



Strategic Plan 2000-2004



Serving Our Customers
Better

Units of measure

\$M: millions of dollars

W: watt
A unit used to measure power.

MW: megawatt
1 million watts

GW: gigawatt
1 million kilowatts

Wh: watthour
A unit used to measure electric energy.

GWh: gigawatthour
1 million kilowatthours

TWh: terawatthour
1 billion kilowatthours

The *Strategic Plan 2000-2004* must be submitted to the Québec government on or before November 1, 1999. It will be subject to review by a parliamentary commission of the National Assembly within three months following the date on which it was tabled.

Note to the reader— Unless otherwise indicated, monetary amounts in the text are expressed in Canadian dollars (\$) and cents (¢).



Montréal, October 26, 1999

Mr. Jacques Brassard
Minister of Natural Resources

Dear Sir:

We are pleased to submit Hydro-Québec's *Strategic Plan 2000-2004*.

The Plan presents a profile of the company and describes the major trends emerging in its business environment. It identifies the forces operating on the Québec, North American and international markets as the company continues to pursue the growth and profitability objectives outlined in the *Strategic Plan 1998-2002*.

The Plan focuses on the strategies that Hydro-Québec intends to implement to improve service for its Québec customers and to generate a higher return for its shareholder over the next five years. To achieve this goal, the company can count on the expertise, know-how and innovative capacity of its work force. Like the members of senior management and the Board of Directors, our employees are preparing to take up the challenges of the coming years, so that Hydro-Québec can continue to offer energy rates that rank among the lowest in North America, while contributing to the collective prosperity of Quebecers.

In an ever-changing global market, Hydro-Québec is fully aware of the role it plays in the Québec economy. As a business-driven publicly owned company, it will continue to assume its economic, social and environmental responsibilities for the benefit of its customers, employees and shareholder.

Yours very truly,

Handwritten signature of L. Jacques Ménard in black ink.

L. Jacques Ménard
Chairman of the Board

Handwritten signature of André Caillé in black ink.

André Caillé
President and Chief Executive Officer

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Mission

“The objects of the Corporation are to supply power and to pursue endeavours in energy-related research and promotion, energy conversion and conservation, and any field connected with or related to power or energy.”

Hydro-Québec Act, Sec. 22

Vision

To become a world leader in energy

By developing its expertise for the benefit of its customers, employees and shareholder, and by working with partners in business ventures.

Values

- Customer satisfaction
- “Business first” approach
- Respect for employees
- Quality improvement
- Respect for the environment, in cooperation with local communities
- Safeguarding the future

Hydro-Québec’s employees,
**the key to high-quality service
and the company’s profitable growth**

Summary

The global electricity market is going through a period of profound changes designed primarily to create conditions for greater competition in power generation for the benefit of consumers, and to open up power transmission systems for better integration and more efficient development of markets.

In Québec, the wholesale electricity market has been open since May 1, 1997. TransÉnergie, a division of Hydro-Québec, now operates the transmission system in Québec on a non-discriminatory basis for all wholesale customers. The Québec government's Energy Policy (1996) calls on Hydro-Québec to help achieve the policy's objective of putting energy to work for Quebecers in accordance with the principles of sustainable development, while taking full advantage of the changes under way in the North American energy industry.

Elsewhere in Canada, only British Columbia and Alberta have opened up their wholesale markets. Alberta is the one province that has opened its retail market, and only partially. As for Ontario, the provincial government plans to open wholesale and retail markets simultaneously in 2000.

In the United States, market restructuring, combined with the decline in fuel prices seen up until the summer of 1999, has lowered electricity prices on wholesale markets. However, there has also been a drop in generation reserve margins, leading to price spikes during "needle peak" periods. Also, the restructuring of retail markets has proven to be slower than anticipated.

On the international stage, despite the recent slowdown in energy demand in many countries, world energy demand is expected to grow by more than 50% over the next 20 years, leading to major investments in infrastructure.

Corporate Orientations 2000-2004

Hydro-Québec's strategic orientations and objectives for the 2000-2004 period stem from the company's desire to **serve its customers better and contribute to the collective prosperity of Quebecers.**

These orientations reflect the business opportunities open to Hydro-Québec in the context of energy market restructuring. They are related to:

- prospects for profitable investments in the electricity industry in Québec and peripheral markets;
- growth potential arising from the convergence of various forms of energy;
- growing energy requirements on international markets.

Hydro-Québec has many advantages that position it to seize these business opportunities:

- hydroelectric potential that can be developed at costs as competitive as its existing generation costs;
- access to attractive Canadian and U.S. markets peripheral to Québec;
- employees with expertise, know-how and innovative ability;
- strong financial capability and attractive financing costs;
- an excellent network of industrial alliances;
- a worldwide reputation.

Armed with these competitive advantages, Hydro-Québec has established seven strategic orientations for the 2000-2004 period, grouped under three major themes.

Serve Customers Better

Orientation 1: *Maintain rate stability*

Hydro-Québec confirms that its Québec rates will remain frozen until April 2002. After that date, the company will aim to maintain rate stability for all its customers.

Rate stability over the Strategic Plan period should allow Hydro-Québec customers to realize a real gain of about 10% compared with the anticipated rise in the consumer price index (CPI) from 1998 to 2004.

Hydro-Québec plans to increase profitability without raising electricity rates, primarily by developing its markets and reducing financial expenses.

Orientation 2: *Improve service quality*

The improvement of service quality will be pursued on three fronts:

- improve service quality based on customers' priority expectations;
- improve the reliability of power supply for all customers;
- ensure security of supply for Québec customers, at competitive conditions.

Hydro-Québec will adjust its services to the priority expectations of its customers in order to raise the percentage of "very satisfied" customers to 50% — a 20% improvement over its performance at the beginning of 1999. The level of satisfied and very satisfied customers will be maintained at over 90%. Additional objectives are to cut down considerably on the annual average duration of service interruptions for all customers, respond more promptly to customers, and improve communications with municipalities.

Moreover, Hydro-Québec will continue to provide Québec customers with all the electricity they require at all times, at competitive conditions. Growth in electricity demand within Québec will increase sales by 17.4 TWh or 12% compared with 1999. The company aims to generate sales of 171 TWh on all markets by 2004. Its objective of 200 TWh, as stated in the *Strategic Plan 1998-2002*, will be reached by 2010.

Ensure the Company's Profitable Growth in Québec

Orientation 3: *Continue to develop profitable hydroelectric potential*

Hydro-Québec plans to continue developing profitable hydroelectric potential within Québec and on its periphery. This orientation reflects both the economic benefits of profitable hydroelectric projects and the many environmental advantages of hydroelectricity, including its contribution to reducing greenhouse gas emissions, acid rain, and other air pollutants.

Hydro-Québec reaffirms the three conditions for undertaking projects:

- They must be profitable under current market conditions, that is, based on a power-station price of 3¢/kWh.
- They must be environmentally acceptable, in accordance with the principles of sustainable development.
- They must be well received by local communities.

To support this orientation, Hydro-Québec intends to be more proactive in communicating the environmental benefits of hydroelectricity and the company's environmental performance.

Orientation 4: *Stimulate technological innovation within the company*

Hydro-Québec will maintain its technological leadership by refocusing its research and development (R&D) efforts on hydroelectric generation, electricity transmission and distribution, areas in which it will continue to innovate. Close coordination will be required between R&D, technology marketing and venture capital operations.

The company also intends to maximize the benefits of its technological innovations for its core activities, and to reposition its venture capital operations.

Seize Business Opportunities

Orientation 5: *Participate in the development of the North American electricity industry*

Hydro-Québec will rely on its technological expertise and recognized leadership in high-voltage transmission to seek business opportunities in the transmission sector, particularly in niches requiring a high level of technological skill. Hence, the company will participate in the development and application of new technologies designed to reduce congestion in certain electricity transmission corridors.

Orientation 6: *Participate in the development of the North American gas industry*

Hydro-Québec will continue to participate in the development of the North American gas industry through its stake in the holding company Noverco. Enbridge and Gaz Métropolitain, Noverco's operating companies, are active in the large-scale transportation of energy (natural gas, oil and natural gas liquids), as well as gas distribution. Hydro-Québec intends to maintain a very active presence in these important growth industries.

Hydro-Québec will also develop an investment plan that is complementary to its current participation in the gas industry. This investment program could include the upstream sector (excluding exploration, however) and could involve new gas-producing regions in Eastern Canada.

Orientation 7: *Continue international development*

Hydro-Québec's primary goal on the international stage is profitability. Specifically, it aims to obtain an average return on equity of 15% from its international investments, which should also foster medium- and long-term growth and open up major business opportunities for Québec's electricity industry.

In this regard, Hydro-Québec plans to focus its international operations on areas in which it has a high level of expertise, and fine-tune its business partnership approach. The company will join forces, first and foremost, with Québec partners to maximize the spinoffs in Québec.

Financial and Economic Outlook

Hydro-Québec's strategies and company-wide objectives will not only improve customer service, but increase the shareholder's return over the 2000-2004 period.

Hydro-Québec's consolidated net income will jump from \$925 million in 1999, the latest estimate for the current year, to \$1.6 billion in 2004, mainly on the strength of higher sales in Québec. Based on the consolidated results, the shareholder can expect to receive \$3 billion in dividend payments over the *Strategic Plan 2000-2004* period, in accordance with Hydro-Québec's dividend policy.

With the increase in net income, operations will generate funds of close to \$14.3 billion, after dividends, for the entire plan period. These funds will allow the company to finance its entire \$11.9-billion investment program for 2000-2004, and to allocate some \$2.4 billion to its financing operations in order to reduce long-term debt.

Shareholder's equity will increase by \$3 billion, from \$13.7 billion in 1999 to \$16.7 billion in 2004, raising the company's capitalization rate from 26.1% in 1999 to 32.3% in 2004.

In addition to paying dividends to its shareholder, the Québec government, Hydro-Québec also makes a major contribution to Québec's economy through its growth, capital investments and purchases of goods and services, as well as through the taxes it pays.

For the 2000-2004 period, Hydro-Québec's activities will help sustain 183,500 person-years of employment in all regions of Québec.

Introduction

Thanks to Hydro-Québec, the same quality of service and low rates are available to all Quebecers.

Brief History

Hydro-Québec has been serving Quebecers for over 50 years.

In 1944, the Québec government acquired Montreal Light, Heat and Power Consolidated for the specially created Québec Hydro-Electric Commission. This marked the beginning of Hydro-Québec. Serving customers mainly in the Montréal area, the new entity inherited four hydroelectric generating stations: Chambly, Rivière-des-Prairies, Les Cèdres and Beauharnois.

The end of the Second World War brought with it a period of profound changes: population explosion, stretching of city boundaries, and strong industrial growth. These changes intensified and accelerated at the end of the 1950s, forcing Hydro-Québec to undertake new development projects in order to meet its customers' growing needs.

In the late 1950s, Hydro-Québec began construction of the Manic-Outardes complex, where it applied all the know-how acquired over the years. To this end, it joined forces with Québec engineering firms, who would gain international prominence for their impressive achievements.

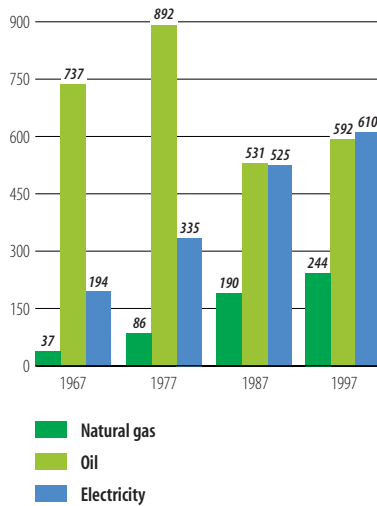
In 1962, to eliminate rate disparities and the excessive prices charged in certain outlying or resource-poor regions, the Québec government announced the nationalization of the electricity industry and brought it under the control of Hydro-Québec.

Hydro-Québec was now able to meet the needs of Quebecers as a whole, guarantee them the same improved quality of service, and develop electricity resources.

Inaugurated in 1968, the Daniel-Johnson dam at Manic-5 is a symbolic monument. The largest arch and buttress dam in the world, it is a source of great pride for Quebecers and a testament to their ingenuity. With a capacity of 5,517 MW, the Manic-Outardes complex guaranteed the availability of low-cost energy for Quebecers.

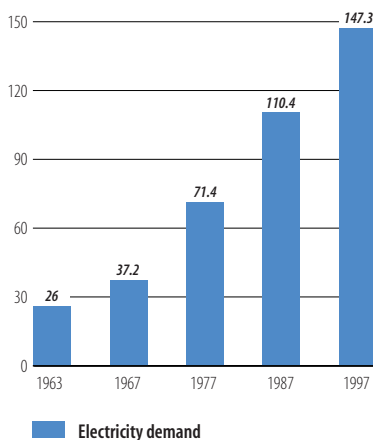
The commissioning of the Manic-Outardes complex also led to major technological innovations. For instance, Hydro-Québec was the first utility in the world to transmit electricity over long distances using very-high-voltage lines (735 kV), an initiative that has been followed elsewhere in the world.

Changes in Québec's Energy Balance
Final Energy Consumption
(in petajoules – PJ)



Source : Statistics Canada.

Electricity Demand in Québec
1963-1997* (TWh)



* Data for 1997 include the impact of energy conservation programs.

At the end of the 1960s, Hydro-Québec and Newfoundland & Labrador Hydro became partners in Churchill Falls (Labrador) Corporation (CFLCo) to develop the hydroelectric potential of the upper Churchill River in Labrador by building a 5,428-MW generating station.

In the early 1970s, the Québec government launched the La Grande hydroelectric complex in the James Bay territory, the largest construction project in Québec history. The soundness of this major investment decision became apparent a few years later, with the 1973 and 1979 oil crises. At the height of construction, more than half of all Québec construction workers were employed at the James Bay sites.

In 1975, Hydro-Québec, the Cree and Inuit communities, and the governments of Québec and Canada signed the *James Bay and Northern Québec Agreement*, which has since served as a model around the world. Over the years, other agreements were added to the original document to broaden its scope. Based on respect, understanding and the sharing of common goals, these agreements paved the way for new partnerships.

Thanks to abundant and low-cost energy from the James Bay facilities, Hydro-Québec was able to meet the growing needs of Quebecers and to promote the development of new industries. Gradually, electricity took on a larger role in Québec's energy balance, offering the province greater self-sufficiency and security of supply from a clean energy source.

In 1978, Hydro-Québec created a subsidiary called Hydro-Québec International (HQI) to open doors to new international markets. For many years, HQI was primarily involved in technical assistance, especially in French-speaking African countries.

Phase I of the La Grande complex was completed in the early 1980s. The Québec National Assembly amended the *Hydro-Québec Act* to allow the company to pay an annual dividend to the government and to sell more electricity outside Québec. At the end of the decade, Hydro-Québec announced the start of phase II of the La Grande complex.

The 1990s saw the continuation of hydroelectric development, the implementation of an ambitious energy efficiency program and the improvement of customer service.

On May 1, 1997, Québec joined the continent-wide movement toward liberalization and opened its transmission system and wholesale electricity market to competition.

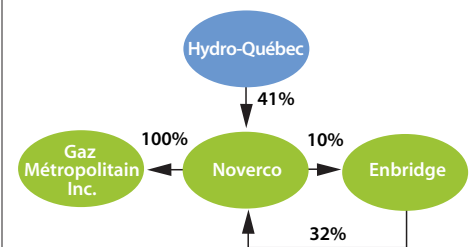
In November 1997, H.Q. Energy Services (U.S.), a subsidiary of Hydro-Québec, was licensed by the U.S. Federal Energy Regulatory Commission (FERC) to sell wholesale electricity at market prices. This allowed the company to conduct transactions directly in the United States under regular market conditions, further profiting from the major assets and commercial expertise developed over the years in Québec.

Spurred by the energy convergence sweeping North American markets, Hydro-Québec acquired a 41% stake in Noverco, the holding company which owns Gaz Métropolitain. It also acquired a major indirect interest in IPL Energy, now known as Enbridge, the world's leading pipeline company and the largest gas distributor in Canada.

In 1997, Hydro-Québec tabled its first Strategic Plan, covering the period from 1998 to 2002. The plan established orientations focusing on growth and profitability, and included a freeze on electricity rates in Québec until 2002.

At the dawn of a new millennium, Hydro-Québec — a business-driven publicly owned company — now has the necessary tools to improve service to its Québec customers, contribute to the collective prosperity of Quebecers, and take advantage of promising business opportunities.

Hydro-Québec and Energy Convergence



Business Environment

The global electricity industry is going through a period of profound changes.

These changes are designed to create conditions for greater competition in power generation for the benefit of consumers, and to open up power transmission systems for better integration and more efficient development of markets.

Market liberalization is causing major restructuring in the industry. More and more, two types of activities and regulatory frameworks are emerging: natural transmission and distribution monopolies regulated on a cost basis, and the competitive activity of generation, which is largely if not completely deregulated.

Within this general context and in an effort to create value for its customers, shareholder and employees, Hydro-Québec has established the orientations in this Strategic Plan.

Situation in Québec

The objective of the Québec government's 1996 Energy Policy is to put energy to work for Quebecers and to respect the principles of sustainable development, while taking full advantage of the changes under way in the North American energy industry.

This policy calls for Hydro-Québec's input and outlines a number of major orientations that concern the company:

- Hydro-Québec shall remain the exclusive property of the Québec government.
- Hydro-Québec shall improve its profit margin and generate a higher return for its shareholder.
- Hydro-Québec shall become the cornerstone of an industrial strategy aimed at making Québec a major energy hub.
- Hydro-Québec shall pursue its research and development (R&D) efforts, while emphasizing the commercial potential of its projects, so as to increase its partnership opportunities with the private sector and generate greater industrial and commercial spinoffs.
- Hydro-Québec shall seek to forge a new economic partnership with Aboriginal nations, with a view to developing the energy resources of northern and eastern Québec.

As it did in the *Strategic Plan 1998-2002*, Hydro-Québec has continued to take these orientations and the central objective of the Energy Policy into account in formulating this Strategic Plan.

Regulatory Framework

Since December 1996, the *Régie de l'énergie* (Québec energy board) has provided a regulatory framework for energy distribution. As a result, electricity rates in Québec are subject to its approval. Hydro-Québec's transmission and distribution activities, like those of the gas industry, are subject to the conventional form of regulation based on the cost of service for those activities. As for power generation, the *Act respecting the Régie de l'énergie* states that the Québec government shall dictate the initial conditions for establishing supply rates, which represent the energy portion of the customer's bill. Hydro-Québec is still awaiting a decision by the Québec government in this regard.

The Québec wholesale electricity market has been open since May 1, 1997. This market comprises 11 distributors: Hydro-Québec, nine distributors operating municipal systems, and one regional electricity cooperative. The opening of the wholesale market means that the municipal systems and the regional electricity cooperative can, like Hydro-Québec, purchase electricity outside Québec, and independent producers in Québec can, like Hydro-Québec, sell their electricity outside Québec.

TransÉnergie, a division of Hydro-Québec, operates the transmission system in Québec on a non-discriminatory basis for the benefit of all wholesale customers.

Because of Hydro-Québec's highly competitive electricity rates for its Québec customers, no transaction has been recorded to date involving outside producers supplying electricity directly to the Québec wholesale market, apart from Hydro-Québec's direct purchases outside Québec.

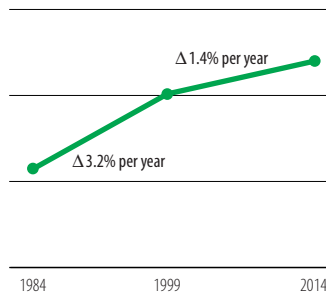
The market pressures that have led to deregulation in retail markets elsewhere are not as significant in Québec. Hence, given the absence of tangible benefits for Québec customers, Hydro-Québec does not intend to promote the opening of this market.

Nevertheless, the *Act respecting the Régie de l'énergie* does state that the government may, when it deems it appropriate, ask the *Régie de l'énergie* to look into the possibility of opening up the retail market. Hydro-Québec does not expect any initiative on this matter in the short term.

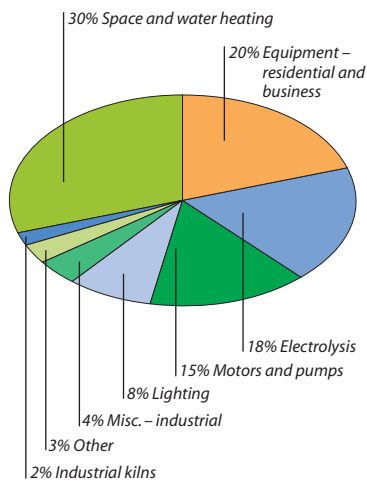
Québec Electric Power Distributors

- Hydro-Québec
- 9 municipal systems
- 1 regional electricity cooperative

**Growth in Demand
1984-2014 (TWh)**



Electricity Sales by Use



Electricity Demand in Québec

The energy market is driven by the economy. From 1984 to 1999, electricity demand increased by an average of 3.2% per year, sparked by strong growth in industrial demand, and tempered by the success of energy efficiency programs.

Since the early 1990s, Hydro-Québec has been the Québec leader in energy efficiency. Its programs have generated energy savings of 2.5 TWh per year, and have substantially changed the consumption habits of more than half its customers.

In fact, energy efficiency gives some large-power customers a major competitive edge. Several high-performance industrial technologies developed by Hydro-Québec researchers have enabled customers to improve their competitive position.

Over the next 15 years, electricity demand in Québec should rise at an average of 1.4% per year — a moderate rate that reflects the steady expansion of a highly diversified and energy-efficient economy.

The lower rate of demand growth in Québec compared with the 1984-1999 period is due to:

- a slowdown in population growth;
- a slowdown in the setting up of large-power industrial plants;
- increased efficiency in electricity use.

Québec's energy efficiency, widely recognized within the industry, is all the more remarkable in that Québec has inexpensive electric power. Following are some of the factors that contribute to this performance:

- Québec buildings are among the best-insulated in the world;
- Most electric water heaters meet a high efficiency standard;
- Electric heating from hydropower results in energy losses of less than 10%, compared with at least 30% for fossil-fuel heating;
- More than 99% of public lighting in Québec uses high-performance sodium technologies;
- Most energy-intensive industries (pulp and paper, metallurgy, motorized processes) utilize cutting-edge technologies.

Competitive Position in Québec

Electricity, closely linked with modern development and new technologies, is the energy of choice in Québec. As the sole distributor for more than 97% of the Québec market, Hydro-Québec benefits from this favorable market position and the multiple uses of electricity.

Apart from uses exclusive to electricity, such as lighting, electronics, household appliances and automation, electricity is also widely used in air conditioning and home heating. It shares the commercial, institutional and multi-family-dwelling heating market with natural gas and oil. The only markets where electricity is absent, with a few exceptions, are road transportation and industrial heating.

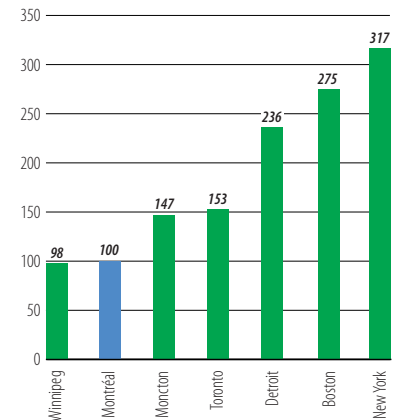
Electricity rates in Québec, as in other regions of the continent with primarily hydro-electric power, are among the lowest in North America. The rate freeze adopted by Hydro-Québec in May 1998 will help maintain this advantage.

To ensure that its business practices are in keeping with the times, Hydro-Québec has been monitoring the expectations of its different customer categories since the early 1990s. It also consults regularly with representatives of various organizations, such as the *Union des producteurs agricoles* (farm producers), the *Union des municipalités du Québec* (municipalities) and the *Union des municipalités régionales de comté du Québec* (regional county municipalities).

The basic expectations are the same for all customer categories, with minor differences related to the particular situation of each customer category.

For example, in the case of scheduled service interruptions for maintenance purposes, commercial, institutional and industrial customers want to be able to negotiate the work schedule and timetable, so that they can better plan the management of their business. Residential customers mainly want to be notified of the timing and duration of these scheduled interruptions.

Residential Customers
Comparative Index of Electricity Prices



Hydro-Québec = 100

Monthly bill for 1,000 kWh excluding sales taxes

Rates effective May 1, 1999

Customer Expectations

Business Relations

- Fair and equitable treatment
- Respect for customers and understanding of their needs
- Low and competitive rates
- Reliable means of measuring consumption
- Prompt, clear and courteous telephone response
- Accurate billing based on actual consumption

Power Supply

- Safe facilities
- Service restored rapidly following power outages
- Prior notification and consultation on scheduled interruptions
- Fewer power failures
- Prompt and accurate information in the event of power failure
- Sufficient supply for the future
- Respect for property when work is required

The order of priority of these expectations changes with time. For example, because customers now use many household appliances with built-in clocks, they are more aware of power outages than 20 years ago. Furthermore, as a result of the improved quality of service in various sectors of the economy, the utility's customers now expect faster service which is backed up by guarantees.

Although for the past five years more than 92% of customers have said they are satisfied or very satisfied with Hydro-Québec, there is a decline in the level of customer satisfaction concerning contact with the company. Indeed, this finding has given rise to some major initiatives, which are described later in this Plan.

Situation in North America

Hydro-Québec has been making substantial electricity sales outside Québec for many years now. In 1998, for example, export sales amounted to over \$800 million, or nearly 10% of overall sales. The development of these markets is therefore important for Hydro-Québec.

Situation in the United States

Market restructuring in the United States stems from the 1992 *Energy Policy Act* and the publication, four years later, of Federal Energy Regulatory Commission (FERC) Orders 888 and 889, which opened up the wholesale market and transmission systems. Order 888-A later confirmed certain complementary provisions concerning the restructuring process, including the obligation for foreign entities wishing to do business on the U.S. wholesale market to provide reciprocal access to their own transmission systems and wholesale markets.

Wholesale market

Since January 1997, the U.S. wholesale market has been deregulated following the establishment of conditions for non-discriminatory open access transmission systems. In this regard, the power marketer license granted by the FERC to H.Q. Energy Services (U.S.) gives the company greater business flexibility in its choice of transactions. Electricity can now be delivered under attractive conditions not only at the Québec border, but also directly to the markets.

Since it was opened to competition, the U.S. wholesale market has undergone profound changes. In the Northeastern states, public utilities have disposed of over 40,000 MW of generating assets, thus opening the door to new players, often large ones, specializing in the generation and trade of electricity and other forms of energy — gas, coal and oil. The opening of the wholesale market has also led to the emergence of power brokers and marketers, who handle an ever-increasing share of the recorded sales volume. This is made possible by the creation of power exchanges which enable producers and resellers to participate in short-term markets via direct tenders.

Generally speaking, market deregulation, combined with the decline in fuel prices seen up until the summer of 1999, has lowered electricity prices on wholesale markets. However, there has also been a sharp drop in production reserve margins, leading to price spikes during peak periods. For example, market prices exceeded U.S.\$1,000 per megawatthour, or 30 times the average price, for several hours in July 1999 on the New York and New England markets. Such developments in the wholesale market allow Hydro-Québec to take advantage of the arbitrage margins provided by its reservoirs and interconnections.

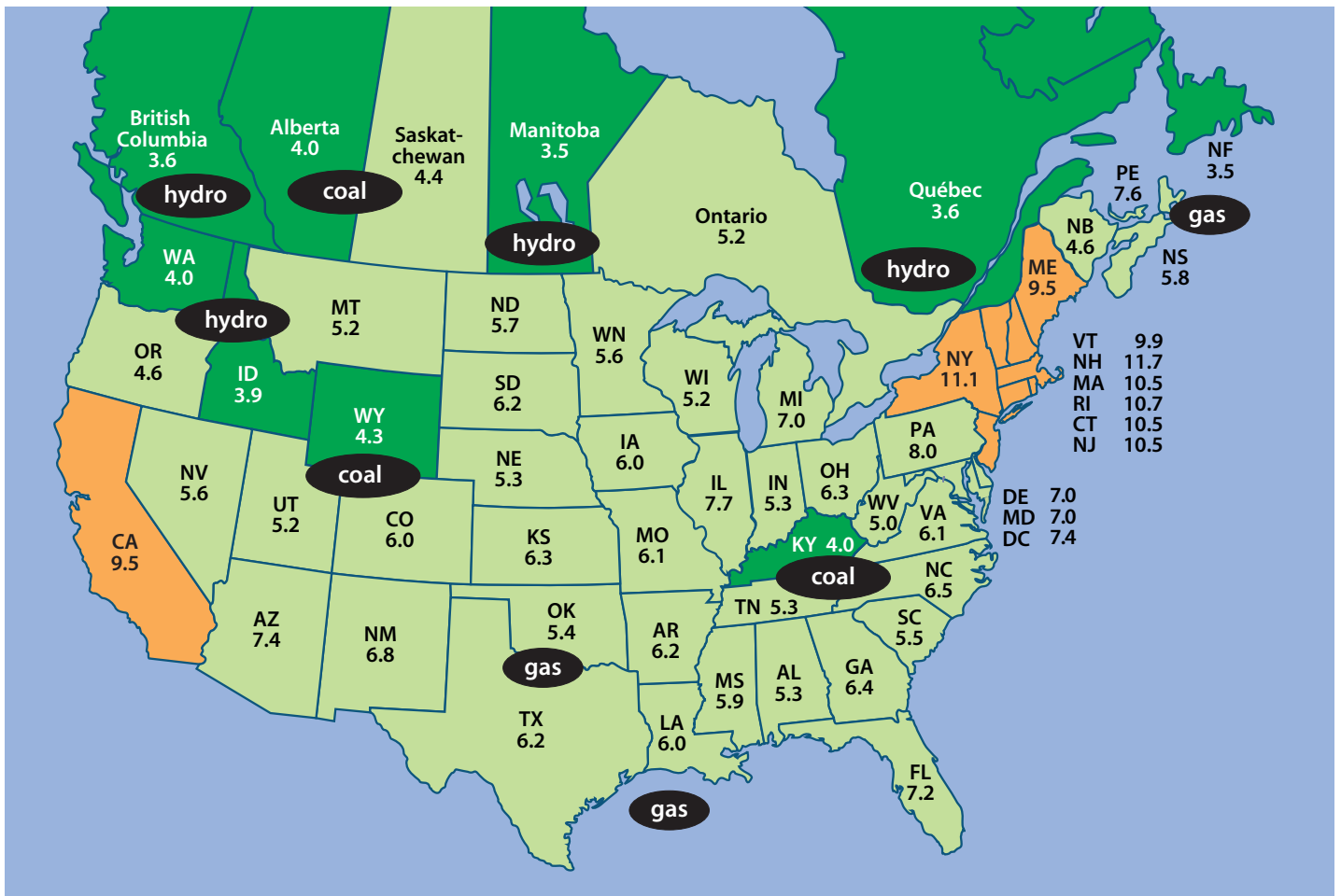
As for transmission systems, the trend is toward consolidation into integrated systems managed by Independent System Operators (ISOs). It appears, however, that this consolidation has not fully met the FERC's expectations with respect to the development of transmission systems and their efficient, secure and non-discriminatory management. Consequently, the FERC recently issued a *Notice of Proposed Rulemaking* to encourage the creation of regional transmission organizations, or RTOs. The purpose of these organizations is to make transmission systems more independent from wholesale market players, while ensuring more uniform transmission rates and facilitating the development of systems in congested areas.

It should be noted that Hydro-Québec's transmission system, operated by TransÉnergie, already meets these requirements, primarily due to three characteristics:

- its geographical reach;
- uniform rates throughout the system, including interconnections and lines located in Labrador;
- independent management ensured by the unbundling of TransÉnergie's operations vis-à-vis Hydro-Québec's generation and wholesale operations.

North American Market

Average Price of Electricity by State and Province
(1997 overall average, in U.S.¢/kWh)



Source: Energy Information Administration (U.S.), Natural Resources Canada

<p>U.S. electricity market U.S.\$200 billion</p> <p>Northeastern U.S. market U.S.\$55 billion</p>	<p>Highest and lowest rate zones</p> <ul style="list-style-type: none"> > 9.0 U.S.¢/kWh: Northeast and California < 4.4 U.S.¢/kWh: mostly hydroelectric regions 	<p>Energy sources of U.S. utilities:</p> <table border="0"> <tr> <td>56% coal</td> <td>10% hydroelectric</td> </tr> <tr> <td>21% nuclear</td> <td>3% oil</td> </tr> <tr> <td>10% gas</td> <td></td> </tr> </table>	56% coal	10% hydroelectric	21% nuclear	3% oil	10% gas	
56% coal	10% hydroelectric							
21% nuclear	3% oil							
10% gas								

Retail market

In the United States, the decision to open the retail market and the establishment of conditions rest with each state. However, certain federal legislative initiatives reflect an intention to encourage a more uniform time frame for market opening across the country. The restructuring process is turning out to be slower than expected.

States are hesitant to open their retail markets largely because of difficulties related to the recovery of stranded costs. These costs are estimated at 1.5 to 3.5 ¢/kWh in many states, which could represent between 30 and 35% of the customer's bill for three to 12 years, depending on how the costs are recovered. This could diminish much of the short-term benefit of retail market restructuring as far as the consumer is concerned.

States where the restructuring process is most advanced are generally those with the highest electricity prices. For example, the retail market has already been opened or is on the verge of being opened in California, Pennsylvania, New York State, and most New England states. However, with the exception of Pennsylvania, where many customers opted for a different electricity supplier, so far the results have not been very significant. In fact, in exchange for complete recovery of their stranded costs, several public utilities have been ordered by their regulators to lower their rates, which has limited business opportunities for potential competitors. Many companies that were once interested in retail markets have therefore decided to withdraw from this sector.

Furthermore, in another major development, regulatory bodies in 23 states where electricity prices are lower than the national average have joined forces to demonstrate their constituents' lack of interest in opening the retail market, given the low prices already in effect.

"Stranded costs" refer to what it will cost, within the context of the opening of retail markets, to:

- write down non-performing facilities owned by utilities, at their probable market value;
- terminate power supply contracts established at above-market prices;
- amortize demand-management programs over a shorter period of time than initially anticipated.

Situation in Canada

Although a major restructuring process is already under way in Canada, the liberalization of electricity markets remains limited in most provinces.

Apart from Québec, only British Columbia and Alberta have opened up their wholesale markets. On the retail side, Alberta is the one province that has opened its market, and only partially.

In Ontario, the review and consultation processes initiated in 1995 on the future of the electricity industry have led the government to embark on a major market restructuring. In 1999, Ontario Hydro was split into three separate entities, all having the government as their sole shareholder: a generation entity, an electricity services entity handling transmission, distribution and customer service, and an entity responsible for the independent management of the system as well as the power exchange to be opened in 2000, when the wholesale and retail markets will be opened to competition simultaneously. Given this planned opening of the Ontario market, Hydro-Québec should be able to make off-peak purchases for power supply and price arbitrage purposes.

The profound changes in Ontario are mainly in response to the rate hikes of the early 1990s and the problems associated with nuclear power facilities. But, as in the United States, stranded costs are expected to mitigate the beneficial effects for consumers.

In New Brunswick, another power system adjacent to Hydro-Québec, the transmission system is open for certain transactions. Hence, the province's independent producers can use New Brunswick Power's transmission system to wheel-out their production. However, the province has still not established non-discriminatory open access conditions allowing external suppliers to use the system to wheel-through energy to customers outside New Brunswick.

International Situation

Despite the recent slowdown in energy demand in many countries because of the international financial crisis, world energy demand is expected to grow more than 50% over the next 20 years. Growth will be driven mainly by the newly industrialized or developing countries of Asia, South America and, to a lesser extent, Eastern Europe.

In most of these regions, the absence or inadequacy of energy infrastructures often constitutes one of the biggest roadblocks to economic growth. New energy demand is expected to give rise to projects worth about \$1,000 billion between now and 2010, half of them in Asia.

This strong growth presents a major challenge in terms of global warming. According to the International Energy Agency, unless new policies are adopted, fossil fuels are expected to meet 95% of new global energy requirements between 1995 and 2020, leading to a 70% increase in carbon dioxide emissions.

The Kyoto Protocol of 1997 set targets for the reduction of greenhouse gas emissions by the signatory countries. Achieving the target in Canada, where 64% of electricity is already generated from water resources, is clearly predicated on the continued development of profitable hydroelectric potential.

Hydroelectricity can, indeed, play a vital role in achieving the goals of the Kyoto Protocol. Given its many advantages, hydroelectricity is an option that complies with the principles of sustainable development:

- It is a renewable source of energy.
- Its operations do not reduce the world's energy reserves.
- It creates very few air pollutants such as greenhouse gases.
- Hydroelectric facilities have a lifespan of over half a century, and are largely paid for by the generation that decides to build them.

Between now and 2005, an estimated \$100 billion in capital investments will be needed just to meet the world's new hydropower demand, primarily in Asia and South America.

Access to capital and know-how is a major hurdle for many countries experiencing rapid economic and demographic growth. They are therefore inviting companies operating on the international scene to invest in their energy infrastructures in order to accelerate development.

Indicators of the Environmental Impacts of Electricity Generation Options^a

Generation options	Energy payback ratio ^b	Land area used (km ² /TWh/year)	Greenhouse gas emissions (kt CO ₂ eq./TWh)	SO ₂ emissions (t SO ₂ /TWh)	NO _x emissions (t NO _x /TWh)
Hydroelectric with reservoir	205	40 to 152	5 to 20	5	11
Coal	11	4	913	1,018	919
Natural gas (combined-cycle turbines)	26	10	511	413	416
Biomass (with tree planting)	5	533	118	26	26
Wind energy (without backup)	23	72	38	69	50

a) The indicators in this table apply to new generating stations that would be built in North America and take into account not only the construction and operation of the facilities, but also the extraction and transportation of fuel.

b) Energy payback ratio: energy produced/energy consumed to build and operate the generation option.

The table above shows the advantages of hydroelectricity compared with other available options. The following conclusions can be drawn from this table:

- In terms of amount of energy supplied versus the amount of energy required to operate its facilities, hydroelectricity is the best-performing option.
- Options using a renewable energy source take up more space than the other options, which means that local environmental and social factors must be considered at the design stage and measures must be taken to ensure environmental and social acceptability.
- Hydroelectricity is the option that emits the least amount of greenhouse gases.
- Hydroelectricity is the option that emits the fewest air pollutants.

Corporate Orientations 2000-2004

Achievements benefiting Québec customers

- *Uniform rates*
- *Low rates*
- *Stable rates*
- *Service quality*
- *Public ownership*

Hydro-Québec's orientations and objectives for the 2000-2004 period stem from the company's desire to **serve its customers better and contribute to the collective prosperity of Quebecers.**

The orientations of the *Strategic Plan 2000-2004* reiterate the social pact based on the benefits gained through the nationalization of electricity in Québec, namely:

- uniform rates by customer category throughout the power system;
- rate stability afforded by hydroelectric generation, for all customer categories;
- low rates, particularly in the residential sector;
- public ownership of the company.

The corporate orientations are also based on Hydro-Québec's commitments for the past 10 years regarding its performance and the continued improvement of service to Québec customers:

- reliable and improved service;
- secure supply consistent with the growth in Québec electricity demand;
- a profitable and efficient government-owned corporation.

Furthermore, the orientations reflect the business opportunities open to Hydro-Québec in the context of energy market restructuring. These new business opportunities are related to:

- prospects for profitable investments in the electricity industry in Québec and peripheral markets;
- growth potential arising from the convergence of various forms of energy;
- growing energy requirements on international markets.

Hydro-Québec has a number of major advantages that position it to achieve the objectives it has set in relation to its strategic orientations for the 2000-2004 period:

- hydroelectric potential that can be developed at costs as competitive as its existing generation costs;
- access to attractive Canadian and U.S. markets peripheral to Québec;
- employees with the necessary expertise, know-how and innovative ability;
- strong financial capability and attractive financing costs;
- an excellent network of industrial alliances;
- a worldwide reputation.

Armed with these competitive advantages, Hydro-Québec has established seven orientations for the 2000-2004 period, grouped under three major themes:

Serve customers better

Ensure the company's profitable growth in Québec

Seize business opportunities

Human resources: the key to high-quality service and the company's growth

On a day-to-day basis, Hydro-Québec's employees are key to the achievement of high-quality service, the development of hydroelectric potential, technological innovation and, more generally, the company's growth and profitability. They embody Hydro-Québec's expertise and know-how.

Hydro-Québec relies first and foremost on its employees to satisfy its customers, in all categories, and achieve the expected financial results.

Know-how

For Hydro-Québec to meet customer expectations, its employees must have a strong ability to adapt to change, particularly with respect to the rapid development of information technologies. Hydro-Québec will therefore provide for the enhancement of employees' technical, business and interpersonal skills, in order to ensure the renewal of its work force and the continuity and development of know-how.

To this end, among other measures, Hydro-Québec plans to hire some 1,500 new employees, most of whom will be recent graduates in strategic technical fields, over the 2000-2004 period.

Rallying employees

The enthusiastic and productive contribution of each employee toward the achievement of the objectives set forth in the *Strategic Plan 2000-2004* is an essential condition for success.

The measures that will be implemented include:

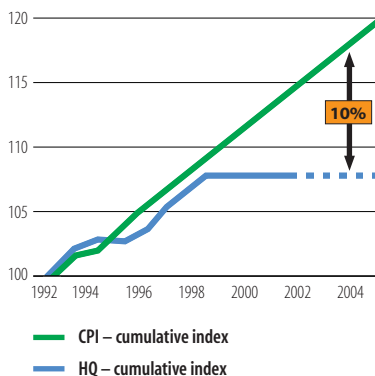
- a company-wide project to help all employees understand Hydro-Québec's issues and strategic orientations, and strengthen their commitment to their jobs;
- increased direct communication with employees by managers at all levels;
- for all employees, incentive compensation tied to the company's annual results, to be evaluated based on achievement of the objectives for Hydro-Québec's President and Chief Executive Officer, as determined by the Board of Directors.

Mutual respect between the unions and management, and the recently negotiated five-year labor contract — which includes a profit-sharing plan tied to performance improvement — should make it easier for the company to achieve its corporate objectives over the next five years.

Serve Customers Better

Hydro-Québec's
raison d'être:
its customers

Rate freeze confirmed
until 2002 – objective of
rate stability thereafter



In keeping with the expectations of its Québec customers, Hydro-Québec plans to maintain rate stability, improve the quality of its customer service, increase the reliability and quality of power supply, and place a priority on meeting new electricity demand in Québec.

With these objectives in mind, Hydro-Québec sets forth the first two orientations of its *Strategic Plan 2000-2004*.

Orientation 1 **Maintain rate stability**

Electricity rates have a direct impact on household budgets and the Québec economy. Hydro-Québec plans to maintain the advantages enjoyed by its customers in terms of electricity rates.

This orientation is based on the following two strategies:

- 1.1** Confirm the rate freeze until 2002 and aim for rate stability thereafter
- 1.2** Improve the company's efficiency

Strategy **1.1**

Confirm the rate freeze until 2002 and aim for rate stability thereafter

Hydro-Québec confirms that its Québec rates will be frozen until April 2002. After that date, the company will aim to maintain rate stability for all its customers.

Rate stability over the Strategic Plan period should allow Hydro-Québec customers to realize a real gain of about 10% compared with the anticipated rise in the consumer price index (CPI) from 1998 to 2004.

In so doing, the company intends to improve profitability without rate increases, primarily by developing its markets and reducing financial expenses. Rate stability also means that Hydro-Québec will not propose any measures to the *Régie de l'énergie* designed to modify the cross-subsidization of distribution service among the different rate categories. This cross-subsidization benefits mainly residential customers, but does not affect large industrial customers.

Rate stability cannot help but stimulate investment in Québec and thus support the company's sales forecasts for the coming years.

Strategy 1.2

Improve the company's efficiency

Rate stability will also be achieved through the rigorous management of the company's activities. Hydro-Québec will maintain its sound management practices with the aim of continuously improving efficiency.

This strategy includes the following objectives over the 2000-2004 period:

- Tight control of annual operating expenses (\$1.7 billion). Doing more at less cost, getting the most out of each dollar spent.
- Control of non-income-generating investments, while ensuring the continued reliability of facilities. As a percentage of the original value of fixed assets in operation, these investments will be limited annually to 1.2% for generation, 1.3% for transmission and 1.4% for distribution.
- Optimizing the value of under-utilized assets.

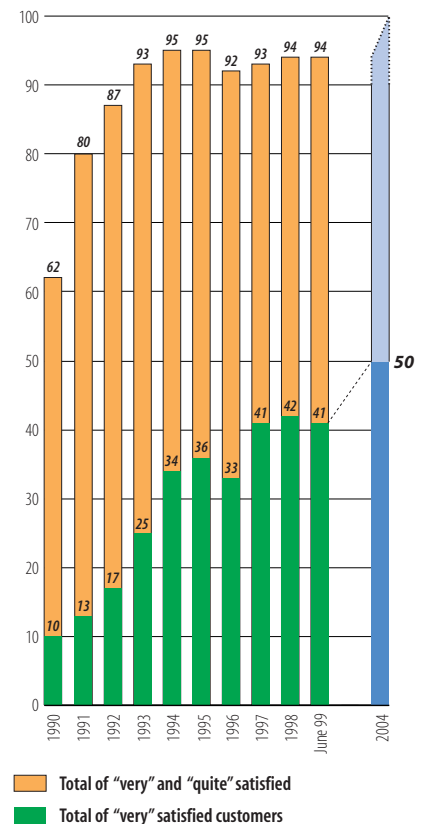
Orientation 2

Improve service quality

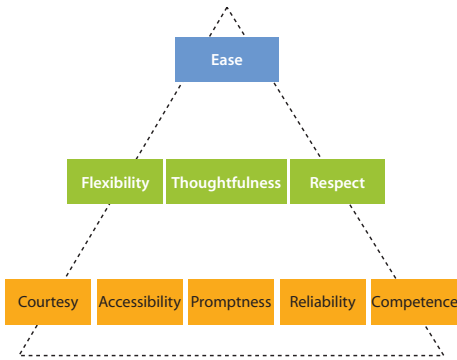
Following a significant upswing in the early 1990s, general customer satisfaction with Hydro-Québec has stabilized over the past three years. The percentage of very satisfied customers today stands at around 40%. However, there has been a noticeable drop in customers' satisfaction regarding their contacts with the company, one of the most important indicators for a utility such as Hydro-Québec.

Today's customers expect improved service from Hydro-Québec in terms of quality, reliability and security of supply. The company plans to meet the challenge and to regain its position as a leader in Québec for the quality of customer service at all levels.

Rate of Customer Satisfaction (%)



Dimensions of Customer Service



Customers tell us ...

- *“When we call, we want quick access to an employee who has the information and who can solve our problem.”*
- *“I like dealing with friendly employees who don’t make me feel I’m bothering them, and who are understanding.”*

Hydro-Québec aims to achieve a “very satisfied” rating among 50% of its customers by 2004, a 20% improvement over its performance at the beginning of 1999. The level of satisfied and very satisfied customers will be maintained at over 90%.

This orientation is based on three strategies:

2.1 *Improve service quality based on customers’ priority expectations*

2.2 *Improve the reliability of power supply for all customers*

2.3 *Ensure security of supply for Québec customers, at competitive conditions.*

Strategy **2.1**

Improve service quality based on customers’ priority expectations

Efforts to improve service quality will be based on the priority expectations of each customer category.

Hydro-Québec plans to improve service through the following actions:

- respond more promptly to customers who contact the company’s call centres;
- offer guarantees regarding priority services such as connection to the power system, including the day (morning or afternoon) on which work will be performed;
- provide customers with reliable and accurate information on the nature and duration of power outages, as well as the date and duration of scheduled service interruptions;
- for the appropriate business customer segments, guarantee the terms of negotiated agreements on scheduled interruptions;

Quality Partnership

The goal of *quality partnership* is to constantly improve customer-supplier relations with large-power customers by holding meetings to assess Hydro-Québec’s performance as well as the customer’s. Through these meetings, action plans will be developed to optimize:

- reliability of electrical service
- rates
- technical issues
- customer service and billing
- marketing of energy products and services
- business relations between the customer and Hydro-Québec.

- offer a choice of more flexible payment and billing methods;
- set up one-stop access to Hydro-Québec's services for business customers with multiple sites. Also offer these customers flexible rate options and information in real time;
- promote *quality partnerships* with large-power customers;
- improve product offerings related to electricity use, such as water heaters, electronic thermostats, convectors and dual-energy heating systems;
- propose business customer programs for the replacement and addition of electrical equipment (electrotechnology implementation support, roof units, etc.);
- offer customers a range of interactive and transactional Internet services: billing, bill payment, transmission of meter data, change of address, etc. Also offer large-power customers full Internet access to their file and the possibility of conducting short-term transactions over and above their current consumption.

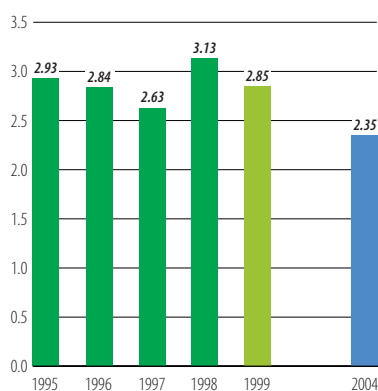
Hydro-Québec recognizes that electricity is also an essential service for lower income households, which sometimes have difficulty paying their bills. As a result, there are no service interruptions for non-payment during the winter.

In this area, Hydro-Québec will continue working toward equitable payment arrangements to make it easier for all customers to pay their electricity bill. Sustainable solutions will be sought with community representatives to help customers who have serious difficulty paying their bills and to prevent them from going deeper into debt. An interesting experiment in this regard, the *Budget éclairé* (budget assistance) project, is currently under way among 600 customers in Montréal and the Mauricie region.

In terms of energy efficiency, Hydro-Québec will offer its customers new services to help them understand and optimize their electricity consumption. Measures will also be taken to advise customers on the purchase of more efficient equipment and on energy conservation in general.

Equitable and sustainable solutions for lower income households.

Average Number of Hours of Service Interruption Per Customer*



* Not including exceptional major weather events.

In addition, to be fair to all customers, Hydro-Québec will propose energy efficiency programs in which any program costs exceeding the supply rate will be assumed solely by the customers who benefit from the program.

Finally, Hydro-Québec will carefully assess the remaining energy conservation potential in Québec, possibly in conjunction with the *Agence de l'efficacité énergétique* (Québec energy efficiency agency).

Strategy 2.2

Improve the reliability of power supply for all customers

The reliability of power supply, measured in terms of service interruptions due to outages or system repairs, is an obvious indicator of Hydro-Québec's service quality. The past few years have seen a deterioration in performance in this regard, even after excluding the effect of extreme weather conditions such as the 1998 ice storm and the violent storms of the summer of 1999.

By 2004, Hydro-Québec aims to lower the average annual duration of service interruptions by 20%, to 2.35 hours per customer for all customer categories. For very densely populated areas, which compare poorly with results in other large North American cities, the goal has been set at 1.3 hours per customer, a 45% improvement for downtown Montréal.

First of all, Hydro-Québec will implement the action plan designed to strengthen the power system following the extreme weather events of the past three years. This action plan includes:

- \$175 million to be invested in the distribution system, beginning in 1999. In high-risk areas, these investments will strengthen priority connections and control the failure mode of other lines so that, in extreme situations, service can be restored to most customers in less than a week;
- \$620 million for transmission system looping and reinforcement.

Secondly, the company will favor undergrounding in urban areas, which will also help make the cityscape more attractive. Hydro-Québec will invite a set of partners, including municipalities, telephone and cable companies, to participate financially in an undergrounding program on an equitable cost-sharing basis. This program, to which Hydro-Québec is prepared to contribute up to \$100 million per year and which will be stepped up over the Strategic Plan period, will be subject to the approval of the *Régie de l'énergie*. It will include:

- undergrounding of the existing distribution system to improve the appearance of sites recommended by the municipalities, for which Hydro-Québec will contribute 70% of the cost up to a maximum of \$25 million annually;

- undergrounding of the existing distribution system in densely populated urban areas, with equitable cost-sharing among the partners;
- undergrounding of any new extension of the distribution system in urban areas with average population density, for which Hydro-Québec will reduce by half the residential customer's current required contribution. Appropriate bylaws will have to be passed by the municipalities concerned.

At the same time, the company will step up its R&D efforts to reduce the cost of installing underground systems and thereby accelerate their development in Québec.

Hydro-Québec also plans to offer its business customers a range of "à la carte" products subject to payment of the corresponding fees, particularly with regard to power quality, which is a major factor in various high-technology manufacturing processes.

Finally, in order to achieve its power supply reliability objectives, the company will continue improving the reliability, availability and security of its generating facilities.

Strategy 2.3

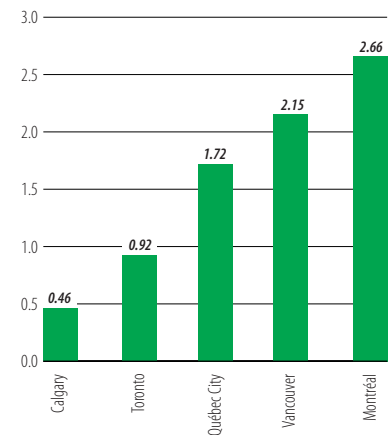
Ensure security of supply for Québec customers, at competitive conditions

Hydro-Québec will continue, as it does today, to provide Québec customers with all the electricity they need at all times, at competitive conditions. This is both a legal obligation and a reflection of Hydro-Québec's key role as a distributor.

By 2004, growth in electricity demand in Québec will generate 17.4 TWh in additional sales compared with 1999, an increase of 12%. These additional sales in Québec break down as follows:

- 7.0 TWh in the small- and medium-power markets (Rates D, G and M);
- 10.4 TWh in the large-power market (Rate L).

Canadian Cities
Average Number of Hours of Service Interruption Per Customer* – 1998



* Not including exceptional major weather events.

The table *Forecast Electricity Demand in Québec by Sector* is based on an average-growth scenario.

Forecast Electricity Demand in Québec by Sector (in TWh)						
	1999	2000	2001	2002	2003	2004
Residential and farm	49.9	51.8	52.0	52.6	53.2	53.7
General and institutional	29.6	30.2	30.6	31.0	31.4	31.8
Industrial	62.7	64.3	69.3	71.5	72.6	73.9
Others	4.4	4.5	4.6	4.6	4.6	4.6
Total sales in Québec	146.6	150.9	156.5	159.7	161.9	164.1
Small and medium power	85.3	88.0	88.8	90.1	91.3	92.3
Large power	61.3	62.9	67.7	69.6	70.6	71.7

In 2004, Hydro-Québec intends to achieve annual sales of 71.7 TWh on Québec large-power markets, 10.4 TWh or nearly 17% more than in 1999.

These new sales will stem from the general increase in industrial output and the penetration of high-performance electrotechnologies. Three major industries account for over 80% of this growth, largely related to industrial projects that have already been announced:

- pulp and paper, with three customers currently supplied by Alcan's system switching to Hydro-Québec;
- smelting and refining, with Alcan's new smelter in Alma and the increased production of magnesium and titanium dioxide;
- iron and steel, due to production catch-up and industrial development projects in ferroalloys.

The company will continue to support industrial development projects by offering, as it does to all its customers, a reliable supply of high-quality power at competitive rates applicable throughout Québec. With this in mind, Hydro-Québec will continue prospecting for companies that are most likely to launch value-added industrial projects in Québec. To do so, the company will increase its knowledge of markets and projects with the specific goal of identifying companies for whom the availability and cost of electricity are determining factors for location.

The restructuring of the North American market will not lead to uniform industrial rates across the continent. Hydro-Québec will continue to sell electricity to its industrial customers in Québec at low and stable regulated rates, while selling at market prices elsewhere in North America. These market prices will inevitably be higher than the Québec supply rate, given the competitive advantage of Québec's hydroelectric generation and the cost of delivery to other markets. Hydro-Québec will not grant more favorable prices or supply conditions to companies located outside Québec than to those within Québec, for similar contracts. As a result, the competitive edge gained through electricity will be maintained, making it unnecessary to grant rate discounts in order to attract new companies to Québec.

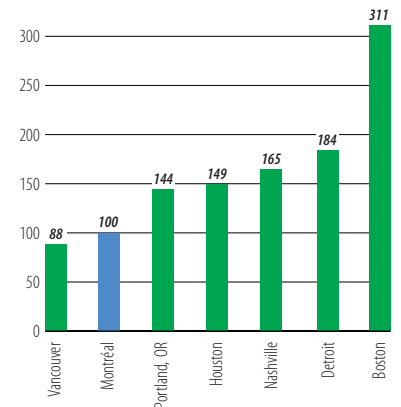
It should be noted that Hydro-Québec offers a variety of options to local companies based on business considerations: combination of Rate L and Rate TTR, payment in U.S. dollars, rate insurance, etc. These business measures foster optimum management of the terms and conditions of electricity purchase for Rate L customers who wish to step up their operations in Québec. The options can constitute attractive arrangements for certain companies without affecting the other rate categories or Hydro-Québec's profitability objectives.

Hydro-Québec plans to achieve annual sales of 92.3 TWh on the Québec small- and medium-power market by 2004, 7.0 TWh or over 8% more than in 1999. After accounting for temperature variations, this increase is similar to that of the past five years.

Market share in the residential, farm, commercial and institutional sectors will be maintained.

The company is aiming for sales of 171 TWh on all markets by 2004. The 200-TWh objective, as stated in the *Strategic Plan 1998-2002*, will be achieved by 2010.

Large-Power Customers (50 MW or more)
 Comparative Index of Electricity Prices



Hydro-Québec = 100
 Monthly bills excluding all sales taxes
 Rates effective May 1, 1999

Energy Balance 1999-2004			
	1999	2004	1999-2004
Energy requirements (TWh)			
Sales in Québec	147 ¹	164	+ 17
Sales on external markets			
• Current contracts and commitments	16	2	- 14
• Short-term net sales ²	5	5	—
Total sales	168	171	+ 3
Deliveries – agreements	6	3	- 3
Electricity losses (transmission and distribution)	13	14	+ 1
Total requirements	188	189	+ 1
Supply (TWh)			
HQ's current generating facilities	151	151	—
Deliveries received under agreement	3	—	- 3
Current purchases	34	33	- 1
Other purchases ³	—	1	+ 1
Completion – partial diversions	—	1	+ 1
New generating stations (Sainte-Marguerite-3 and other)	—	3	+ 3
Total supply	188	189	+ 1
1. Actual temperature (normal temperature = +1.6 TWh)			
2. Under average runoff conditions			
3. Purchases from Québec independent power producers and outside markets			

**Short-term
management criteria**

- Energy reserve to cover a 64-TWh runoff deficit over two years
- Capacity reserve equivalent to 10-12% of firm demand

In the short term, more than 80% of the energy needed to meet additional demand in Québec (14 TWh) will be made available through a net reduction in sales to external markets due to the expiry of long-term export contracts by 2002. The expiry of these contracts will also enable the company to increase its short-term purchase-resale transactions on external markets and thereby benefit from arbitrage transactions.

Hydro-Québec will continue its sound management of electricity supply for Québec customers in every respect. The means used will include: optimum operation of existing generating facilities, meeting deadlines for new plant commissionings, and maintaining sufficient energy and capacity reserves in accordance with industry practices in North America.

Hydro-Québec maintains a sufficient energy reserve to cover a possible runoff deficit of 64 TWh over two consecutive years. The capacity reserve is equivalent to 10-12% of firm demand. This reserve allows the company to remain within the standard load-shedding risk of 2.4 hours per year, a reliability criterion used by other North American electricity producers, including those belonging to the Northeast Power Coordinating Council (NPCC), of which Hydro-Québec is a member.

In terms of new supply between now and 2004, two new hydroelectric stations generating a total of 3 TWh per year will be commissioned: Sainte-Marguerite-3 and the new Grand-Mère generating station (replacing the current plant). This is in addition to projects involving the partial diversion of rivers toward existing generating stations, including projects in the Betsiamites watershed, for a gain of 0.9 TWh per year.

Furthermore, Hydro-Québec will make all authorized purchases from Québec independent producers (wind, small hydropower, and biomass).

Reliable electricity supply depends not only on these new supplies in Québec, but also on better access to competitive resources located outside Québec. As a result, Hydro-Québec plans to:

- improve the management of interconnections in order to keep downtime to a minimum;
- build a new 1,250-MW interconnection with Ontario by 2003;
- intervene before the appropriate regulators to obtain complete non-discriminatory open access to the U.S. portion of the 2,000-MW multiterminal direct current system linking Québec and Massachusetts.

Interconnections and markets outside Québec will thus continue contributing to security of supply for Québec customers, at competitive conditions.

Energy Reserve

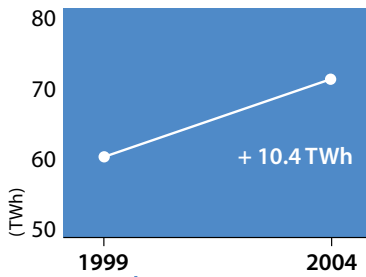
- *Borrowing from existing water reserves*
- *Tracy thermal generating station*
- *Reduction of short-term sales outside Québec*
- *Short-term imports*

TransÉnergie Interconnections 1999

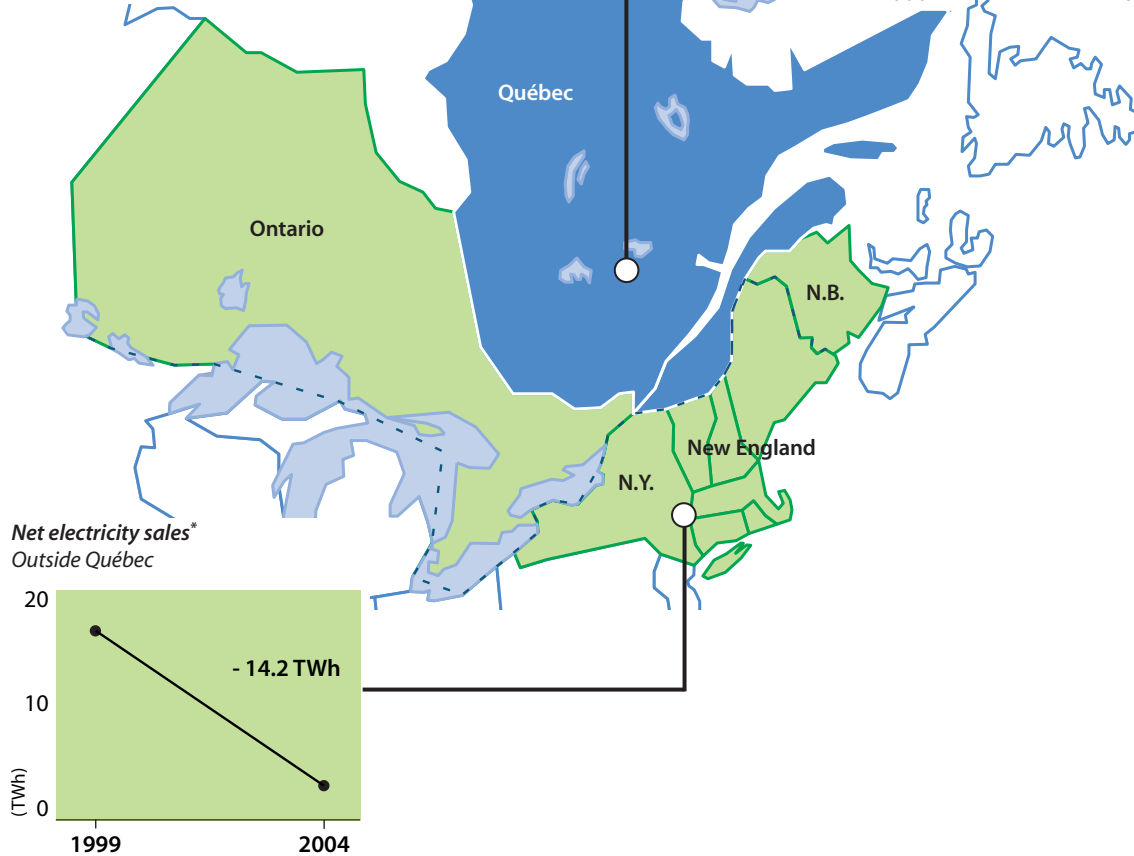
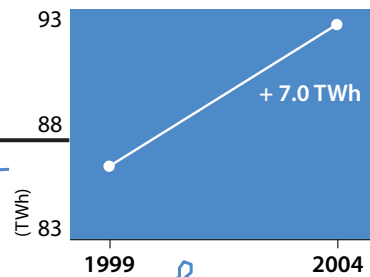
- *Export capacity
5,800 MW*
- *Import capacity
3,800 MW*

Hydro-Québec's Sales Growth 1999-2004

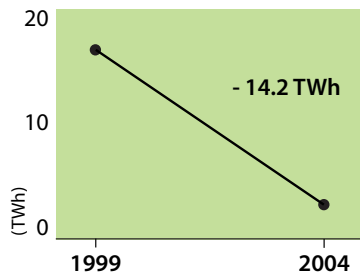
Electricity sales in Québec
Industrial sector



Electricity sales in Québec
Small- and medium-power market



Net electricity sales*
Outside Québec



* Long-term contracts and committed deliveries

Ensure the Company's Profitable Growth in Québec

Hydro-Québec already contributes greatly to Québec's economic development through its operations, and plans to make an even bigger contribution by growing its business profitably in Québec. Much of this growth will be based on continuing the work done over the past 40 years to develop Québec's hydroelectric potential in order to ensure the supply required over the medium term for Québec markets.

The company's profitable growth in Québec also depends on sustained technological innovation in the core areas of electricity generation, transmission and distribution.

It is in this light that Hydro-Québec sets forth the third and fourth orientations of its *Strategic Plan 2000-2004*.

Orientation 3

Continue to develop profitable hydroelectric potential

Hydro-Québec has provided Québec with one of the most competitive hydroelectric generating systems in North America, and is among the leading power producers on the continent. The company plans to continue developing profitable hydroelectric potential within and on the periphery of Québec.

This orientation reflects both the economic benefits of profitable hydroelectric projects and the many environmental advantages of hydropower, including its role in reducing greenhouse gas emissions, acid rain, and other air pollutants.

There are two strategies underpinning this orientation:

3.1 *Complete the development of profitable hydroelectric potential*

3.2 *Be proactive in communicating the environmental benefits of hydroelectricity and Hydro-Québec's environmental performance*

Three conditions for completing the development of profitable hydroelectric potential

A project must be:

- *profitable at 3¢/kWh*
- *environmentally acceptable*
- *well received by local communities*

Betsiamites-Toulousteuc Projects

Agreements concluded (as at October 15, 1999)

- *Betsiamites Band Council*
- *Regional County Municipalities (RCMs)*
- *Essipit Band Council*

Strategy 3.1

Complete the development of profitable hydroelectric potential

To achieve its sales growth and profitability objectives, Hydro-Québec will require additional generation and supply under competitive terms. That is why the company will continue working to complete the development of Québec's hydroelectric potential.

Projects will be undertaken on three conditions:

- They must be profitable under current market conditions, based on a power-station price of 3¢/kWh.
- They must be environmentally acceptable, in accordance with the principles of sustainable development.
- They must be well received by local communities.

1. Make projects more acceptable to host communities

Acceptance by local communities, including Aboriginal communities, is one of the essential conditions for completing the development of hydroelectric potential. Hydro-Québec will continue, as it has done for a few years, to offer local communities business partnerships for all phases of new projects — from development and construction, up to and including ownership of future hydroelectric projects.

The forms such partnerships take can vary as needed, from a simple business transaction to joint ownership of new facilities through limited partnerships. In this regard, RCMs and Aboriginal band councils are the company's partners, given that as public organizations they have a role to play in land-use development, to various degrees. The recent agreements concluded with respect to the Betsiamites and Toulousteuc projects are a case in point.

Similar partnerships have been proposed for projects such as the partial diversion of the Romaine River as part of the major Lower Churchill development in Labrador, or the Eastmain-1 generating station project, combined with the partial diversion of the Rupert River in the James Bay region.

Hydroelectric projects create significant economic spinoffs for local communities. Hydro-Québec will continue to develop the strategies and means that will allow it to carry out projects in a competitive manner, while offering major business opportunities to local and regional companies in the form of direct contracts or subcontracting. An example is the Sainte-Marguerite-3 project, which will have pumped close to \$500 million into the North Shore region by the end of 2001 and provided employment for local workers, who make up 69% of the project's work force.

Hydro-Québec will also continue the process of public consultations with host communities. Regional information and discussion forums will allow host communities to closely monitor Hydro-Québec projects. As well, the company will communicate information of public interest regarding new hydroelectric projects to Quebecers at large.

2. Reduce construction lead times and costs

The profitability of a hydroelectric development depends largely on completing the project on schedule and within budget, while complying with environmental requirements and construction quality standards.

Reducing lead times at all stages contributes directly to the profitability of projects by reducing the amount of capitalized interest paid for financing during construction, and by generating revenue more rapidly thanks to the timely commissioning of facilities. Great efforts will be made to achieve improvements in this regard over the 2000-2004 period. In the medium and long term, Hydro-Québec aims to cut construction costs by at least 10% and significantly reduce construction lead times.

Hydro-Québec will also continue to support the efforts of the Canadian electricity industry as it lobbies governments to improve the project approval and environmental review process. While ensuring effective environmental protection and in accordance with existing laws, this improvement aims to reduce uncertainties about the duration and requirements of processes by making them as clear and efficient as possible. These processes will also have to be modified to explicitly recognize the contribution of hydroelectric projects to the reduction of greenhouse gas emissions.

Strategy 3.2

Be proactive in communicating the environmental benefits of hydroelectricity and Hydro-Québec's environmental performance

Hydro-Québec has more than 25 years of experience in studying and understanding the environmental impacts of hydroelectric projects. The company's environmental expertise is recognized worldwide and is reflected in the quality of its environmental management. Given this expertise, Hydro-Québec is able not only to design projects that are acceptable with respect to the environment and local communities, but also to reduce and adequately compensate the impacts of its projects.

In 2001, the commissioning of Sainte-Marguerite-3 power station will add 2.8 TWh to Hydro-Québec's annual generating capacity

*A record of excellent
environmental practices
at the La Grande
Complex*

In cooperation with the International Energy Agency, Hydro-Québec will continue to participate in the synthesis of knowledge on hydroelectric development around the world, aimed at identifying the conditions leading to projects that are acceptable in terms of the environment and human impacts. Hydro-Québec will also help finance and participate in the efforts of the World Dam Commission created by the World Bank and the World Conservation Union.

Following the signing of the Kyoto Protocol by Canada, the federal government set up a process to review the Protocol's implications. Hydro-Québec is contributing to the work of several consultation committees, including the table on electricity, which allows the company to demonstrate the advantages of hydroelectricity in the fight against global warming.

The company's Internet site will be used to inform the public about environmental management at Hydro-Québec. It will provide information on the implementation of ISO 14001, the international standard on environmental management, which will be implemented by the end of 2000 for the generation component and by 2002 for all the company's activities. This standard, which is based on regulatory compliance, continuous improvement and pollution prevention, will systematize the company's environmental activities and improve its environmental performance.

The company plans to continue establishing partnerships with environmental groups and organizations. The project to restore the salmon population of the Betsiamites River and its tributaries is an example of an active partnership.

Hydro-Québec will also take other measures to better publicize the company's environmental initiatives, such as the implementation of a biodiversity support program in cooperation with the *Ministère de l'Environnement* and the *Société de la faune et des parcs du Québec* (wildlife and parks organization). This five-year program is designed to protect biodiversity on Hydro-Québec's properties.

Finally, the company will make a major effort to support the preservation of natural habitats by creating, in 2000, a *Fondation Hydro-Québec pour l'environnement* (environment foundation). The foundation's mandate will be to carry out projects that support and promote the conservation and development of flora and wildlife, in a context of sustainable development.

Orientation 4

Stimulate technological innovation within the company

The technological quality of Hydro-Québec's facilities, operations, products and services is both a source of pride and a springboard for the growth and profitability of the company and Québec's electricity industry. Maintaining the corporation's technological leadership in its core operations is critical to its future.

Over the years, many technological successes have made Hydro-Québec a world leader in hydroelectric generation and high-voltage transmission. However, more recently, research and development (R&D) activities have sometimes veered off course into various technologies not related to the company's core businesses.

Hydro-Québec will therefore refocus its R&D efforts on hydroelectric generation, electricity transmission and distribution, where it will continue to innovate. Close coordination will be required between R&D, technology marketing and venture capital operations.

Three strategies will be used to implement this fourth orientation:

- 4.1 Focus R&D efforts on the company's strategic sectors, products and services**
- 4.2 Use the gains achieved through innovation to benefit Hydro-Québec's core activities**
- 4.3 Reposition the company's venture capital operations**

Creativity and innovation contribute to Hydro-Québec's profitable growth

R&D priorities

9 major themes linked to Hydro-Québec's core activities

Strategy 4.1

Focus R&D efforts on the company's strategic sectors, products and services

Hydro-Québec plans to concentrate its R&D efforts in areas that will contribute directly to the success of its business strategies in electricity generation, transmission and distribution.

Research and development budgets will be maintained at about \$100 million per year.

Consequently, Hydro-Québec has established nine research areas associated with major technological challenges for its core activities:

Generation

- 1** Develop new concepts for the construction of facilities
 - Cut construction costs by 10%
 - Reduce construction lead time for new facilities by one year
- 2** Increase the life span of facilities by 10%
- 3** Improve the energy capability of generating facilities by 1%

Transmission

- 4** Increase the life span of equipment by 10%
- 5** Increase system capacity
 - Make the costs of underground and underwater transmission lines competitive
 - Increase the capacity of certain existing corridors by 33%
- 6** Reduce the impact of major weather events by 50%

Distribution and Customers

- 7** Lower the costs of underground lines by 50%
- 8** Increase the life span of equipment by 10%
- 9** Improve energy efficiency

Strategy 4.2

Use the gains achieved through innovation to benefit Hydro-Québec's core activities

Like the world's most successful research centres, Hydro-Québec will manage its technological innovation cycle on an integrated basis and focus on the challenges of its business units. Integrated management will lead to:

- tighter management of the company's R&D project portfolio, teams, budgets and schedules;
- faster and more systematic assessment of ideas emerging from R&D based on the company's strategic objectives, and evaluation of their potential gains, costs, lead times and technical feasibility;
- earlier research and evaluation of the external potential of ideas that emerge from R&D in terms of customers, competitors and financial prospects;
- speedy termination of R&D projects which prove to lack promise for the company;
- better implementation of new technologies within Hydro-Québec and better external marketing through partnerships.

Strategy 4.3

Reposition the company's venture capital operations

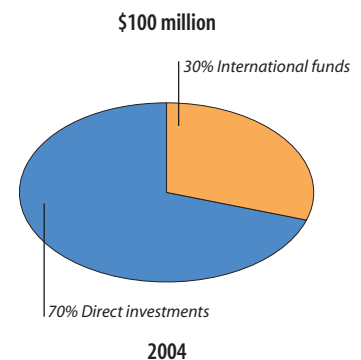
Hydro-Québec must be strategically positioned with regard to information about world developments in energy research and technology.

The company must also maintain ties with world-class research centres and partnerships in the international venture capital community. Given venture capital's stage of development in the energy industry and the company's limited experience in this area, the initial approach should be one of prudence and direct support for the strategies of Hydro-Québec's business units.

Total venture capital investment will be limited to a maximum of \$100 million. New investments in this area will be made gradually over the 2000-2004 period.

These investments will be made through Hydro-Québec CapiTech, a wholly owned subsidiary of Hydro-Québec. Over the long term, the company aims for a return of about 20% on its total venture capital portfolio.

Venture Capital Portfolio



Over the next few years, Hydro-Québec CapiTech will adhere to the following investment policy:

- 30% of its portfolio will be invested in international venture capital funds in the energy industry, to ensure participation in world technological innovation trends.
- 70% of its portfolio will be made up of direct investments in line with the needs and strategies of Hydro-Québec's business units.
- Direct investments will be focused where opportunities are most numerous, particularly in the United States, Asia and Europe, in partnership with world-class players.
- Regular contacts will be established between venture capital operations and the business units that may benefit from them.

Seize Business Opportunities

Exciting business opportunities are being created by market growth and deregulation in North America and by the increase in world energy demand. To achieve its growth and profitability objectives, Hydro-Québec plans to seize business opportunities that will put its know-how, expertise, holdings, and strategic alliances to maximum use. By participating in the development of the energy sector outside Québec, Hydro-Québec will ensure the continuity of its own development and that of Québec's electricity industry.

This is the context in which Hydro-Québec sets forth the fifth, sixth and seventh orientations of its *Strategic Plan 2000-2004*.

Orientation 5

Participate in the development of the North American electricity industry

Market restructuring in North America offers promising business opportunities for Hydro-Québec in high-voltage transmission, an area in which the company has a high level of expertise. The opening of the wholesale market to competition has demonstrated the essential role played by transmission systems in the smooth operation and development of the wholesale electricity market.

In the United States in particular, the developments of the past few years have shown that the efficiency of electricity markets is sometimes limited by "bottlenecks" affecting transmission systems. Major investments will be required — particularly in new, cutting-edge technologies — in order to increase the capacity of transmission systems.

The other areas in which Hydro-Québec has a high level of expertise, such as hydro-electric generation, are less suitable avenues for major initiatives in North America, outside of Québec and Labrador, given their advanced stage of development.

The following strategy will therefore be pursued:

5.1 Focus development projects in North America on high-voltage transmission

Strategy 5.1

Concentrate development projects in North America on high-voltage transmission

Hydro-Québec will rely on its technological expertise and recognized leadership in high-voltage transmission to seek business opportunities in the transmission sector, particularly in niches requiring a high level of technological expertise. Hence, the company will participate in the development and application of new technologies designed to reduce congestion in certain transmission corridors.

Hydro-Québec will concentrate on projects in the northeastern part of North America, which will contribute to the emergence of an efficient electricity market in this key region.

Orientation 6

Participate in the development of the North American gas industry

Over the 2000-2004 period, Hydro-Québec will continue to participate in the development of the North American gas industry. This involvement currently takes the form of Hydro-Québec's equity in the holding company Noverco. Enbridge and Gaz Métropolitain, Noverco's operating companies, play a prominent role in the large-scale transportation of energy (natural gas, natural gas liquids and oil), as well as gas distribution. Hydro-Québec intends to maintain a very active presence in these important growth industries.

Having thoroughly analyzed the business opportunities in thermal generation, Hydro-Québec does not plan to invest in this area in Québec over the next five years, unless significant and persistent runoff deficits are experienced during this period.

However, over the longer term (for example, by 2015), natural gas could be called upon to play a role in new electricity generation in Québec. In that time frame, the development of new technologies could also start changing the energy market dramatically by moving electricity production towards small-capacity distributed generation.

New distributed generation technologies, including microturbines and fuel cells, could allow a growing number of customers to directly produce the electricity they need, at competitive conditions. It is reasonable to assume that natural gas would be a prime fuel source for these technologies.

Hydro-Québec plans to closely monitor developments in this area. In the short term, the company will develop a capital investment program that complements its current gas operations and that could include the upstream sector (excluding exploration, however). This program could involve new gas-producing regions in Eastern Canada.

The following strategies will be adopted with respect to the gas industry in North America:

6.1 *Maintain development focus on current sectors: energy transportation and natural gas distribution*

6.2 *Develop a program of complementary investments in the gas industry*

Strategy 6.1

Maintain development focus on current sectors: energy transportation and natural gas distribution

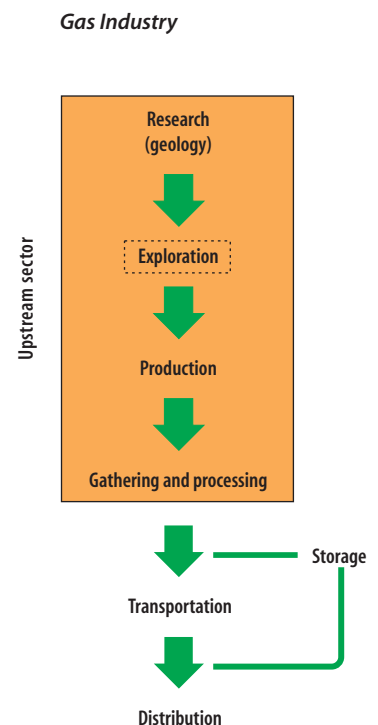
Through its equity interest in Noverco, Hydro-Québec plans to support the strategic development initiatives of Gaz Métropolitain and Enbridge in the areas of energy transportation (natural gas, oil and natural gas liquids) and gas distribution.

Strategy 6.2

Develop a program of complementary investments in the gas industry

While ruling out direct investments in gas exploration, Hydro-Québec intends to identify and seize complementary investment opportunities in the North American gas industry, particularly in the upstream sector on the periphery of Québec. Appropriate steps will be taken to this end, including the consolidated management of current financial interests in the sector.

Nevertheless, Hydro-Québec plans to support the development of new geological modeling and interpretation techniques for determining Québec's gas-producing potential.



Hydro-Québec's equity committed to international ventures as at August 31, 1999:

- \$279 million

Orientation 7

Continue international development

Over the period covered by the *Strategic Plan 2000-2004*, Hydro-Québec will continue its development on the international scene. In recent years, the company has made capital investments of \$279 million in 10 international projects which represent a total of \$2.8 billion in assets. The approach to such development will be adjusted over time.

Hydro-Québec's primary goal on the international stage is profitability. International operations will foster the company's growth over the medium and long term and, through business partnerships, create significant business opportunities for Québec's electricity industry.

Two strategies have been designed to further this orientation and its objectives:

7.1 *Focus international activities on areas in which the company has a high level of expertise and fine-tune the business partnership approach*

7.2 *Aim for an average return on equity of 15%*

Strategy 7.1

Focus international activities on areas in which the company has a high level of expertise and fine-tune the business partnership approach

Hydro-Québec's international operations will be conducted:

- in areas in which the company has a high level of expertise, mainly hydropower construction and management and high-voltage transmission;
- in territories located outside Hydro-Québec's grid and neighboring power systems, but with priority given to North America, China, and certain targeted countries in Latin America and Africa;
- through business partnerships established, first and foremost, with Québec companies and in which Hydro-Québec can both invest and act as an industrial operator.

Strategy 7.2***Aim for an average return on equity of 15%***

Hydro-Québec will aim for an overall return on equity of at least 15% from its international investments. This return will be reviewed and adjusted periodically, based on changes in the project portfolio and risks associated with international operations.

The company's commitments to international projects will be limited to a level that will not affect the stability of Hydro-Québec's total annual cash flow.

Financial and Economic Outlook

Financial Framework of the Strategic Plan 2000-2004

Hydro-Québec's strategies and company-wide objectives for the 2000-2004 period, common to all employees, will not only improve customer service, but will lead to a sustained improvement in the company's financial position and a higher return for its shareholder. In this regard, the recently negotiated labor contract, which ties a portion of employee compensation to the company's performance, should help Hydro-Québec achieve its objectives for the next five years.

The following analysis is based on the most recent estimates for 1999 and, for subsequent years, on financial forecasts that are derived from the *Strategic Plan 2000-2004*.

Consolidated Results

Hydro-Québec's consolidated net income will jump from \$925 million in 1999, the latest estimate for the current year, to \$1.6 billion in 2004. This increase is mainly on the strength of higher sales within Québec.

While the net increase in electricity sales volume on all markets will be only about 2% over the period, the sustained growth of sales in Québec in lieu of sales on wholesale markets outside Québec will lead to an increase in the revenue component related to distribution operations in Québec. Selling prices on external markets will rise by about 38%. These two factors explain the greater part of the increase in revenue, which is expected to increase from nearly \$9.6 billion in 1999 to about \$11.3 billion in 2004.

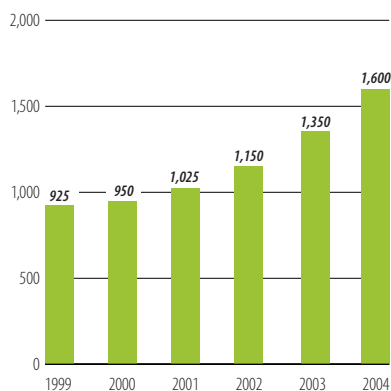
Operating expenses will rise by \$175 million over the 2000-2004 period. Nearly three-quarters of this increase is attributable to the operating expenses of the subsidiaries and holdings.

Other direct expenses are expected to reach \$4.9 billion in 2004, compared with \$3.6 billion in 1999. The \$1.3-billion increase can be ascribed to depreciation and decommissioning expenses, purchases of fuel and electricity (particularly for resale purposes in arbitrage transactions), and other direct expenses of the subsidiaries.

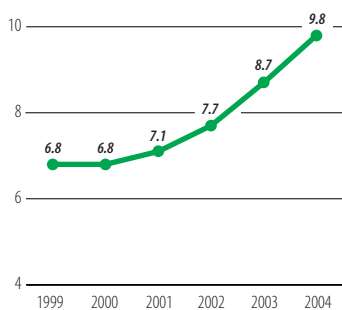
Interest expenses and exchange loss will decline from 2001 on, decreasing to about \$2.7 billion in 2004. This decline is attributable to the reduction of long-term debt and the recovery of the Canadian dollar against the U.S. dollar over that period.

The sustained increase in profitability will result in improved financial ratios across the board for the 2000-2004 period. Return on equity will jump from 6.8% in 1999 to 9.8% in 2004, a level closer to the majority of corporations in the same sector of activity as Hydro-Québec. Interest coverage will rise from 1.26 in 1999 to 1.48 in 2004.

Net Income
1999-2004 (\$ millions)



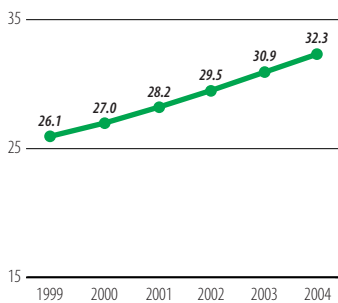
Return on Equity
1999-2004 (%)



Based on these forecast consolidated results, the shareholder can expect to receive \$3 billion in dividend payments over the *Strategic Plan 2000-2004* period, in accordance with Hydro-Québec's dividend policy.

Statement of Consolidated Results (\$ millions)		PRO FORMA					
	1999	2000	2001	2002	2003	2004	
Revenue	9,603	9,668	10,229	10,700	11,174	11,342	
Less							
Operating expenses	1,908	1,925	1,915	2,032	2,077	2,083	
- excluding subsidiaries and holdings	1,647	1,691	1,696	1,693	1,687	1,694	
Other expenses	3,632	3,577	4,203	4,472	4,720	4,912	
Financial expenses	3,126	3,203	3,072	3,032	3,013	2,733	
Non-controlling interest	12	13	14	14	14	14	
Consolidated net income	925	950	1,025	1,150	1,350	1,600	
Dividend likely to be declared	463	475	513	575	675	800	
Return on equity (%)	6.8	6.8	7.1	7.7	8.7	9.8	
Interest coverage	1.26	1.27	1.34	1.40	1.46	1.48	
Average cost of debt (%)	8.7	9.1	8.9	8.8	9.0	8.7	

**Capitalization
1999-2004 (%)**



Changes in Financial Position

Over the 2000-2004 period, operations will generate funds of nearly \$14.3 billion after dividends, thanks to the increase in net income.

Hydro-Québec will use these funds to finance its entire \$11.9-billion capital investment program for 2000-2004, and to allocate some \$2.4 billion to its financial operations in order to reduce long-term debt.

Financing activities will result in a net repayment of debt, with the \$11.9-billion repayment of debt at maturity exceeding the estimated \$9.5 billion in new issues.

Self-financing for the period as a whole is estimated at 61%, slightly higher than for the 1994-1999 period.

Consolidated Statement of Changes in Financial Position (\$ millions)		PRO FORMA					
	1999	2000	2001	2002	2003	2004	2000-2004
Operating activities							
Net income	925	950	1,025	1,150	1,350	1,600	6,075
Depreciation – Fixed assets	1,550	1,592	1,655	1,650	1,664	1,661	8,222
Other	67	99	(61)	(13)	(38)	(17)	(30)
	2,542	2,641	2,619	2,787	2,976	3,244	14,267
Financing activities							
Long-term debt							
Issues	2,137	2,084	3,060	1,496	1,739	1,126	9,505
Repayments	(2,579)	(2,454)	(3,442)	(2,296)	(2,455)	(1,232)	(11,879)
	(442)	(370)	(382)	(800)	(716)	(106)	(2,374)
Investing activities							
Fixed assets in Québec	(1,729)	(2,005)	(2,004)	(1,774)	(2,023)	(2,900)	(10,706)
International and other	(371)	(266)	(233)	(213)	(237)	(238)	(1,187)
	(2,100)	(2,271)	(2,237)	(1,987)	(2,260)	(3,138)	(11,893)

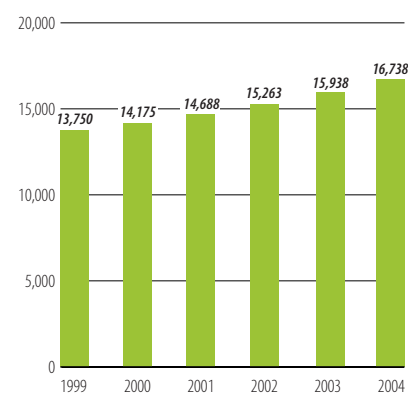
Balance Sheet

At the end of the 2000-2004 period, fixed assets will be valued at close to \$50 billion, with total assets worth \$56.9 billion in 2004. Commissionings will be concentrated on electricity generation and transmission, the areas most directly related to the company's program to complete the development of Québec's hydroelectric potential.

On the liabilities side, long-term debt will decrease by more than \$4.4 billion between 1999 and 2004, primarily due to a stronger Canadian dollar, which will lead to a downward adjustment of the U.S.-dollar denominated debt. The Canadian dollar exchange rate against the U.S. dollar will rise from 66.6¢ in 2000 to 72.3¢ in 2004, based on the economic parameters of the *Strategic Plan 2000-2004*.

Shareholder's equity will increase by \$3 billion during this period, from \$13.7 billion in 1999 to \$16.7 billion in 2004, raising the company's capitalization rate from 26.1% in 1999 to 32.3% in 2004.

**Shareholder's Equity
1999-2004 (\$ millions)**



<i>Consolidated Balance Sheet (\$ millions)</i>	<i>PRO FORMA</i>					
	1999	2000	2001	2002	2003	2004
Assets						
Fixed assets (net)						
Generation	23,072	23,114	23,120	22,955	23,174	23,793
TransÉnergie	14,927	15,078	15,315	15,441	15,473	15,768
Distribution	7,917	7,962	7,989	8,020	7,992	7,970
Other	2,090	2,167	2,103	2,076	2,030	1,978
Total	48,006	48,321	48,527	48,492	48,669	49,509
Current assets	2,891	2,790	2,734	2,545	2,576	2,609
Other long-term assets						
Investments and deferred charges	5,848	5,845	5,210	5,156	4,981	4,743
Other financial and sundry assets	400	196	122	82	53	28
Total: Assets	57,145	57,152	56,593	56,275	56,279	56,889
Liabilities						
Long-term debt	37,151	35,422	35,588	34,597	34,935	32,761
Current liabilities	5,555	6,821	5,514	5,541	4,456	6,363
Other long-term liabilities	549	594	663	734	810	887
Non-controlling interest	140	140	140	140	140	140
Total: Liabilities	43,395	42,977	41,905	41,012	40,341	40,151
Shareholder's equity						
Share capital	4,374	4,374	4,374	4,374	4,374	4,374
Retained earnings	9,376	9,801	10,314	10,889	11,564	12,364
Total: Shareholder's equity	13,750	14,175	14,688	15,263	15,938	16,738
Total: Liabilities and Shareholder's equity	57,145	57,152	56,593	56,275	56,279	56,889
Capitalization (%)	26.1	27.0	28.2	29.5	30.9	32.3

Sensitivity Analysis of Consolidated Net Income for 2002

A sensitivity analysis of the net income forecast for 2002 gives an idea of the potential impact of certain business risks on Hydro-Québec.

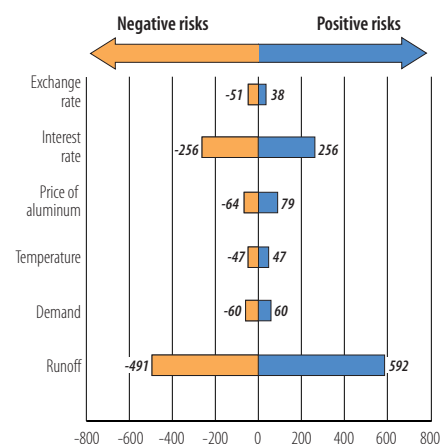
The results shown opposite cover a 68% probability range. When applied to interest rate risk, for instance, this analysis indicates that there is only a 16% chance that interest rate fluctuations will result in a drop of more than \$256 million in net income, and, conversely, only a 16% chance that they will lead to an increase of over \$256 million in net income.

Among the business risks most likely to affect net income between now and 2004 are changes in interest rates, considering the size of the company's debt, and variations in runoff, given the nature of Hydro-Québec's generating facilities.

Risks related to economic parameters, such as changes in interest rates, exchange rates and the price of aluminum, have been managed on an integrated basis for several years now. By using the appropriate derivative instruments, the company can keep the volatility of its financial results stemming from these parameters within established limits, which are reviewed every year.

Variations in runoff were taken into account in the planning of Hydro-Québec's generating facilities and related reservoirs. Sound reservoir management, combined with appropriate short-term transactions, will allow Hydro-Québec to keep the impact of the runoff risk on net income at an acceptable level.

Sensitivity Analysis of Consolidated Net Income Forecast for 2002 (\$1,150 million)



Note: A standard deviation of ± 1 covers a 68% probability of the event occurring; consequently, the probability of a standard deviation greater than +1 or less than -1 is 16%.

Principal Economic Parameters

	1999	2000	2001	2002	2003	2004
Rise in CPI in Canada (%)	1.0	1.6	1.8	1.7	1.7	1.6
Price of aluminum (in U.S.¢/pound)	65.1	63.1	68.0	74.5	83.0	87.6
Value of C\$ against U.S.\$	0.670	0.666	0.695	0.698	0.706	0.723
Interest rates on 90-day T-bills (%)						
- Canadian market	4.8	4.6	4.9	5.1	5.1	5.0
- U.S. market	4.5	4.4	4.6	4.8	4.8	4.8
Interest rate on 10-year Hydro-Québec bonds (%)						
- Canadian market	5.7	5.7	5.9	6.1	6.1	6.1
- U.S. market	6.0	5.9	6.0	6.1	6.1	6.1

Economic Impact

Sustaining Employment

In addition to paying dividends to its shareholder, the Québec government, Hydro-Québec also makes a significant contribution to the Québec economy through its growth, capital investments and purchases of goods and services, as well as through the taxes it pays.

Jobs Sustained by Hydro-Québec's Activities (in person-years)						
	2000	2001	2002	2003	2004	2000-2004
Jobs related to operation of facilities	21,800	21,100	20,300	19,900	19,700	102,800
Jobs related to capital projects (generation, transmission and distribution)	14,200	14,100	12,900	14,300	20,300	75,800
Jobs related to energy efficiency programs	300	300	300	100	100	1,100
Jobs related to purchases from independent power producers	700	700	800	800	800	3,800
Total	37,000	36,200	34,300	35,100	40,900	183,500

Over the 2000-2004 period, Hydro-Québec's activities will help sustain 183,500 person-years of employment in all regions of Québec.

Operations alone will sustain 102,800 direct and indirect jobs.

Capital investments in generation, transmission and distribution will reach nearly \$11.5 billion over this period, sustaining 75,800 direct and indirect jobs.

Purchases from independent power producers will contribute 3,800 person-years of employment.

In addition, Hydro-Québec's 19 technology subsidiaries employ more than 900 people in highly specialized jobs, primarily in the Montréal region.

Tax Contribution

For the year 2000, Hydro-Québec will pay some \$825 million in taxes to the provincial and municipal governments, in addition to \$463 million in dividend payments to its shareholder. The largest tax component for Hydro-Québec is the capital tax, which will generate close to \$350 million for the Québec government. This is followed by real estate tax of \$220 million (in the form of tax on gross revenue) and debt guarantee fees of almost \$190 million. In all, the company will pay taxes equivalent to more than 85% of its net income — one of the largest tax contributions paid by an electricity company of this size in North America.

Regional Economic Impact

Hydro-Québec's presence in all regions of Québec has translated into purchases of goods and services worth an average of \$1.1 billion per year over the past three years. In terms of direct and indirect jobs, this is the equivalent of more than 8,600 person-years, excluding Hydro-Québec's own employees located across the province.

The geographic distribution of these economic impacts in Québec will depend on the specific projects approved and carried out. Hydro-Québec will nevertheless maintain its purchasing policies, which recommend that purchases be made throughout Québec at the best possible cost for the company.

In both its development and its operations, therefore, Hydro-Québec will continue to focus on economic activities that benefit regions and local communities in Québec.

Glossary

Air pollutant

Any substance (suspended solids or gases) introduced into the atmosphere that changes the latter's physical and chemical characteristics, and that is likely to have a disruptive, harmful or toxic effect on human beings and the environment. In the context of this document, the principal air pollutants are sulfur dioxide (SO₂) and nitrogen oxide (NO_x).

Capacity reserve

Generating capacity available to cover situations of generating equipment failure and uncertainties in runoff and demand.

Distributed generation

Electricity generation by small independent units installed on customers' premises (gas microturbines, fuel cells, solar panels, wind turbines, etc.).

Energy capability

The maximum quantity of energy that may potentially be generated by all hydraulic inflows in a given time interval (one year, for example), under optimum conditions.

Energy reserve

Electrical energy stored in the form of water in reservoirs that the company can use to make up for any runoff deficit.

Federal Energy Regulatory Commission (FERC)

An autonomous agency of the United States Department of Energy that controls access to energy transmission systems and wholesale electricity markets in the United States.

Fuel cell

An electrochemical electricity generation system in which the chemical energy in a fuel is tapped for direct generation of electric current. This is a promising technology which, over the medium term, could make a breakthrough in North America and elsewhere in the world.

Gas microturbine

A low-capacity gas turbine (from a few dozen to a few hundred kW) with a very high rotation speed and a single axle connected to the compressor, the turbine and the alternator. Microturbines offer customers greater autonomy, since they can be installed directly on the customers' premises.

Greenhouse gas

A gas that absorbs the energy given off by the Earth (in the form of infrared radiation) and radiates it back toward Earth, thereby warming the surface of the planet. The principal greenhouse gases are carbon dioxide (CO₂) and methane.

Kyoto Protocol

Protocol on climate change signed in Kyoto, Japan, in December 1997, which aims to reduce greenhouse gas emissions from industrialized countries by 5.5% for the 2008-2012 period, compared with 1990 levels.

Partial diversion

Diversion of a portion of a river's flow to make more water available from a watershed that has already been developed for hydroelectric purposes, while maintaining an environmentally acceptable controlled flow in the original river bed.

Québec Energy Policy

A policy adopted in 1996 that sets out the Québec government's major orientations and courses of action in the energy sector.

Regional transmission organization (RTO)

A new electricity transmission regulatory organization proposed by the FERC to ensure the reliable and efficient management of transmission systems in a given territory, as well as the efficient, safe and non-discriminatory operation of these systems.

Sustainable development

A planning, intervention and management concept aimed at achieving development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

Upstream gas sector

A sector of the gas industry comprising operations preceding the transportation of natural gas (research, exploration, production, gathering and processing).

Venture capital

Capital invested in an innovative business undertaking (cutting-edge technologies, new ideas, high-risk markets). In return for greater risk, investors hope for above-average returns.

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