51	**820**
Contracts – Currency risk and interest rate risk	–	–	–	**–**
Contracts – Interest rate risk	420	3	2	**425**
Contracts – Price risk	–	8	61	**69**
	420	780	114	**1,314**
Liabilities				
Contracts – Currency risk	–	(266)	(251)	**(517)**
Contracts – Currency risk and interest rate risk	–	–	–	**–**
Contracts – Interest rate risk	–	–	–	**–**
Contracts – Price risk	–	(267)	(24)	**(291)**
	–	(533)	(275)	**(808)**
Total	420	247	(161)	**506**

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

a) These derivative instruments are mainly traded as part of Hydro-Québec's risk management. As at December 31, 2017, $(210) million was in consideration of amounts received or disbursed [$(1,023) million as at December 31, 2016] with respect to agreements to limit the market value of the main portfolios of derivative instruments. These agreements arise from frameworks applied by Hydro-Québec to reduce its credit risk exposure and limit risk concentration.

b) Fair value measurements of derivative instruments are Level 2 measurements. These measurements are obtained by discounting future cash flows, which are estimated on the basis of the spot rates, forward rates or forward prices (foreign exchange rates, interest rates, and energy or aluminum prices) in effect on the balance sheet date and take into account the credit risk assessment. The valuation techniques make use of observable market data.

The impact of offsetting derivative instruments is presented in the table below:

	2017				2016			
	Gross amounts of derivatives recognized	Gross amounts offset[a]	Cash (received) paid as collateral[b]	Net amounts presented on the balance sheet	Gross amounts of derivatives recognized	Gross amounts offset[a]	Cash (received) paid as collateral[b]	Net amounts presented on the balance sheet
Assets								
Current	143	(68)	(6)	**69**	223	(110)	(13)	100
Long-term	1,171	(527)	(625)	**19**	1,740	(974)	(482)	284
	1,314	(595)	(631)	**88**	1,963	(1,084)	(495)	384
Liabilities								
Current	(509)	321	1	**(187)**	(1,091)	939	–	(152)
Long-term	(299)	274	3	**(22)**	(158)	145	–	(13)
	(808)	595	4	**(209)**	(1,249)	1,084	–	(165)
Total	506	–	(627)	**(121)**	714	–	(495)	219

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

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

Moreover, although certain derivatives cannot be offset for lack of enforceable master netting arrangements, margin calls may result in amounts received from or paid to clearing agents, based on the fair value of the instruments concerned. As at December 31, 2017, $111 million receivable from clearing agents in consideration of net cash payments was included in Accounts receivable and other receivables, under Current assets on the balance sheet ($27 million as at December 31, 2016). No amount payable to clearing agents in consideration of net cash receipts was included in Accounts payable and accrued liabilities, under Current liabilities on the balance sheet ($16 million as at December 31, 2016).

The impact of derivative instruments on results and other comprehensive income is presented in the tables below. It should be noted that most derivative instruments traded are designated as cash flow hedges or fair value hedges and therefore reduce the volatility of results, except for the ineffective portion of the hedges, which is insignificant.

Derivative instruments which are not designated as hedges, but which nonetheless provide an economic hedge for at-risk opposite positions, also reduce the volatility of results. The sensitivity of results is thus limited to net exposure to unhedged risks.

	2017				
	Losses (gains) on derivatives designated as fair value hedges	Losses (gains) on derivatives designated as cash flow hedges			Losses (gains) on derivatives not designated as hedges
	Recognized in results	Effective portion recognized in Other comprehensive income	Ineffective portion recognized in results	Effective portion reclassified from Other comprehensive income to results	Recognized in results
Contracts – Currency risk	–	473	(1)[a]	443[a]	29
Contracts – Interest rate risk	117	(6)	–	3[b]	(5)
Contracts – Price risk	–	177	10[c]	(73)[c]	(48)
	117[d]	**644**	**9**	**373**	**(24)**[e]
Impact of hedged items on results	**(113)**			**(373)**	**(36)**

	2016				
	Losses (gains) on derivatives designated as fair value hedges	Losses (gains) on derivatives designated as cash flow hedges			Losses (gains) on derivatives not designated as hedges
	Recognized in results	Effective portion recognized in Other comprehensive income	Ineffective portion recognized in results	Effective portion reclassified from Other comprehensive income to results	Recognized in results
Contracts – Currency risk	–	428	(1)[a]	272[a]	133
Contracts – Interest rate risk	32	–	–	3[b]	1
Contracts – Price risk	–	(177)	(4)[c]	(392)[c]	(47)
	32[d]	251	(5)	(117)	87[e]
Impact of hedged items on results	(32)			117	(126)

a) In 2017, $(70) million was recognized in Revenue ($13 million in 2016), and $512 million in Financial expenses ($258 million in 2016).

b) In 2017 and 2016, $3 million was recognized in Financial expenses.

c) In 2017, $(63) million was recognized in Revenue [$(396) million in 2016].

d) This amount, including the ineffective portion of $4 million in 2017 (nil in 2016), was recognized in Financial expenses.

e) These instruments are essentially related to integrated risk management transactions. The impact of these instruments on results is recognized in the line item affected by the managed risk. Therefore, in 2017, $(36) million was recognized in Revenue [$(49) million in 2016)], $(14) million in Electricity and fuel purchases [$(16) million in 2016] and $26 million in Financial expenses ($152 million in 2016).

In 2017 and 2016, Hydro-Québec did not reclassify any amounts from Accumulated other comprehensive income to results after having discontinued cash flow hedges.

As at December 31, 2017, Hydro-Québec estimated the net amount of losses presented in Accumulated other comprehensive income that would be reclassified to results in the next 12 months to be $203 million (net gain of $17 million as at December 31, 2016).

As at December 31, 2017 and 2016, the maximum period during which Hydro-Québec hedged its exposure to the variability of cash flows related to anticipated transactions was two years.

FAIR VALUE OF OTHER FINANCIAL INSTRUMENTS

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

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

	2017		2016	
	Carrying amount	Fair value	Carrying amount	Fair value
Long-term debt[a]	**45,008**	**61,271**	45,616	60,931
Perpetual debt	**251**	**204**	293	217

a) Including the current portion.

Note 16 Equity

SHARE CAPITAL

The authorized share capital consists of 50,000,000 shares with a par value of $100 each, of which 43,741,090 shares were issued and paid up as at December 31, 2017 and 2016.

RETAINED EARNINGS

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

For 2017, the dividend is $2,135 million ($2,146 million for 2016).

ACCUMULATED OTHER COMPREHENSIVE INCOME

				2017
	Cash flow hedges	Employee future benefits	Translation differences	Accumulated other comprehensive income
Balance, beginning of year	(135)	(1,799)	3	**(1,931)**
Other comprehensive income before reclassifications	(644)	(485)	(2)	**(1,131)**
Amounts reclassified to results	373	98	–	**471**
Other comprehensive income	(271)	(387)[a]	(2)	**(660)**
Balance, end of year	(406)	(2,186)	1	**(2,591)**

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

a) Other comprehensive income includes the change in the employee future benefit regulatory asset, which totaled $545 million in 2017 ($245 million in 2016).

Note 17 Supplementary Cash Flow Information

	2017	2016
Change in non-cash working capital items		
Accounts receivable and other receivables	**(461)**	182
Materials, fuel and supplies	**(9)**	(6)
Accounts payable and accrued liabilities	**271**	(96)
Accrued interest	**(40)**	(59)
	(239)	21
Investing activities not affecting cash		
Increase in property, plant and equipment	**77**	173
Interest paid	**2,084**	2,112

Note 18 Employee Future Benefits

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

The other post-retirement benefits are provided by group life, medical and hospitalization insurance plans, which are contributory plans with contributions adjusted annually.

Post-employment benefits are under non-contributory salary insurance plans, which pay short- and long-term disability benefits. Most of these plans are not funded, with the exception of the long-term disability plan, which is fully funded, and the supplementary group life insurance plan, which is partially funded.

All Hydro-Québec's plans are defined benefit plans. The projected benefit obligations of these plans, valued by independent actuaries, and their assets, at fair value, are valued as at December 31 of each year. The most recent actuarial valuation of the Pension Plan for funding purposes was as at December 31, 2016, at which date the plan was funded at 129.1%. The next valuation must be as at December 31, 2017.

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

	Pension Plan		Other plans	
	2017	2016	**2017**	2016
Projected benefit obligations				
Balance, beginning of year	**24,003**	23,126	**1,471**	1,420
Current service cost	**430**	424	**44**	45
Employee contributions	**179**	163	**–**	–
Benefit payments and refunds	**(999)**	(970)	**(72)**	(67)
Interest on obligations	**792**	766	**49**	48
Actuarial loss	**1,995**	494	**90**	25
Balance, end of year	**26,400**	24,003	**1,582**	1,471
Plan assets, at fair value				
Balance, beginning of year	**22,935**	22,243	**83**	72
Actual return on plan assets[a]	**2,316**	1,195	**–**	5
Employee contributions	**179**	163	**–**	–
Contributions by Hydro-Québec	**275**	304	**18**	18
Benefit payments and refunds	**(999)**	(970)	**(13)**	(12)
Balance, end of year	**24,706**	22,935	**88**	83
Funded status – Plan deficits	**1,694**	1,068	**1,494**	1,388
Presented as:				
Accounts payable and accrued liabilities	**–**	–	**61**	61
Other liabilities	**1,694**	1,068	**1,433**	1,327

a) Administrative and management expenses billed to the Pension Plan by Hydro-Québec amounted to $16 million in 2017 ($15 million in 2016).

As at December 31, 2017, accumulated benefit obligations under the Pension Plan totaled $24,706 million ($22,531 million as at December 31, 2016). Unlike projected benefit obligations, accumulated benefit obligations do not take into account the salary escalation rate assumption.

PENSION PLAN ASSETS

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

The target allocation of Pension Plan investments, as established by the Investment Policy in effect as at December 31, 2017, was as follows:

%	Target allocation
Fixed-income securities	35
Equities	50
Alternative investments[a]	15
	100

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

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

				2017				2016
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Short-term investments[a]	–	343	–	**343**	–	234	–	234
Bonds[a, b]	1,076	7,277	–	**8,353**	1,038	7,671	–	8,709
Listed shares	10,553	–	–	**10,553**	9,129	–	–	9,129
Real estate investments[a, c]	233	68	2,856	**3,157**	183	72	2,703	2,958
Private equity investments[d]	–	–	573	**573**	–	–	360	360
Hedge funds[e]	392	981	–	**1,373**	445	976	–	1,421
Derivatives[f]	(7)	22	–	**15**	(12)	(17)	–	(29)
	12,247	8,691	3,429	**24,367**	10,783	8,936	3,063	22,782
Other[g]				**245**				182
				24,612[h]				22,964[h]

a) The fair value of Level 2 short-term investments, bonds and real estate investments is essentially measured by discounting net future cash flows, based on the current market rate of return.
b) Pension Plan assets include securities issued by Hydro-Québec, as well as by the Québec government and some of its agencies, for a total of $846 million ($1,142 million in 2016).
c) The fair value of Level 3 real estate investments is measured by independent appraisers. The main method used to determine the fair value of these investments is discounting future cash flows. This method is based on observable and unobservable inputs, in particular the discount rate and future cash flows.
d) The fair value of private equity investments is measured by various techniques including future cash flow discounting or using data such as earnings multiples or the price of recent comparable transactions.
e) Hedge funds are measured at the values provided by the fund managers, which are determined on the basis of the fair value of the underlying investments or of the net asset value.
f) Level 2 derivatives are measured using the market closing prices of the underlying products or by discounting net future cash flows.
g) "Other" includes cash, as well as interest and dividends receivable.
h) The fair value of investments does not take into account the net amount of payables and receivables, which is a receivable of $94 million (payable of $29 million in 2016).

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

	2017			2016		
	Real estate investments	Private equity investments	Total	Real estate investments	Private equity investments	Total
Balance, beginning of year	2,703	360	**3,063**	2,474	234	2,708
Acquisitions and disposals	74	152	**226**	208	112	320
Realized net gains	6	2	**8**	6	3	9
Unrealized net gains	73	59	**132**	15	11	26
	153	213	**366**	229	126	355
Balance, end of year	2,856	573	**3,429**	2,703	360	3,063

In 2017 and 2016, there was no reclassification between Level 3 and Levels 1 and 2.

OTHER PLAN ASSETS

Other plan assets as at December 31, 2017, were composed of bonds issued by Hydro-Québec for a total of $83 million ($70 million as at December 31, 2016), as well as cash amounting to $5 million ($13 million as at December 31, 2016). Bonds are classified at Level 2 in the fair value hierarchy.

PLAN COSTS

NET COST COMPONENTS RECOGNIZED FOR THE YEAR

	Pension Plan		Other plans	
	2017	2016	**2017**	2016
Operational expenditure				
Current service cost	**430**	424	**44**	45
Other components of employee future benefit cost				
Interest on obligations	**792**	766	**49**	48
Expected return on plan assets	**(1,422)**	(1,337)	**(3)**	(3)
Amortization of net actuarial loss	**222**	247	**26**	26
Amortization of past service costs (credits)	**11**	16	**(5)**	(5)
Actuarial loss on long-term disability plan	**–**	–	**8**	9
	(397)	(308)	**75**	75
Net cost recognized for the year	**33**	116	**119**	120

COMPONENTS OF OTHER COMPREHENSIVE INCOME FOR THE YEAR

	Pension Plan		Other plans	
	2017	2016	**2017**	2016
Actuarial loss	**1,101**	636	**85**	14
Amortization of net actuarial loss	**(222)**	(247)	**(26)**	(26)
Amortization of past service (costs) credits	**(11)**	(16)	**5**	5
Total decrease (increase) in Other comprehensive income	**868**	373	**64**	(7)
Less				
Increase (decrease) in the employee future benefit regulatory asset	**509**	249	**36**	(4)
Net decrease (increase) in Other comprehensive income	**359**	124	**28**	(3)

COMPONENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME

	Pension Plan		Other plans	
	2017	2016	**2017**	2016
Unamortized net actuarial loss	**5,378**	4,499	**468**	409
Unamortized past service costs (credits)	**32**	43	**(25)**	(30)
Aggregate of amounts recognized in Accumulated other comprehensive income	**5,410**	4,542	**443**	379
Less				
Employee future benefit regulatory asset	**3,388**	2,879	**279**	243
Net amount recognized in Accumulated other comprehensive income	**2,022**	1,663	**164**	136

For 2018, the amortization of the net actuarial loss and the past service costs (credits) in the net cost recognized for the year should amount to $275 million and $7 million, respectively, for the Pension Plan, and to $30 million and $(4) million, respectively, for the Other plans.

SIGNIFICANT ACTUARIAL ASSUMPTIONS

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

	Pension Plan		Other plans	
	2017	2016	**2017**	2016
Projected benefit obligations				
Rate at end of year (%)				
Discount rate – Projected benefits	**3.42**	3.83	**3.43**	3.84
Salary escalation rate[a]	**3.10**	3.14	**–**	–
Net cost recognized				
Rate at end of prior year (%)				
Discount rate – Current service cost	**3.94**	4.00	**3.89**	4.00
Discount rate – Interest on obligations	**3.33**	3.34	**3.39**	3.41
Expected long-term rate of return on plan assets[b]	**6.50**	6.50	**3.37**	3.95
Salary escalation rate[a]	**3.14**	3.21	**–**	–
Active employees' average remaining years of service	**13**	13	**12**	12

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

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

As at December 31, 2017, health care costs were based on an annual growth rate of 4.50% for 2018. According to the assumption used, this rate will increase on a linear basis to reach 6.50% in 2021 and subsequently decrease to a final rate of 4.50% in 2036. A change of 1% in this annual growth rate would have had the following impact in 2017 and 2016:

	1% increase		1% decrease	
	2017	2016	**2017**	2016
Impact on current service cost and interest cost on projected benefit obligations for the year	**5**	9	**(3)**	(8)
Impact on projected benefit obligations at end of year	**121**	99	**(94)**	(78)

BENEFITS TO BE PAID IN NEXT 10 YEARS

	Pension Plan	Other plans
2018	1,042	68
2019	1,090	70
2020	1,138	72
2021	1,186	75
2022	1,245	77
2023–2027	7,109	426

In 2018, Hydro-Québec expects to make contributions of $270 million and $18 million, respectively, to the Pension Plan and the Other plans.

Note 19 Commitments and Contingencies

COMMITMENTS

ELECTRICITY PURCHASES

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

As at December 31, 2017, Hydro-Québec was also committed under contracts to purchase electricity from other power producers. Based on the renewal clauses, the terms of these contracts extend through 2052. Hydro-Québec had also undertaken to purchase power transmission rights.

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

2018	1,841
2019	1,888
2020	1,920
2021	1,955
2022	2,104
2023 and thereafter	28,454

INVESTMENTS

As part of its development projects and activities aimed at maintaining or improving the quality of its assets, Hydro-Québec plans to invest approximately $3.6 billion in property, plant and equipment and intangible assets per year in Québec over the 2018–2022 period.

CONTINGENCIES

GUARANTEES

In accordance with the terms and conditions of certain debt securities issued outside Canada, Hydro-Québec has undertaken to increase the amount of interest paid to non-residents in the event of changes to Canadian tax legislation governing the taxation of non-residents' income. Hydro-Québec cannot estimate the maximum amount it might have to pay under such circumstances. Should an amount become payable, Hydro-Québec has the option of redeeming most of the securities in question. As at December 31, 2017, the amortized cost of the long-term debts concerned was $3,289 million.

LITIGATION

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

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

As well, in November 2006 the Innus of Pessamit reactivated an action brought in 1998, aimed at obtaining, among other things, the recognition of ancestral rights related to Québec lands on which certain hydroelectric generating facilities of the Manic–Outardes complex are located. This community is claiming $500 million. Hydro-Québec is challenging the legitimacy of this claim. In 2015, the Superior Court granted a motion in which the Innus of Pessamit requested a stay of proceedings. In November 2017, the parties agreed on a new timetable for the resumption of proceedings, whereby the Innus of Pessamit have been granted a period of 18 months to have expert assessments prepared which they intend to file. A case management conference will then be convened.

Note 20 Segmented Information

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

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

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

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

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

Corporate and Other Activities: The corporate units help the business segments carry out their operations.

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

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

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

Most of Hydro-Québec's revenue is from Québec, and substantially all its property, plant and equipment are related to its Québec operations. In 2017, revenue from outside Québec amounted to $1,773 million, with $1,368 million originating from the United States ($1,771 million and $1,405 million, respectively, in 2016).

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

	2017						
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	1,790	10	11,621	1	46	–	**13,468**
Intersegment customers	4,726	3,297	80	2,479	1,711	(12,293)	**–**
Depreciation and amortization	805	998	752	4	127	–	**2,686**
Financial expenses	1,173	863	450	–	32	(5)	**2,513**
Net income	1,948	554	333	–	11	–	**2,846**
Total assets	32,944	22,494	13,639	39	6,768	(154)	**75,730**
Investments in property, plant and equipment and intangible assets affecting cash	963	1,971	650	13	157	–	**3,754**

	2016						
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	1,766	75	11,434	3	61	–	13,339
Intersegment customers	4,716	3,140	80	2,222	1,758	(11,916)	–
Depreciation and amortization	775	917	779	4	122	–	2,597
Financial expenses	1,205	839	460	–	33	(5)	2,532
Net income	1,870	561	342	1	87	–	2,861
Total assets	32,773	21,476	13,546	59	7,499	(186)	75,167
Investments in property, plant and equipment and intangible assets affecting cash	906	1,757	657	8	132	–	3,460

Note 21 Comparative Information

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

CONSOLIDATED FINANCIAL INFORMATION

$M	**2017**	2016	2015	2014	2013
OPERATIONS					
Revenue	**13,468**	13,339	13,754	13,652	12,878
Expenditure					
Operations	**2,664**	2,671	2,559	2,400	2,460
Other components of employee future benefit cost	**(322)**	(233)	(32)	(34)	–
Electricity and fuel purchases	**2,005**	1,866	1,938	1,968	1,568
Depreciation and amortization	**2,686**	2,597	2,713	2,593	2,483
Taxes	**1,076**	1,045	980	975	1,000
	8,109	7,946	8,158	7,902	7,511
Income before financial expenses	**5,359**	5,393	5,596	5,750	5,367
Financial expenses	**2,513**	2,532	2,449	2,425	2,429
Income from continuing operations	**2,846**	2,861	3,147	3,325	2,938
Income from discontinued operations	**–**	–	–	–	4
Net income	**2,846**	2,861	3,147	3,325	2,942
DIVIDEND	**2,135**	2,146	2,360	2,535	2,207
BALANCE SHEET SUMMARY					
Total assets	**75,730**	75,167	75,199	73,108	73,110
Long-term debt, including current portion and perpetual debt	**45,259**	45,909	45,983	44,752	44,477
Equity	**19,755**	19,704	19,475	17,961	19,394
INVESTMENTS FOR CONTINUING OPERATIONS AFFECTING CASH					
Property, plant and equipment and intangible assets	**3,754**	3,460	3,440	3,815	4,335[a]
FINANCIAL RATIOS					
Return on equity (%)[b]	**12.9**	13.4	15.3	16.6	15.0
Capitalization (%)[c]	**30.7**	30.5	30.1	28.9	30.5
Profit margin (%)[d]	**21.1**	21.4	22.9	24.4	22.8
Interest coverage[e]	**2.13**	2.16	2.20	2.23	2.09
Self-financing (%)[f]	**66.6**	58.8	82.8	56.4	68.3

a) Including the Energy Efficiency Plan.
b) Net income divided by average equity for the year less average accumulated other comprehensive income for the year.
c) Equity divided by the sum of equity, long-term debt, current portion of long-term debt, perpetual debt, borrowings and derivative instrument liabilities, less derivative instrument assets and sinking fund.
d) Net income divided by revenue.
e) Sum of income before financial expenses and net investment income divided by interest on debt securities.
f) Cash flows from operating activities less dividend paid, divided by the sum of cash flows from investing activities, excluding net change in short-term investments and sinking fund, and repayment of long-term debt.

Note: The data for 2017 to 2014 are presented according to U.S. GAAP, while the data for 2013 are presented according to Canadian GAAP, as published in the *Annual Report 2014*.

OPERATING STATISTICS

	2017	2016	2015	2014	2013
GWh					
Electricity sales					
In Québec, by segment					
Residential	**66,111**	65,065	66,558	68,074	65,983
Commercial, institutional and small industrial	**45,816**	45,483	45,335	45,189	44,620
Large industrial	**53,699**	53,635	54,200	55,738	56,855
Other	**5,077**	5,062	5,170	5,222	5,818
	170,703	169,245	171,263	174,223	173,276
Outside Québec					
Canada/U.S.	**34,935**	32,744	29,864	26,624	32,208
Total electricity sales	**205,638**	201,989	201,127	200,847	205,484
$M					
Revenue from electricity sales					
In Québec, by segment					
Residential	**5,285**	5,155	5,222	5,162	4,825
Commercial, institutional and small industrial	**3,873**	3,842	3,774	3,657	3,504
Large industrial	**2,288**	2,265	2,350	2,389	2,439
Other	**317**	311	316	308	317
	11,763	11,573	11,662	11,516	11,085
Outside Québec					
Canada/U.S.	**1,651**	1,626	1,700	1,629	1,525
Total revenue from electricity sales	**13,414**	13,199	13,362	13,145	12,610
As at December 31					
Number of customer accounts					
In Québec, by segment					
Residential	**3,958,300**	3,924,992	3,890,956	3,857,782	3,821,012
Commercial, institutional and small industrial	**316,430**	314,816	319,294	317,671	316,585
Large industrial	**184**	183	181	183	186
Other	**4,582**	4,550	4,290	4,214	4,207
Total customer accounts	**4,279,496**	4,244,541	4,214,721	4,179,850	4,141,990

OPERATING STATISTICS (CONTINUED)

	2017	2016	2015	2014	2013
MW					
Installed capacity					
Hydroelectric	**36,767**	36,366	36,370	36,100	35,364
Thermal	**542**	542	542	543	704
Total installed capacity	**37,309**[a]	36,908	36,912	36,643	36,068
GWh					
Total energy requirements[b]	**226,824**	223,143	222,172	222,045	226,576
MW					
Peak power demand in Québec[c]	**38,204**	36,797	37,349	38,743	39,031
km					
Lines (overhead and underground)					
Transmission	**34,479**[d]	34,292	34,272	34,187	33,885
Distribution	**224,033**	221,843	220,920	219,793	218,486
Total lines (overhead and underground)	**258,512**	256,135	255,192	253,980	252,371

a) In addition to the generating capacity of its own facilities, Hydro-Québec has access to almost all the output from Churchill Falls generating station (5,428 MW) under a contract with Churchill Falls (Labrador) Corporation Limited that will remain in effect until 2041. It also purchases all the output from 39 wind farms (3,508 MW) and 7 small hydropower plants (107 MW) and almost all the output from 8 biomass and 4 biogas cogeneration plants (272 MW) operated by independent power producers. Moreover, 988 MW are available under long-term contracts with other suppliers.

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

c) The 2017 figure was valid on February 16, 2018. The values indicated correspond to the needs for the winter beginning in December, including interruptible power. The peak for a given period is based on measurements at fixed intervals. The 2017–2018 winter peak was 38,204 MW and occurred on December 28, 2017, at 5:00 p.m. However, the system load momentarily reached 38,420 MW at 4:58 p.m.

d) 34,207 km of lines operated by Hydro-Québec TransÉnergie and 272 km by Hydro-Québec Distribution.

OTHER INFORMATION

	2017	2016	2015	2014	2013
%					
Rate increase as at April 1	**0.7**[a]	0.7[a]	2.9[a]	4.3[a]	2.4
As at December 31					
Total number of employees[b]					
Permanent	**17,338**	17,282	17,475	17,793	17,861
Temporary	**2,448**	2,270	2,319	2,250	2,382
	19,786	19,552	19,794	20,043	20,243
%					
Representation of target groups					
Women	**28.9**	28.7	29.0	29.4	30.0
Other[c]	**8.1**	7.7	7.4	6.8	6.6

a) Excluding Rate L.

b) Excluding employees of subsidiaries and joint ventures.

c) Self-reported members (men and women) of the following groups: Indigenous peoples, ethnic minorities, visible minorities and people with disabilities.

CONSOLIDATED RESULTS BY QUARTER

					2017
$M	1st quarter	2nd quarter	3rd quarter	4th quarter	12-month period
Revenue	4,257	2,908	2,753	3,550	**13,468**
Expenditure					
Operations	669	670	635	690	**2,664**
Other components of employee future benefit cost	(82)	(83)	(83)	(74)	**(322)**
Electricity and fuel purchases	569	448	392	596	**2,005**
Depreciation and amortization	641	654	649	742	**2,686**
Taxes	300	245	246	285	**1,076**
	2,097	1,934	1,839	2,239	**8,109**
Income before financial expenses	2,160	974	914	1,311	**5,359**
Financial expenses	617	615	626	655	**2,513**
Net income	1,543	359	288	656	**2,846**

					2016
$M	1st quarter	2nd quarter	3rd quarter	4th quarter	12-month period
Revenue	4,302	2,815	2,740	3,482	13,339
Expenditure					
Operations	649	654	604	764	2,671
Other components of employee future benefit cost	(60)	(61)	(60)	(52)	(233)
Electricity and fuel purchases	562	422	402	480	1,866
Depreciation and amortization	625	628	633	711	2,597
Taxes	289	240	239	277	1,045
	2,065	1,883	1,818	2,180	7,946
Income before financial expenses	2,237	932	922	1,302	5,393
Financial expenses	653	626	616	637	2,532
Net income	1,584	306	306	665	2,861

BOARD OF DIRECTORS

Seated, from left to right: Éric Martel, Michelle Cormier, Michael D. Penner. Standing, from left to right: Anik Brochu, Laurent Ferreira, Marie-Josée Morency, Paul Stinis, Hélène V. Gagnon, Geneviève Bich, Yvon Marcoux, Carl Cassista, Suzanne Gouin, Geneviève Brouillette, Anne-Marie Croteau, Robert Keating, François Lafortune.

Michael D. Penner

Chairman of the Board,
Hydro-Québec

Appointment: October 8, 2014

Term: May 15, 2023

Status: Independent director

Place of residence: Westmount

A graduate of McGill University and Hofstra University in New York, and a member of the bar association for the State of New York, where he practised law, Michael D. Penner has sat on numerous boards and is involved in international governance-related events and organizations. He is a member of the board of Banque Scotia, where he sits on the corporate governance and audit committees. He is also active in a variety of social causes. Mr. Penner turned PEDS Chaussettes, a small local business, into a world leader in the textile industry before selling it to Gildan Activewear (NYSE: GIL) in 2016.

Éric Martel

President and Chief Executive Officer, Hydro-Québec

Appointment: July 6, 2015

Term: July 6, 2020

Status: Non-independent director

Place of residence: Mont-Royal

Éric Martel holds a Bachelor's degree in electrical engineering from Université Laval and is a member of the Ordre des ingénieurs du Québec. Before joining Hydro-Québec in July 2015, he held a number of management positions at Bombardier from 2002 to 2015, including President of the Avions d'affaires and Services à la clientèle divisions. Mr. Martel has also worked for several high-profile international companies such as Pratt & Whitney, Rolls Royce, Procter & Gamble and Kraft Foods. He serves on the board of the Global Sustainable Electricity Partnership and is Chair of the Electricity Industry community of the World Economic Forum. He has been actively involved with Centraide of Greater Montréal since the late 1990s. In 2017, he was honorary chair of the 63rd edition of the Traversée internationale du lac St-Jean.

Geneviève Bich

Vice President, Human Resources, Metro inc.

Appointment: September 9, 2015

Term: September 9, 2019

Status: Independent director

Place of residence: Westmount

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

Anik Brochu

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

Appointment: September 13, 2006

Term: July 6, 2020

Status: Independent director

Place of residence: Val-d'Or

Anik Brochu holds a law degree from the University of Ottawa and is a member of the Barreau du Québec. After serving as General Manager of the Chambre de commerce de Val-d'Or from 1997 to 2008, she was a lawyer with Cain Lamarre Casgrain Wells from 2008 to 2010. In 2011, she joined Groupe T.A.P., where she now holds the position of Director, Special Projects. She sits on the board of the Centre de musique et de danse de Val-d'Or.

Geneviève Brouillette

Vice President, Finance, Keurig Green Mountain, Inc.

Appointment: July 12, 2017

Term: December 16, 2018

Status: Independent director

Place of residence: Montréal

With a Bachelor of Commerce from McGill University and a Bachelor's degree in accounting from the Université du Québec à Montréal, Geneviève Brouillette is a member of the Ordre des comptables professionnels agréés du Québec (CPA, CA) and has certification from the Collège des administrateurs de sociétés. Over the course of her career, she has held senior positions at Kraft Canada, Pratt & Whitney Canada, Groupe St-Hubert and Colabor. Since 2014, she has been Vice President, Finance, at Keurig Green Mountain.

Carl Cassista

Corporate Director

Appointment: September 26, 2007

Term: December 17, 2018

Status: Independent director

Place of residence: Lévis

A graduate of Université Laval, Carl Cassista worked in electrical engineering at Technologies Axion from 1982 to 2017. He piloted the company's expansion in North America and Europe, and served as its president from 1994 to 2017. Mr. Cassista has also sat on the boards of numerous economic development organizations.

Michelle Cormier

Operating Partner, Wynnchurch Capital (Canada) Ltd., and Vice Chair of the Board of Directors, Hydro-Québec

Appointment: November 4, 2009

Term: December 17, 2018

Status: Independent director

Place of residence: Montréal

With a Bachelor of Business Administration from Bishop's University and a Graduate Diploma in Public Accountancy from McGill, Michelle Cormier is a member of the Ordre des comptables professionnels agréés du Québec (CPA, CA) and has certification from the Collège des administrateurs de sociétés. Currently Operating Partner at Wynnchurch Capital (Canada), she has held senior positions with Alcan Aluminium, Entreprises Repap and TNG Corporation. Ms. Cormier serves on the boards of Cascades, Industries Dorel, Uni-Sélect and Mines de fer Champion.

Anne-Marie Croteau

Dean, John Molson School of Business, Concordia University

Appointment: July 6, 2016

Term: July 6, 2020

Status: Independent director

Place of residence: Montréal

Anne-Marie Croteau holds a Bachelor's degree in actuarial mathematics from Concordia University, a Bachelor of Business Administration and a Master's in Management from HEC Montréal, and a PhD in administration from Université Laval. She is dean of the John Molson School of Business at Concordia University and full professor of business technology management. She is certified by the Collège des administrateurs de sociétés and serves on the boards of the Société de l'assurance automobile du Québec and Finance Montréal.

Laurent Ferreira

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

Appointment: December 17, 2014

Term: December 17, 2018

Status: Independent director

Place of residence: Westmount

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

Hélène V. Gagnon

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

Appointment: April 22, 2015

Term: April 22, 2019

Status: Independent director

Place of residence: Outremont

A graduate of McGill University in both civil law and common law, Hélène V. Gagnon also has a Master's degree in public administration and public policy from the London School of Economics. She is a member of the Barreau du Québec and holds accreditation from the Canadian Public Relations Society. Ms. Gagnon has been Vice President, Public Affairs and Global Communications at CAE since 2015 and has held similar positions at Bombardier Aéronautique, Bombardier Transport and Noranda. She chairs the board of directors of Aéro Montréal and sits on the boards of Aéroports de Montréal and the Canadian American Business Council.

Suzanne Gouin

Chair of the Board of Management, Canada Revenue Agency

Appointment: September 26, 2007

Term: July 6, 2020

Status: Independent director

Place of residence: Hampstead

Suzanne Gouin has a Bachelor's degree in political science from Concordia University, where she also pursued media studies at the graduate level. She completed an MBA at the University of Western Ontario and has earned certification from the Institute of Corporate Directors. She has held several management positions in media companies, including that of President and Chief Executive Officer of TV5 Québec Canada from 2002 to 2015. She was named Chair of the Board of Management at the Canada Revenue Agency in 2017. She chairs the board of directors of Montreal Digital Spring and sits on the boards of the Bell Fund and the Foundation of Greater Montreal.

Robert Keating

Deputy Minister of Energy and Natural Resources

Appointment: November 9, 2016

Term: July 12, 2021

Status: Non-independent director

Place of residence: Montréal

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

François Lafortune

Founder and Chief Executive Officer, Commandité Entreprises Diagram inc.

Appointment: July 12, 2017

Term: July 12, 2021

Status: Independent director

Place of residence: Montréal

With a Bachelor of Engineering from McGill University and an MBA from Stanford University in California, François Lafortune began his career at Qualité Étudiants as a franchisee from 1999 to 2002, and was subsequently president of Vitres.net from 2002 to 2005. In 2006, he joined McKinsey & Company management consulting, where he rose through the ranks to become a partner and co-leader of its Canadian technology practice, a position he held until he left the company in 2015. In 2016, he founded Commandité Entreprises Diagram, where he is Chief Executive Officer.

Yvon Marcoux

Corporate Director

Appointment: December 17, 2014

Term: December 17, 2018

Status: Independent director

Place of residence: Boucherville

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

Marie-Josée Morency

Director – Operio Business Development, Raymond Chabot Grant Thornton LLP

Appointment: July 6, 2016

Term: July 6, 2020

Status: Independent director

Place of residence: Québec

After completing a Bachelor's in communications at Université Laval, Marie-Josée Morency began her career as an entrepreneur. She has worked in communications in the Saguenay region for Cystic Fibrosis Québec, the Association provinciale des constructeurs d'habitations du Québec and Promotion Saguenay. From 2010 to 2017, she was Executive Director, Chambre de commerce et d'industrie Saguenay-Le Fjord, and has served on the boards of numerous economic development organizations. In 2017 she joined Raymond Chabot Grant Thornton as Director of Business Development at their subsidiary Operio.

Paul Stinis

Senior Vice-President and Treasurer, BCE Inc.

Appointment: April 22, 2015

Term: July 6, 2020

Status: Independent director

Place of residence: Westmount

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

Directors' Compensation and Benefits in 2017[a,b]

	Base compensation	Meeting fees	Taxable benefits[c]
Geneviève Bich	$19,004	$30,191	$6,343
Anik Brochu	$19,004	$28,867	$133
Geneviève Brouillette	$8,573	$7,080	$70
Carl Cassista	$24,943	$24,061	$6,343
Michelle Cormier	$24,943	$32,832	$5,078
Anne-Marie Croteau	$20,658	$12,845	$196
Laurent Ferreira	$19,004	$23,082	$133
Hélène V. Gagnon	$23,000	$25,757	$133
Suzanne Gouin	$19,004	$28,918	$2,643
François Lafortune	$8,573	$5,310	$70
Yvon Marcoux	$26,339	$28,364	$196
Marie-Josée Morency	$18,932	$11,975	$6,343
Michael D. Penner[d]	$67,870	$63,967	$6,343
Paul Stinis	$24,943	$26,197	$133

a) Compensation set by the government under Order-in-Council No. 610-2006 of June 28, 2006. It consists of a basic annual retainer plus a fee for each Board or committee meeting attended. A yearly supplement is also paid to the chairs of Board committees.

b) By law, non-independent directors—Éric Martel and Robert Keating—receive no compensation or meeting fees as members of the Board of Directors.

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

d) Michael D. Penner's compensation was set under Order-in-Council No. 877-2014. He receives an annual base compensation of $57,370, plus a meeting fee of $885 for each Board or committee meeting attended, and a $5,904 yearly supplement as Chair of the Governance and Ethics Committee. In 2017, he also received a prorated supplement as Chair of the Information Technologies Committee until September 7.

Hydro-Québec is proud to support the visual arts in Québec. Some pieces from our collection are displayed in high-traffic areas of our premises, where they can be enjoyed by as many people as possible. Michael Merrill, *Walkway*, 2010, ink on paper. © Michael Merrill

Board of Directors

Chaired by Michael D. Penner, the Board of Directors met 13 times in 2017, while its committees held 63 meetings over the same period. The Board closely monitored the implementation of Hydro-Québec's *Strategic Plan 2016–2020*, with particular focus on the company's growth strategies. It approved the bids submitted in response to two major requests for proposals for supplying power to the states of Massachusetts and New York. It also approved capital projects in power generation, transmission and distribution, including the ongoing refurbishment of Robert-Bourassa generating station, construction of the 315/25-kV Patriotes substation and supply line in preparation for the Réseau électrique métropolitain (REM) project, and connection of the communities of La Romaine and Unamen Shipu to the power system. The Board further authorized investments to optimize the processes and systems of Hydro-Québec Innovation, équipement et services partagés. It approved organizational changes and the appointment of executive managers reporting to the President and Chief Executive Officer. In addition, it approved the updating of the employee Code of Conduct and the Health and Safety Action Plan 2017–2020. In the course of its recurring deliberations, the Board examined the company's objectives and approved its Business Plan and its quarterly and annual financial results, as well as the financial statements of the Hydro-Québec pension plan. It reviewed the progress of the company's main capital projects and studied the status report on the Distributor's Electricity Supply Plan 2017–2026. It examined the consolidated portfolio of residual business risks and approved the annual internal audit plan. In addition, it closely monitored activities related to occupational health and safety. The independent members hold a closed-door session at the end of each Board meeting.

EXECUTIVE (A)

The Executive Committee, chaired by Michael D. Penner, did not hold any meetings in 2017.

GOVERNANCE AND ETHICS (B)

The Governance and Ethics Committee, chaired by Michael D. Penner, met seven times in 2017. It submitted recommendations to the Board of Directors for the approval of Hydro-Québec's *Annual Report 2016*, the updating of its employees' Code of Conduct and the amendment of the mandates of certain Board committees. To meet the requirements of the *Act to facilitate the disclosure of wrongdoings relating to public bodies* adopted in 2017, the Committee, together with the Audit Committee, recommended that the Board update the procedure for handling allegations concerning wrongdoings or inappropriate situations. It also recommended updating the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec* with regard to the confidential nature of information related to Board activities. In addition, it recommended the appointment of directors to Board committees, as well as the most senior officer of each of Hydro-Québec's wholly owned subsidiaries and the directors and external auditors of its first-tier wholly owned subsidiaries. The Committee examined the annual reviews of several company policies. It also oversaw the continuous improvement of the Board's effectiveness as well as the entire process of evaluating the Board's performance. Moreover, governance training sessions were offered to the directors as part of their ongoing training program.

AUDIT (C)

The Audit Committee, chaired by Michelle Cormier, held nine meetings in 2017. As part of its recurring deliberations, it examined the quarterly and annual financial statements of Hydro-Québec and its pension plan, and the annual financial statements of Société d'énergie de la Baie James. It also reviewed and followed up on the annual control plans and its pension plan of the company. It monitored the independence of the independent auditors and met with them in order to plan the audit and receive its results. The Committee recommended that the Board approve the financial year's audit plans and engagement letters for the company and its pension plan. It conducted the annual evaluation of the independent auditors. It further recommended that the Board approve the annual performance objectives of the Vérification interne unit and, at year-end, evaluated its satisfaction with internal audit operations. It examined internal audit results and reports regarding control and optimization of the company's operations and resources, as well as management of the related risks. It also reviewed the management of Hydro-Québec Distribution's accounts receivable and the performance audit of Hydro-Québec conducted by the Auditor General of Québec. Lastly, it examined the company's 2018 internal audit plan and recommended its approval by the Board.

HUMAN RESOURCES (D)

In 2017, the Human Resources Committee, chaired by Carl Cassista, held 11 meetings. It examined Hydro-Québec's Business Plan, executives' performance objectives and the consolidated portfolio of residual business risks. The Committee coordinated the evaluation of Hydro-Québec's President and Chief Executive Officer and closely monitored the extent to which the company had met its performance objectives for 2017. It also monitored the management succession process and submitted recommendations to the Board for the appointment of members of Senior Management. It reviewed the overall compensation of Hydro-Québec's employees, executives and President and Chief Executive Officer, and of the employees and executives of its wholly owned subsidiaries, and recommended approval by the Board. It monitored the management of employees' performance and the collective agreement renewal process. Finally, the Committee studied the 2016 report of activities of the Corporate Ombudsman and reports on the corporate policy on human resources.

ENVIRONMENT AND PUBLIC AFFAIRS (E)

Chaired by Isabelle Hudon from January 1 to October 31 and by Michael D. Penner on an interim basis since November 1, the Environment and Public Affairs Committee met six times in 2017. Among other topics, it studied the results of the annual environmental management review as well as the semiannual reports on environmental compliance. It recommended that the Board approve the granting of donations and sponsorships, and worked closely on the revision of the related corporate policy. It examined the annual results with respect to the company's communication activities and related performance indicators. In addition, it monitored the company's communication plan and advertising campaign. The Committee commented on Hydro-Québec's *Sustainability Report 2016* and met with the report's auditor. It reviewed the results of the university research chairs program, the annual report on the international cooperation initiatives financed by Hydro-Québec in French-speaking nations, and the annual activity reports of the Fondation Hydro-Québec pour l'environnement and of the liaison committees established by the company with the Union des producteurs agricoles and the Fédération québécoise des municipalités. The Committee reviewed the results of Hydro-Québec's chairmanship of the Global Sustainable Electricity Partnership in 2017, and of the summit held in Montréal in May 2017.

FINANCE (F)

The Finance Committee, chaired by Paul Stinis, held eight meetings in 2017. It analyzed the company's Business Plan, objectives and consolidated portfolio of residual business risks. It examined various annual programs and files of a financial nature before recommending their approval by the Board: borrowings, guarantees, financial risk management, swaps, sinking fund management, derivatives and underlying products. In addition, it recommended Board approval of the updating of risk management programs for Hydro-Québec Production's wholesaling and trading activities and Hydro-Québec Distribution's procurement activities, and of credit limits for each counterparty for each of the functions concerned. The Committee also examined various capital and international investment projects and followed up on the development and application of Hydro-Québec's strategic acquisitions framework.

PENSION PLAN FINANCIAL MANAGEMENT (G)

In 2017, the Pension Plan Financial Management Committee, chaired by Yvon Marcoux, met four times. It examined the annual actuarial valuation for pension plan funding and solvency purposes, amendments to the Pension Fund Investment Management Policy and the annual pension fund management and pension plan administration budgets, and recommended their approval by the Board. It further recommended that the Board approve the selection of the independent actuary, in particular for the annual actuarial valuations of the pension fund from 2017 to 2021. The Committee evaluated the performance and structure of the pension fund portfolio and the performance of specialized portfolio managers. It monitored changes in the pension plan's financial position and its funding and solvency results. It also studied the annual and interim financial statements, as well as the 2017 control plan and the performance report on the 2016 control plan for the pension plan. The Committee examined the results of the evaluation of the pension fund's carbon footprint. In addition, it closely monitored the management of risks related to the pension fund.

INFORMATION TECHNOLOGIES (H)

Chaired by Michael D. Penner from January 1 to September 7 and by Anne-Marie Croteau from September 8 on, the Information Technologies Committee met four times in 2017. The Committee closely monitored the progress of the project to overhaul the Vice-présidence – Technologies de l'information et des communications. It examined the portfolio of information and communication technologies projects. It recommended Board approval of the process and system optimization project to replace the applications used to plan and manage project costs at Hydro-Québec Innovation, équipement et services partagés. In addition, it monitored issues related to cybersecurity and the impacts of the *Act to reinforce the governance and management of the information resources of public bodies and government enterprises* on Hydro-Québec's operations. The Committee also examined reports on the application of the policy on information technologies.

SPECIAL COMMITTEE ON WORKPLACE HEALTH AND SAFETY (I)

The Special Committee on Workplace Health and Safety held 14 meetings in 2017, including one at the Romaine jobsite to meet with stakeholders. Consulting firm ERM was tasked with analyzing the company's safety practices, both on the Romaine jobsite and within the company's divisions. The Committee closely monitored ERM's work and kept the Board informed. It also monitored all the actions taken by Management to improve safety practices and to change the corporate culture. It carefully examined the ERM report and recommended that the Board follow through on it. It studied the action plan developed by Management further to the report's conclusions, commented on it and recommended approval by the Board. The ERM report and Management's action plan have been made public. In addition, the Committee recommended that an independent firm be hired to audit the implementation of the action plan. Éric Martel co-chaired the Committee with Yvon Marcoux from January 1 to April 20; Hélène V. Gagnon succeeded Mr. Marcoux as co-chair on April 21. The Board will continue to monitor the improvement of the company's occupational health and safety record through a standing committee.

Director attendance at meetings of the Board of Directors and Board committees in 2017

DIRECTOR	Notes	Board	A	B	C	D	E	F	G	H	I
	Number of meetings →	13		7	9	11	6	8	4	4	14
Michael D. Penner A B C D E F G H I		13/13		7/7	9/9	11/11	5/6	8/8	4/4	4/4	14/14
Éric Martel A E F G H I	1	13/13		7/7	9/9	10/11	6/6	8/8	4/4	4/4	14/14
Geneviève Bich D I	2	12/13			2/2	9/11					13/14
Anik Brochu D E I	3	12/13			1/1	7/11	4/6				11/14
Geneviève Brouillette C	4	5/5			4/4						
Carl Cassista B D H		11/13		5/7		10/11				3/4	
Michelle Cormier A B C F	5	11/13		3/3	8/9	1/1		7/8			9/9
Anne-Marie Croteau H	6	13/13								3/3	
Laurent Ferreira B C D H	7	11/13			7/9	5/6		1/1		3/4	
Hélène V. Gagnon E I		12/13					5/6				14/14
Suzanne Gouin A B D G	8	13/13		5/5	1/1	11/11	2/2		3/3		
Robert Keating		13/13									
François Lafortune H	9	5/5								2/2	
Yvon Marcoux B F G I		9/13		5/7				8/8	4/4		12/14
Marie-Josée Morency E	10	11/13					4/4				
Paul Stinis A C F G	11	12/13			7/7			8/8	4/4		

Committees of the Board of Directors

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

Notes

1. Éric Martel attends meetings of the Governance and Ethics, Audit and Human Resources committees as a guest.
2. Geneviève Bich participated as a guest in the Audit Committee meetings held on November 1 and November 7, 2017.
3. Anik Brochu participated as a guest in the Audit Committee meeting held on November 7, 2017.
4. Geneviève Brouillette was appointed effective July 12, 2017, and joined the Audit Committee on September 8, 2017.
5. Michelle Cormier participated as a guest in the meeting of the Special Committee on Workplace Health and Safety held on November 28, 2017, and in the Human Resources Committee meeting held on November 16, 2017. She joined the Governance and Ethics Committee on September 8, 2017, and was a member of the Special Committee on Workplace Health and Safety from January 1 to September 8, 2017.
6. Anne-Marie Croteau joined the Information Technologies Committee on April 21, 2017.
7. Laurent Ferreira participated as a guest in the Finance Committee meeting held on March 6, 2017. He joined the Human Resources Committee on April 21, 2017. Having joined the Governance and Ethics Committee on December 15, 2017, he did not attend any meetings of that committee during the year.
8. Suzanne Gouin participated as a guest in the Audit Committee meeting held on November 7, 2017. She joined the Governance and Ethics Committee and the Pension Plan Financial Management Committee on April 21, 2017. She served on the Environment and Public Affairs Committee until April 20, 2017.
9. François Lafortune was appointed effective July 12, 2017, and joined the Information Technologies Committee on September 8, 2017.
10. Marie-Josée Morency joined the Environment and Public Affairs Committee on April 21, 2017.
11. Paul Stinis joined the Audit Committee on April 21, 2017.

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

Independence

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

Rules of ethics

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

Compensation and benefits paid to directors

Compensation for all independent directors is set out in Order-in-Council No. 610-2006 and is indexed periodically by the government. Compensation consists of a basic annual retainer of $18,890 plus a fee of $885 for each Board or committee meeting. A yearly supplement of $5,904 is paid to the chairs of Board committees. Under Order-in-Council No. 877-2014, the Chairman of the Board receives annual compensation of $57,370 and earns the same compensation as the independent directors for participating in meetings of the Board and its committees as well as for chairing a committee. Board members are also entitled to reimbursement of travel expenses incurred in the performance of their duties.

Hiring of independent experts

Board members may retain the services of independent experts at the company's expense in order to obtain advice on matters related to their mandate.

Director induction and training program

When Board members are first appointed, they receive training on their roles and responsibilities, the nature and business context of Hydro-Québec's principal activities, and the company's legal and regulatory context. New directors also receive training providing them with a solid grasp of the basic notions of electricity, as well as tours of the system control center and the energy trading floor. By the end of the induction program, new members have received a total of 15 hours of training.

Board members were given ongoing training in 2017 in the form of five governance training sessions offered by the Collège des administrateurs de sociétés. These three-hour sessions addressed the following topics: strategic management, value creation and the role of Board committees; sustainability challenges facing directors; market globalization, corporate internationalization and strategic directions; innovation governance; and managing the risk of reputation attacks.

As part of the regular Board meetings in 2017, members were given presentations on such topics as Hydro-Québec's export strategy and long-term electricity sales agreements, growth of electricity sales in Québec, Hydro-Québec's research institute and the evolution of the company's Strategic Plan. In addition, members had the opportunity to attend two detailed presentations on Hydro-Québec's *Strategic Plan 2016–2020* and the company's strategy for growth through acquisitions.

At a meeting held in Rouyn-Noranda, Board members visited the telecontrol center and were given a presentation on Hydro-Québec's operations in the region.

Deintegration

In 1997, Hydro-Québec began restructuring itself into divisions, which enabled it to obtain a power marketer's license and sell electricity at market prices on U.S. wholesale markets. Among other things, this deintegration, or structural unbundling, ensures that the Transmission Provider's operations are kept separate from those of its affiliates. Rules of conduct and ethics were enacted and integrated into internal directives, which are briefly described here.

- *Transmission Provider Code of Conduct*[1] – Governs relations between the Transmission Provider and its affiliates, and is intended to prevent any form of preferential treatment or cross-subsidization.
- *Reliability Coordinator Code of Conduct*[2] – Ensures that the reliability of the transmission system remains the Reliability Coordinator's top priority and prevents any form of preferential treatment in favor of other branches of the Transmission Provider, its affiliates or other system users.
- *Code of Ethics on Conducting Calls for Tenders*[3] – Ensures that the Distributor's tendering process is conducted fairly for all electricity suppliers.
- *Code de conduite du Distributeur* (Distributor Code of Conduct)[4] – Regulates transactions between the Distributor and the Generator for non-tendered electricity supply in order to ensure that the Generator does not benefit from any unfair advantage. It also governs dealings between the Distributor and its affiliates, with the aim of preventing affiliates' business operations from being financed, in whole or in part, by electricity service customers.

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

1. *Transmission Provider Code of Conduct* (www.oatioasis.com/HQT/HQTdocs/code_de_conduite_en.pdf)
2. *Reliability Coordinator Code of Conduct* (www.hydroquebec.com/data/transenergie/pdf/code_conduite-en.pdf)
3. *Code of Ethics on Conducting Calls for Tenders* (www.hydroquebec.com/data/achats-electricite-quebec/pdf/code_240701_en.pdf)
4. *Code de conduite du Distributeur* (Distributor Code of Conduct) (in French only) (www.hydroquebec.com/data/a-propos/pdf/code-conduite-distributeur.pdf)

Compensation and benefits paid to the company's five most highly compensated officers as at December 31, 2017

	Base salary as at December 31	Incentive compensation for 2016, paid in 2017	Perquisites used[a]	Taxable benefits			
				Automobile			Life insurance and health insurance
				Nature of benefit	Allowance	Usage and parking	
Éric Martel President and Chief Executive Officer, Hydro-Québec	$543,559	$258,838	$5,070	Executive vehicle	–	–	$7,999
Réal Laporte President, Hydro-Québec Innovation, équipement et services partagés President and Chief Executive Officer, Société d'énergie de la Baie James[b]	$442,000	$122,278	$1,380	Car allowance or provision of a vehicle, plus parking	$1,566	$11,322	$9,544
Richard Cacchione President, Hydro-Québec Production	$424,349	$104,316	$5,000		–	$12,587	$9,542
David Murray President, Hydro-Québec Distribution	$420,000	$95,245	$2,443		$16,290	$7,127	$7,639
Marc Boucher President, Hydro-Québec TransÉnergie	$416,000	$56,345	$5,000		$16,290	$5,044	$8,058
	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 incentive compensation as pensionable earnings for purposes of the HQPP, up to a maximum of 20% of salary **Supplementary Benefits Program** - Contribution assumed by Hydro-Québec - Additional benefits to offset the tax limits under the HQPP (lifting of ceiling on the permitted maximum amount) - Payment of benefits according to the same terms as those applicable under the HQPP *Other provisions applicable to the President and Chief Executive Officer of Hydro-Québec* - Pension calculated on the basis of average salary for the best three years (less pension payable under the HQPP) - Credit of 4% per contribution year (less pension credit under the HQPP) - Recognition of 100% of the maximum incentive compensation as pensionable earnings (less portion recognized for purposes of the HQPP)						

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

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

Compensation and benefits paid to the only officer compensated by a wholly owned subsidiary as at December 31, 2017

	Base salary as at December 31[a]	Incentive compensation for 2016, paid in 2017	Perquisites used[b]	Benefits
Sophie Paquette General Manager, Société de transmission électrique de Cedars Rapids limitée	$126,621	$21,438	$329	Hydro-Québec pension plan and group insurance plans

a) The secondment of Sophie Paquette to the Société de transmission électrique de Cedars Rapids limitée as General Manager ended on December 10, 2017. Ms. Paquette is ensuring the transition until a new general manager is appointed.

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

Internal control system

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

Auditors' fees and independence

KPMG LLP, Ernst & Young LLP and the Auditor General of Québec are Hydro-Québec's independent auditors for 2017. The professional fees billed by KPMG LLP and by Ernst & Young LLP in 2017 for services other than auditing and certification amounted to 13.8% of the total $4.9 million in fees billed. Hydro-Québec uses various mechanisms to enable the Audit Committee to ensure that independent auditors remain independent, including a process whereby any audit engagement is analyzed beforehand. No professional service engagement may be assigned to the Auditor General of Québec, since that office serves the National Assembly exclusively.

Access to documents and protection of personal information

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

The corporate Web site contains information of interest to the public. In accordance with the *Action Plan for People with Disabilities*, the company makes every reasonable effort to ensure that people with disabilities can exercise their right to complete, high-quality information.

HIGHLIGHTS FOR 2017

Hydro-Québec received 428 requests for access to information; of these, 147 were granted in full, 169 were granted in part and 50 were turned down. When requests were denied, it was mostly due to the need to protect third-party personal information, or to security, commercial or strategic concerns that prevented disclosure of the document. As for the other 62 requests, either they could not be fulfilled because the company did not have the document, or the request was withdrawn. Sixteen responses were the subject of requests for review by the Commission d'accès à l'information (CAI). The average request processing time was 21 days.

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

None of the requests necessitated special accommodation measures for people with disabilities. One complaint against Hydro-Québec was filed with the CAI. Two cases of loss or theft of customer personal information were reported to the authorities in charge of protecting personal information. In all these cases, the company acted diligently by rapidly taking the necessary steps to deal with the situation and prevent its recurrence, to the extent possible. The report on 2017 requests for access to information is available at www.hydroquebec.com/publications/en/act-respecting-access/access-information-response.html.

Ethics

Hydro-Québec attaches great importance to ethics in all aspects of its activities. As a government-owned corporation, Hydro-Québec must demonstrate exemplary probity, and it can do so only with the consistent support of its employees, who must meet the highest standards with respect to ethics and irreproachable conduct. Loyalty, integrity, respect, discretion and fairness are ethical principles reflecting Hydro-Québec's social commitment to its customers and the community. Ethical rules resulting from these principles are set out in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec* and in the employee Code of Conduct, which was updated in 2017. The latter document, available (in French only) at www.hydroquebec.com/data/a-propos/pdf/code-conduite.pdf, is intended to help all employees fulfill their duties with integrity and loyalty, in accordance with Hydro-Québec's ethical principles. The company's ethics training activities include a mandatory self-training program on these principles, for all employees.

Language guidelines

As in past years, Hydro-Québec maintained its efforts to ensure the quality of French in its internal and external communications. Various proficiency courses were offered to employees, who have access to a vast energy-related terminology database as well. They were also reminded of the company's language policy. An intranet site devoted to the language guidelines applicable to Hydro-Québec includes a number of tools to facilitate their day-to-day application. A presentation on language guidelines at Hydro-Québec marked the 40th anniversary of the adoption of the *Charter of the French Language*.

Sustainable development

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

Sustainable Development Action Plan 2015–2020

Hydro-Québec published its *Sustainable Development Action Plan 2015–2020* in July 2015. This is one way we contribute to the implementation of Québec's *Government Sustainable Development Strategy*, its strategy to ensure the occupancy and vitality of territories and its *Agenda 21 for Culture*. A formal accounting of the company's performance with respect to the Action Plan is presented in the *Sustainability Report 2017*.

	Action		Indicator	Results as at December 31, 2017
1	Build hydropower projects	OVT	Cumulative capacity made available by the Romaine complex	1,305 MW
2	Increase the capacity of existing hydroelectric generating stations	OVT	Cumulative gains in additional available peak capacity	54 MW[a]
3	Continue energy efficiency initiatives		New annual energy savings	524 GWh[a]
4	Continue efforts in the field of transportation electrification in Québec		Number of Electric Circuit charging stations in service and number of regions served	1,271 charging stations/ 16 regions
		OVT	R&D partnership agreements	3 agreements[a]
			Number of patents held	552 patents
5	Publicize the knowledge acquired through Hydro-Québec environmental studies	C	Number of documents published on the Web	7 documents published
6	Continue to protect and enhance the company's built, technological and intangible heritage	C OVT	Number of measures carried out by 2020	3 measures
7	Strengthen environmentally responsible management practices		Annual GHG emissions from the light-vehicle fleet	21,532 t CO_2eq[a]
		OVT	Number of videoconferences held annually	12,250 videoconferences[a]
			Percentage of company printers that are print-release enabled	16%[a]
8	Continue measures that take into account and protect biodiversity and ecosystem services	OVT	Number of innovative measures implemented annually to take into account and protect biodiversity and ecosystem services	6 measures[a]
9	Optimize the application of sustainability principles to projects and activities		Number of projects or activities analyzed each year	1 project
10	Promote the integration and favorable reception of Hydro-Québec's system equipment	OVT	Percentage of MRCs that have received the information program	18%
11	Integrate the life cycle approach into our innovation efforts		Number of projects to which sustainability and eco-innovation principles have been applied	1 project
12	Keep updating current knowledge on the life cycle assessment of electricity distributed in Québec		Number of updates of inventory data on the life cycle of Québec's electricity mix per year	1 update

a) Preliminary data. The final figure will be published in the *Sustainability Report 2017*.

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

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

TO CONTACT US

hydroquebec.com

HYDRO-QUÉBEC
Édifice Jean-Lesage
75, boulevard René-Lévesque Ouest
20e étage
Montréal (Québec) H2Z 1A4
CANADA
Telephone: 514 289-2211, ext. 2316
E-mail: accueil@hydro.qc.ca

INVESTOR RELATIONS
Édifice Jean-Lesage
75, boulevard René-Lévesque Ouest
5e étage
Montréal (Québec) H2Z 1A4
CANADA
Telephone: 514 289-2518
E-mail: rel.inv@hydro.qc.ca

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This is a translation of the original French text.
The French version shall prevail.
Ce document est également diffusé en français.

OUR GENERATING, TRANSMISSION AND DISTRIBUTION FACILITIES

GENERATION

INSTALLED CAPACITY — 37,309 MW

63 HYDROELECTRIC GENERATING STATIONS[a] — 36,767 MW

Robert-Bourassa	5,616	Eastmain-1-A	768	Paugan	226
La Grande-4	2,779	Carillon	753	Rapide-Blanc	204
La Grande-3	2,417	Romaine-2	640	Shawinigan-2	200
La Grande-2-A	2,106	Toulnustouc	526	Shawinigan-3	194
Beauharnois	1,900	Outardes-2	523	Manic-1	184
Manic-5	1,596	Eastmain-1	480	Rapides-des-Îles	176
La Grande-1	1,436	Brisay	469	Chelsea	152
René-Lévesque	1,326	Romaine-3	395	Sarcelle	150
Jean-Lesage	1,229	Péribonka	385	La Gabelle	131
Bersimis-1	1,178	Laforge-2	319	Première-Chute	131
Manic-5-PA	1,064	Trenche	302	Les Cèdres	113
Outardes-3	1,026	La Tuque	294	Rapides-des-Quinze	109
Sainte-Marguerite-3	882	Romaine-1	270	Rapides-Farmer	104
Laforge-1	878	Beaumont	270	Other (18 generating stations rated less than 100 MW)	771
Bersimis-2	845	McCormick	235		
Outardes-4	785	Rocher-de-Grand-Mère	230		

24 THERMAL GENERATING STATIONS[b] — 542 MW

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

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

OTHER SOURCES OF SUPPLY — 10,303 MW

Churchill Falls generating station [Churchill Falls (Labrador) Corporation Limited][a]	**5,428**
39 wind farms operated by independent power producers[b]	**3,508**
8 biomass and 4 biogas cogeneration plants operated by independent power producers[c]	**272**
7 small hydropower plants operated by independent power producers[b]	**107**
Other suppliers[d]	**988**

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

HYDROELECTRIC GENERATING STATIONS UNDER CONSTRUCTION — 245 MW

Romaine-4	245

TRANSMISSION

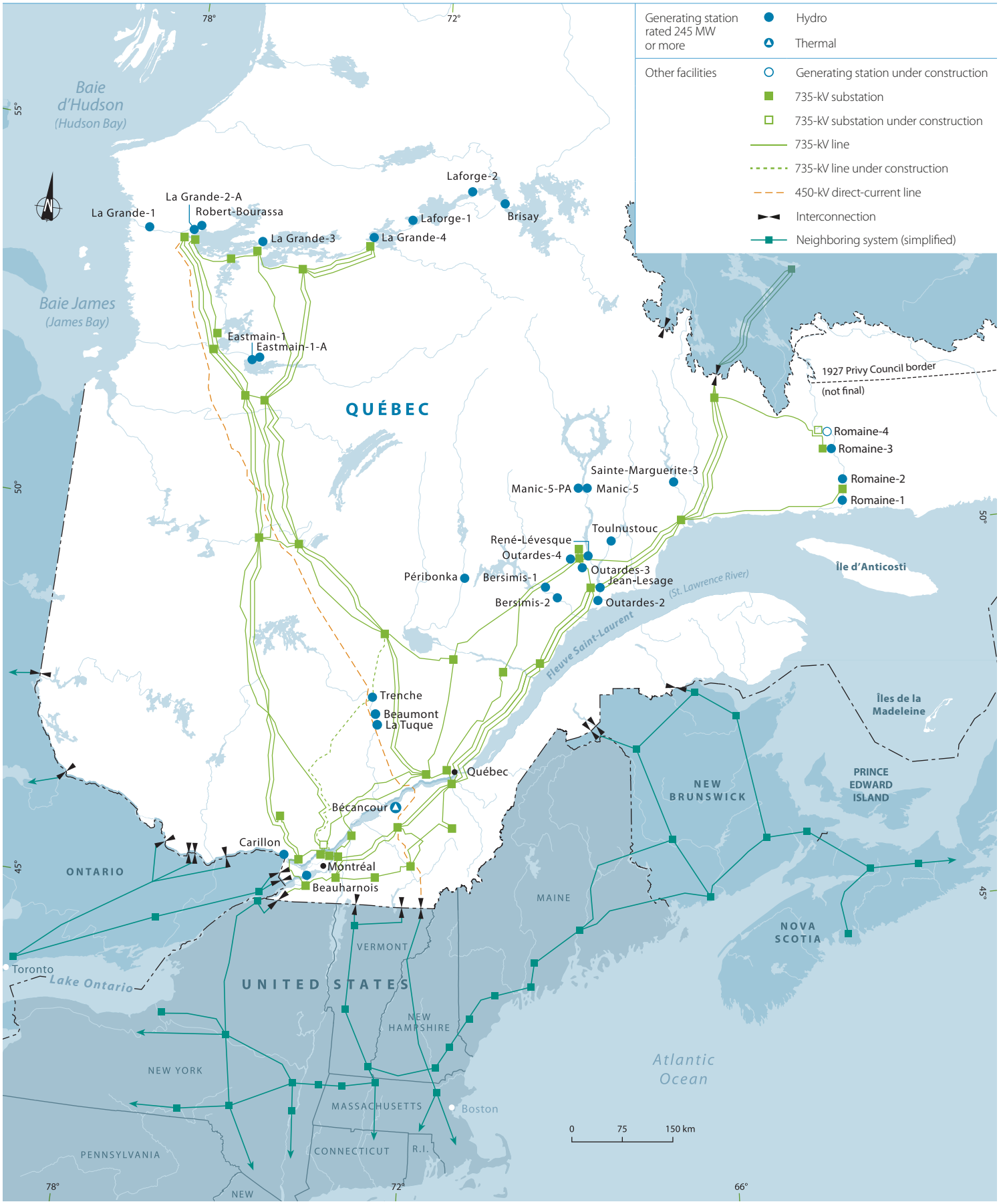
Voltage	Lines (km)	Substations (number)
765 and 735 kV	11,899[a]	40
450 kV DC	1,218	2
315 kV	5,488	79
230 kV	3,257[b]	53
161 kV	2,140	43
120 kV	6,960	218
69 kV or less	3,517[c]	98[d]
Total	**34,479**	**533**

a) Including 469 km of 735-kV lines operated at 315 kV.
b) Including 33 km of 230-kV lines operated at 120 kV.
c) 3,245 km of lines operated by Hydro-Québec TransÉnergie and 272 km by Hydro-Québec Distribution.
d) 87 substations operated by Hydro-Québec TransÉnergie and 11 by Hydro-Québec Distribution.

DISTRIBUTION

Medium voltage	Lines (km)
34 kV	746
25 kV	111,946
12 kV	4,862
4 kV or less	193
Total	117,747
Low voltage	106,286
Total	**224,033**

OUR MAJOR FACILITIES



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