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Notes: (1) In this document, all references to “dollars”, “Can \$” and “\$” are to Canadian dollars, except as otherwise indicated. As of June 2, 2009, the noon spot rate for the Japanese yen as published by the Bank of Canada was 0.0113 dollar per JPY1.00.

(2) In this document, where figures in tables have been rounded, the total may not necessarily agree with the sum of the figures.

(3) In this document, the units of measure are as follows:

	kV:	kilovolt, or 1 thousand volts		
kW:	kilowatt, or 1 thousand watts		kWh:	kilowatthour, or 1 thousand watthours
MW:	megawatt, or 1 million watts		MWh:	megawatthour, or 1 million watthours
GW:	gigawatt, or 1 million kilowatts		GWh:	gigawatthour, or 1 million kilowatthours
			TWh:	terawatthour, or 1 billion kilowatthours

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*(This English version of the Securities Report has been prepared
solely for reference and shall not have any binding force.)*

I. STATE OF THE BONDS OFFERED FOR SUBSCRIPTION

None

II. THE MOVEMENT OF FOREIGN EXCHANGE RATES

(1) The Movement of Foreign Exchange Rates for the recent five fiscal years

Not applicable.

(2) The Movement of Foreign Exchange Rates for the recent six months during the fiscal year ended December 31, 2008

Not applicable.

(3) Recent Foreign Exchange Rate

Not applicable.

III. OUTLINE OF THE ISSUER

(1) In case the Issuer is a state/nation/country

Not applicable.

(2) In case the Issuer is a provincial, municipal and other regional or local public body

Not applicable.

(3) In case the Issuer is an international organization or a government agency

1. Establishment

(1) Establishment, Legal Status and Domicile

Hydro-Québec was created on April 15, 1944, without limitation as to time, by the *Hydro-Québec Act* of the Parliament of Québec, Revised Statutes of Québec, Chapter H-5, as amended (the "*Hydro-Québec Act*"), and is an agent of the government of Québec (the "Government").

Hydro-Québec has special rights and powers conferred upon it by the *Hydro-Québec Act* and all those pertaining to corporations in general. It has unlimited power to possess moveable and immoveable property. Its property belongs to Québec, but performance of the obligations of Hydro-Québec may be levied on such property. Hydro-Québec binds none but itself when acting in its own name.

All capital stock of Hydro-Québec is held by the Minister of Finance on behalf of the Government.

The head office of Hydro-Québec is located at 75 René-Lévesque Boulevard West, Montréal, Québec, Canada H2Z 1A4.

(2) Mandate

Under the provisions of the *Hydro-Québec Act*, Hydro-Québec is mandated to supply power and to pursue endeavors in energy-related research and promotion, energy conversion and conservation, and any field connected with or related to power or energy.

(3) Relations with Japan

None.

2. Capitalization

The following table sets forth a summary of the capitalization of Hydro-Québec on a consolidated basis as at December 31, 2008.

	(in millions of dollars)
Equity	
Share capital ⁽¹⁾	4,374
Retained earnings at the beginning of the year	15,556
Net income	3,141
Dividends declared	(2,252)
Retained earnings at the end of the year	16,445
Accumulated other comprehensive income	1,243
Total Equity	<u>22,062</u>
Long-term debt	
In Canadian dollars	25,482
In foreign currencies	10,480
	35,962
Adjustment for fair-value hedged risk	98
Total long-term debt ⁽²⁾	<u>36,060</u>
Perpetual debt	<u>355</u>
Short-Term borrowings	<u>91</u>
Derivative instruments	
Assets (short-term)	659
Assets (long-term)	1,428
Liabilities (short-term)	(82)
Liabilities (long-term)	(1,887)
	<u>118</u>

(1) 50,000,000 shares authorized: par value \$100 each. Issued and fully paid 43,741,090 shares.

(2) Long-term debt, according to the currency at time of issue, including \$770 million of dollars representing the current portion of long-term debt.

3. Organization

The affairs of Hydro-Québec are administered by a board of directors (the “Board”) composed of a maximum of seventeen members, including the Chairman and the President and Chief Executive Officer. The Government appoints the members of the Board based on the expertise and experience profiles established by Hydro-Québec. Directors are appointed for a term of up to four years and the Chairman for a term of up to five years; they may be reappointed twice, successively or not.

The Board administers Hydro-Québec’s business efficiently, in accordance with the *Hydro-Québec Act*, the *Companies Act* and the applicable regulations. The Board is responsible for compliance with the rules set out in the *Code of Ethics and Rules of Professional Conduct for Directors, Executives and Controllers of Hydro-Québec*, which are based on the *Regulation respecting the ethics and professional conduct of public office holders*.

The present members of the Board are:

Chairman of the Board	Michael L. Turcotte
President and Chief Executive Officer	Thierry Vandal
Other members	Normand Bergeron Gaston Blackburn Anik Brochu Carl Cassista Bernard Gaudreault Suzanne Gouin Louis Lagassé Jacques Leblanc Nathalie Le Prohon Michel Plessis-Bélair Marie-France Poulin Marie-Anne Tawil Emmanuel Triassi Gilles Vaillancourt

4. Outline of Operations

(1) General

Hydro-Québec operates one of the two largest systems in Canada for the generation and distribution of electric power. Hydro-Québec supplies virtually all electric power distributed in Québec, the largest province in Canada in land area and the second largest in population.

Hydro-Québec's operations are allocated among five business segments:

- **Generation:** *Hydro-Québec Production* operates and develops Hydro-Québec's generation facilities in Québec. It also sells electricity in markets outside Québec and engages in energy trading. *Hydro-Québec Production* is required to provide *Hydro-Québec Distribution* with up to 165 TWh a year of heritage pool electricity, at an average price of 2.79 ¢/kWh ("Heritage Pool Electricity"). In excess of this volume, it may participate in *Hydro-Québec Distribution*'s calls for tenders in a context of free market competition;
- **Transmission:** *Hydro-Québec TransÉnergie* operates and develops Hydro-Québec's power transmission system in Québec and manages power flows on the transmission grid;
- **Distribution:** *Hydro-Québec Distribution* operates and develops Hydro-Québec's distribution system and is responsible for sales and services to Québec customers. It also promotes energy efficiency and ensures the security of the supply of electricity to the Québec market;
- **Construction:** *Hydro-Québec Équipement* carries out engineering, construction and refurbishment projects for power generating facilities throughout Québec, except in the territory governed by the *James Bay and Northern Québec Agreement*, where Hydro-Québec's wholly-owned subsidiary, *Société d'énergie de la Baie James* ("SEBJ"), assumes this responsibility. *Hydro-Québec Équipement* also carries out projects for the construction of power transmission lines and substations throughout Québec; and
- **Corporate and Other Activities:** The corporate units support the divisions in the achievement of their business objectives. These units include *Groupe de la technologie* (Technology Group), *Vice-présidence – Comptabilité et contrôle* (Accounting and Control Vice Presidency), *Vice-présidence – Financement, trésorerie et caisse de retraite* (Financing, Treasury and Pension Fund Vice Presidency), *Groupe des affaires corporatives et du secrétariat général* (Corporate Affairs and General Secretariat Group), as well as *Groupe des ressources humaines et des services partagés* (Human Resources and Shares Services Group). The *Centre de services partagés* (Shared Services Centre) brings together internal services including goods and services procurement, real estate management, and material and transportation service management.

(2) Generation

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

Generation Operations

Facilities

In Québec, Hydro-Québec's electric generation system comprises 88 power stations currently in service, of which 59 are hydroelectric, 27 are thermal, one is nuclear and one is a wind farm, with a total installed capacity of 36,429 MW as of December 31, 2008.

The following table lists the generation facilities in service as of such date.

GENERATION FACILITIES IN SERVICE IN QUÉBEC ⁽¹⁾

<u>Name of Facility</u>	<u>Years Commissioned ⁽²⁾</u>	<u>Capacity (MW)</u>
<u>Hydroelectric</u>		
Robert-Bourassa	1979-1981	5,616
La Grande-4	1984-1986	2,779
La Grande-3	1982-1984	2,417
La Grande-2-A	1991-1992	2,106
Beauharnois	1932-1961	1,903
Manic-5	1970-1971	1,596
La Grande-1	1994-1995	1,436
Manic-3	1975-1976	1,244
Bersimis-1	1956-1959	1,178
Manic-2	1965-1967	1,123
Manic-5-PA	1989-1990	1,064
Outardes-3	1969	1,026
Sainte-Marguerite-3	2003	884
Laforge-1	1993-1994	878
Bersimis-2	1959-1960	869
Outardes-4	1969	763
Carillon	1962-1964	753
Toulnustouc	2005	526
Outardes-2	1978	523
Eastmain-1	2006	507
Brisay	1993	469
Péribonka	2007-2008	405
Laforge-2	1996	319
Trenche	1950-1955	302
La Tuque	1940-1955	294
Beaumont	1958-1959	270
Rocher-de-Grand-Mère	2004	230
Rapide-Blanc	1934-1955	204
Paugan	1928-1956	204
Shawinigan-2	1911-1929	200
Shawinigan-3	1948-1949	194
Manic-1	1966-1967	184
Rapides-des-Îles	1966-1973	176
Chelsea	1927-1939	152
La Gabelle	1924-1931	131
Première-Chute	1968-1975	131
Les Cèdres	1914-1924	122
Rapides-Farmer	1927-1947	104
Rapides-des-Quinze	1923-1955	103
Others (20 facilities - less than 100 MW) ⁽³⁾	1910-2008	733
Total		<u>34,118</u>
<u>Thermal</u>		
Tracy (steam)	1964-1968	660
Bécancour, La Citière and Cadillac (gas-turbine)	1976-1993	852
Others (23 diesel plants) ⁽³⁾	1946-2001	122
Total		<u>1,634</u>
<u>Nuclear</u>		
Gentilly-2 ⁽⁴⁾	1983	<u>675</u>
<u>Wind Farm</u>		
Saint-Ulric (3 wind turbines)	2001	<u>2</u>

(1) Installed capacity shown for the generation stations reflects the capacity of alternators operating in winter conditions at a water temperature of 41°F.

(2) Indicates years when facilities began commercial operation.

(3) Some facilities are owned by Hydro-Québec Distribution.

(4) The Gentilly-2 plant has a Canada-Deuterium-Uranium heavy water moderated reactor, using heavy water as a moderator and coolant, and uranium dioxide as fuel.

Power Purchases

Hydro-Québec purchases power and energy from the Churchill Falls generation station in Labrador through agreements with Churchill Falls (Labrador) Corporation Limited (“CF(L)Co”), in which Hydro-Québec has a 34.2% equity interest (see “Note 22 to the 2008 Consolidated Financial Statements”), and Newfoundland and Labrador Hydro (“N&LH”). Under an initial power contract with CF(L)Co, Hydro-Québec agreed to purchase annually, through the year 2041, 4,083 MW of power. In June 1999, Hydro-Québec signed another agreement with CF(L)Co to guarantee Hydro-Québec the availability of 682 MW of additional power until 2041 for each November 1 to March 31 period. In February 2001, Hydro-Québec agreed to purchase approximately 1.5 TWh annually from N&LH until 2004. This contract was renewed in March 2004 for the purchase of approximately 1.4 TWh annually for a five-year period and was not renewed at maturity.

Hydro-Québec has a capacity agreement with New Brunswick Power Generation Corporation (formerly known as New Brunswick Power Corporation) for the purchase of 200 MW annually until October 31, 2011. Hydro-Québec also has an agreement with Rio Tinto Alcan Inc., which was amended in 2006, for the purchase of 365 MW of peak power and 375 MW of additional peak power until December 31, 2045. Under this 2006 amendment, Hydro-Québec agreed to purchase from Rio Tinto Alcan Inc. an additional 150 MW of peak power until January 1, 2013 which, if certain conditions are met, will be extended until December 31, 2045.

In addition, Hydro-Québec purchases power under 83 long-term contracts with independent producers located in Québec. For 2009, Hydro-Québec expects to purchase approximately 4.1 TWh under these contracts.

Hydro-Québec also purchases power in connection with its trading operations (see “Wholesale and Trading Operations”).

Peak

Hydro-Québec uses energy purchased from its neighboring systems, which experience different demand patterns, to meet a portion of its peak power needs in Québec (see “Wholesale and Trading Operations”). The following table summarizes Hydro-Québec’s peak power demand in Québec and installed capacity as at December 31 for the years 2006 through 2008:

	Peak Power Demand ⁽¹⁾	Installed Capacity ⁽²⁾⁽³⁾	Total Average Load ⁽⁴⁾
		(MW)	
2006.....	36,251	35,315	22,768
2007.....	35,352	35,647	23,952
2008.....	37,230	36,429	24,047

(1) Total power demand at the annual domestic peak for the winter beginning in December, including interruptible power. The 2008-2009 winter peak occurred at 8:00 a.m. on January 16, 2009.

(2) Hydro-Québec also has access to 4,765 MW of the output from the Churchill Falls generating station (5,428 MW). In 2008, Hydro-Québec purchased all the output from eight privately-owned wind farms with a total installed capacity of 530 MW and 1,277 MW are available under agreements with other independent suppliers.

(3) Installed capacity shown for the generation stations reflects the capacity of alternators operating in winter conditions at a water temperature of 41°F.

(4) Annual energy demand, including sales outside Québec, divided by the number of hours in the year.

Investments outside Québec

Hydro-Québec holds an indirect interest in Bucksport Energy LLC, a thermal energy plant located in Maine, U.S. The plant, which started its commercial operations in January 2001, produces approximately 1.3 TWh of electricity per year. Hydro-Québec’s wholly-owned U.S. energy-trading subsidiary, H.Q. Energy Services (U.S.) Inc. (“HQUS”), supplies the plant with natural gas and receives most of the electricity under fifteen-year contracts through January 2016.

Wholesale and Trading Operations

Québec Wholesale Market

The Québec wholesale electricity market has been open since May 1, 1997. This market is comprised of 11 distributors: *Hydro-Québec Distribution*, nine distributors operating municipal systems and one regional electricity cooperative. As a result of the opening of the wholesale market, the municipal systems can, subject to the Government's authorization, purchase electricity from suppliers other than *Hydro-Québec Distribution*, and independent generators in Québec can sell their electricity on the wholesale market using *Hydro-Québec TransÉnergie's* transmission facilities.

Under a call for tenders issued by *Hydro-Québec Distribution* in 2002, *Hydro-Québec Production* signed agreements with *Hydro-Québec Distribution* for the supply of 600 MW over a 20-year period starting in March 2007, which is in addition to the Heritage Pool Electricity.

Markets Outside Québec

Currently, Hydro-Québec's main markets outside Québec consist of neighboring networks located in Canada and the northeastern United States.

In 2008, net exports by *Hydro-Québec Production* accounted for only 8% (2007 – 6%) of sales volume, but generated 32% (2007 – 25%) of Hydro-Québec's income from continuing operations.

Hydro-Québec's energy-trading subsidiary, HQUS, is a member of New York ISO, ISO New England, Midwest ISO (which includes all or parts of Illinois, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nebraska, North Dakota, Ohio, Pennsylvania, South Dakota, Wisconsin and Manitoba) and PJM Interconnection (which included all or parts of Delaware, Illinois, Indiana, Kentucky, Maryland, Michigan, New Jersey, North Carolina, Ohio, Pennsylvania, Tennessee, Virginia, West Virginia and the District of Columbia). ISOs, or Independent Systems Operators, and RTOs, or Regional Transmission Organizations, enable participants to buy and sell energy, schedule bilateral transactions and reserve transmission service. HQUS holds a permit from the U.S. Federal Energy Regulatory Commission to sell at market-based rates.

Hydro-Québec's wholly-owned energy-trading subsidiary operating in Canada, HQ Energy Marketing Inc. ("HQEM"), trades in the Ontario and New Brunswick wholesale markets. HQEM is a member of the Independent Electricity System Operator (the Ontario ISO).

Hydro-Québec has three long-term export contracts for the sale of energy or power. The following table summarizes Hydro-Québec's principal energy export agreements:

PRINCIPAL ENERGY EXPORT AGREEMENTS

	<u>Expiry Date</u>	<u>Power (MW)</u>	<u>Maximum Annual Deliveries (TWh)</u>
<i>Long-term sales - Power and Energy (not interruptible)</i>			
Cornwall Electric - Canada	2019	45	0.2
Cornwall Electric - Canada	2019	100	0.4 ⁽¹⁾
Vermont Joint Owners ("VJO")	2020	335 ⁽²⁾	2.2

(1) Based on historical data.

(2) By separate agreement with a VJO Member, 25 MW (0.2 TWh) are being repurchased annually until April 30, 2012.

Electricity Sales and Revenue

The following table summarizes electricity sales and revenue outside Québec, by category, for the years 2006 through 2008:

ELECTRICITY SALES AND REVENUE OUTSIDE QUÉBEC

	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(in GWh)		
Electricity Sales			
Canada/U.S. (long-term)	2,384	2,384	2,516
Canada/U.S. (short-term)	12,074	17,240	18,783
Total Electricity Sales	<u>14,458</u>	<u>19,624</u>	<u>21,299</u>
	(in millions of dollars)		
Revenue from Electricity Sales			
Canada/U.S. (long-term)	\$ 198	\$ 225	\$ 220
Canada/U.S. (short-term)	951	1,392	1,699
Total Revenue From Electricity Sales	<u>\$ 1,149</u>	<u>\$ 1,617</u>	<u>\$ 1,919</u>

(3) Transmission

Hydro-Québec TransÉnergie provides the following services:

- transmission of electricity to supply native load. The native load is made up of the total transmission requirements of the Québec wholesale market (see “Generation – Québec Wholesale Market”) but excludes customers in remote communities; *Hydro-Québec Distribution* is *Hydro-Québec TransÉnergie*’s largest customer;
- point-to-point transmission service; as at the end of 2008, *Hydro-Québec TransÉnergie* had signed transmission service agreements with 18 customers, including *Hydro-Québec Production* which is the largest customer for this service; and
- connections of privately-owned generation facilities to *Hydro-Québec TransÉnergie*’s transmission system; *Hydro-Québec TransÉnergie* currently serves 30 private producers.

Transmission System

Some generation stations in Québec are located at substantial distances from consumer centers. As a result, *Hydro-Québec TransÉnergie*’s power transmission system is one of the most extensive and comprehensive in North America, comprising more than 20,500 miles of lines.

This system includes the following facilities as at December 31, 2008:

<u>Voltage</u>	<u>Substations</u>	<u>Lines (miles) ⁽¹⁾</u>
765 kV and 735 kV	38	7,097
450 kV DC	2	757
315 kV	63	3,186
230 kV	50	1,894
161 kV	40	1,251
120 kV	214	4,115
69 kV or less	103	2,241
TOTAL	<u>510</u>	<u>20,541</u>

(1) Miles covered by the transmission system. Many facilities carry two lines on the same infrastructure.

In 1997, *Hydro-Québec TransÉnergie* opened access to its transmission grid in accordance with the Hydro-Québec Open Access Transmission Tariff. Consequently, electricity distributors, producers and marketers in and outside Québec have the option to enter into transactions with distributors and producers located outside Québec to buy or sell electricity and to wheel in, wheel out or wheel through *Hydro-Québec TransÉnergie*'s transmission lines at specified rates. The capacity available on the system is posted on the OASIS (Open Access Same-Time Information System) website.

Hydro-Québec TransÉnergie's *Direction – Contrôle des mouvements d'énergie* (System Control unit), with its system control center in Montréal and regional telecontrol centers, is designed to dispatch energy resources, supervise power flows and monitor system security. The transmission system is linked through interconnections with other major power systems in Canada and the northeastern United States.

The following table shows existing interconnections with neighboring systems outside Québec, excluding the lines to Churchill Falls, as at December 31, 2008:

INTERCONNECTIONS WITH NEIGHBORING SYSTEMS OUTSIDE QUÉBEC

	Maximum Carrying Capacity (MW)	<i>Hydro-Québec TransÉnergie</i> 's Current Reception Capacity (MW)	Voltage (kV)
CANADA			
Ontario	1,455 ^(a)	720	120 and 230
New Brunswick	1,080	785	230, 315 and 345
UNITED STATES			
New York	2,000 ^(a)	1,100	120 and 765
New England	2,275	1,870	120 and 450

(a) Ontario and New York State are partially served by the same installations, limiting the simultaneous export capacity to these two systems to 3,100 MW.

(4) Distribution

The primary responsibility of *Hydro-Québec Distribution* is to deliver electricity to Québec customers. To fulfill this responsibility, *Hydro-Québec Distribution* purchases the Heritage Pool Electricity from *Hydro-Québec Production* and, to meet demand beyond that volume, purchases additional electricity under market conditions by issuing calls for tenders from suppliers in the market (see "Regulatory Framework – *Energy Board Act*").

Hydro-Québec Distribution's system is comprised of 68,400 miles of medium voltage lines (almost exclusively 25 kV), as well as 38,300 miles of low voltage lines. Approximately 10% of all such lines are underground.

Hydro-Québec Distribution sells to a wide range of customers, from industrial users, which accounted for 40.6% of sales volume in 2008, to residential customers and farms, which represented 35.7% of sales volume in the same period. Revenues are also derived from sales to commercial and institutional customers as well as municipalities.

Through marketing efforts, *Hydro-Québec Distribution* has developed some flexibility in the management of its system. *Hydro-Québec Distribution* currently has 1,600 MW of interruptible power and 810 MW of concurrent peak-saving capacity in its residential dual-energy market.

Hydro-Québec Distribution has entered into special agreements with nine industrial customers for whom electricity costs represent a substantial proportion of total production costs. Some of these agreements provide for the sale, on a long-term basis, of firm energy at prices that vary in accordance with a formula based on the market price of aluminum produced by those customers. Hydro-Québec manages the exposure to fluctuations in aluminum prices resulting from these contracts by entering into financial transactions, such as futures or swaps (see "Note 16 to the 2008 Consolidated Financial Statements"). In 2008, deliveries under these agreements accounted for 39.7% of the total energy deliveries to industrial users.

Hydro-Québec Distribution relies on various sources to supply the Québec market. To meet requirements in excess of the Heritage Pool Electricity reserved for it by *Hydro-Québec Production*, *Hydro-Québec Distribution* issues short- and long-term calls for tenders. For requirements of less than three months, it may also buy electricity directly in the market, without a call for tenders, under an exemption granted by the *Régie de l'énergie* (the “Energy Board”). For unforeseen needs that cannot be met otherwise, it relies on a master agreement with *Hydro-Québec Production*. Since the previous agreement expired on December 31, 2008, the two divisions signed a new five-year agreement which was submitted in February 2009 to the Energy Board for approval.

Further to calls for tenders issued since 2002, *Hydro-Québec Distribution* signed contracts with *Hydro-Québec Production* for the supply of 600 MW over a 20-year period beginning in March 2007 and with fourteen independent producers for the supply of more than 3,500 MW (including 2,995 MW of wind-generated electricity) for deliveries beginning between 2006 and 2015.

Hydro-Québec Distribution manages its flexible and diversified energy portfolio to deal with fluctuations in demand. For example, in 2008, *Hydro-Québec Distribution* initiated or renewed measures to suspend or defer contracted deliveries that exceeded the requirements of the Québec market. In the fall of 2008, the Energy Board approved the 2008-2017 Electricity Supply Plan which presents the procurement strategies based on domestic demand forecasts for the next decade. Given the decline in demand, *Hydro-Québec Distribution* took the following measures to ensure a balance:

- In May 2008, the Energy Board approved the agreements signed between *Hydro-Québec Distribution* and *Hydro-Québec Production* to defer a portion of the contract deliveries scheduled for 2008-2011. These deliveries have been carried over to 2012-2020;
- Following a decision by the Energy Board in September 2008, *Hydro-Québec Distribution* renewed for another year (2009) the suspension of deliveries from TransCanada Energy’s Bécancour generating station;
- *Hydro-Québec Distribution* sold 430 GWh of surplus energy on short-term markets.

Calls for tenders could be made in the coming years in order to balance energy supply and demand in Québec (see “Regulatory Framework – *Energy Board Act*”).

Electricity Rates

Under the applicable provisions of the *Energy Board Act*, rates are fixed or modified by the Energy Board (see “Regulatory Framework – *Energy Board Act*”). Rates are fixed to allow recovery of authorized service costs, including estimated supply costs, and a reasonable rate of return on shareholder’s equity. In March 2009, the Energy Board approved an average rate increase of 1.22% effective April 1, 2009.

The following table shows rate increases applicable for each year, from 2006 to 2009, as well as annual inflation rates:

	2006	2007	2008	2009
Rate increase as of April 1.....	5.33%	1.92%	2.90%	1.22%
Inflation Rate ⁽¹⁾	2.0%	2.2%	2.3%	0.2% ⁽²⁾

(1) *Canadian Consumer Price Index for the calendar year.*

(2) *Estimate.*

Electricity Sales and Revenue

The following table summarizes electricity sales and revenue in Québec, by category of customers, for the years 2006 through 2008:

ELECTRICITY SALES AND REVENUE IN QUÉBEC

	<u>2006</u>	<u>2007</u> (in GWh)	<u>2008</u>
Electricity Sales			
In Québec, by category			
Residential and farm.....	56,722	60,046	60,747
General and institutional.....	32,440	34,751	35,228
Industrial.....	73,297	73,005	69,144
Other.....	4,878	5,353	5,278
Total Electricity Sales.....	<u>167,337</u>	<u>173,155</u>	<u>170,397</u>

(in millions of dollars)

Revenue from Electricity Sales			
In Québec, by category			
Residential and farm.....	\$ 3,775	\$ 4,144	\$ 4,300
General and institutional.....	2,356	2,602	2,687
Industrial.....	3,022	3,336	3,174
Other.....	249	286	284
Total Revenue from Electricity Sales.....	<u>\$ 9,402</u>	<u>\$ 10,368</u>	<u>\$ 10,445</u>

(5) Construction

Hydro-Québec Équipement carries out engineering, construction and refurbishment projects for power generating facilities throughout Québec, except in the territory governed by the *James Bay and Northern Québec Agreement*, where the SEBJ assumes this responsibility. *Hydro-Québec Équipement* also carries out projects for the construction of power transmission lines and substations throughout Québec.

(6) Corporate and Other Activities

This segment includes the Technology Group, the Accounting and Control Vice Presidency, the Financing, Treasury and Pension Fund Vice Presidency, the Corporate Affairs and General Secretariat, the Human Resources and Shared Services Group and our subsidiary *Hydro-Québec International Inc.* (“HQI”).

In 2006 and 2007, Hydro-Québec sold its interests in foreign holdings previously held through HQI (See “Note 7 to the 2008 Consolidated Financial Statements”).

(7) Capital Investment Program

Hydro-Québec's capital investment program includes capital expenditures for fixed and intangible assets and investments in energy efficiency programs. The following table is a summary of Hydro-Québec's projected capital investments affecting cash for the years 2006 through 2008. The table also includes estimates for 2009 and 2010; these estimates are based on, among other things, a projected growth in demand for electricity in Québec of 1.2% yearly for the next two years. In 2008, capital investments in fixed and intangible assets, excluding energy efficiency programs, totaled \$3,756 million.

	CAPITAL INVESTMENT AFFECTING CASH			
	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>Estimated</u>
	(millions of dollars)			<u>2009 and 2010</u>
Fixed and Intangible Assets				
Generation.....	\$ 1,615	\$ 1,807	\$ 1,894	\$ 4,661
Transmission ⁽¹⁾	940	844	1,097	3,000
Distribution.....	690	721	664	1,554
Construction.....	4	3	5	14
Corporate and Other Activities	99	89	96	253
	<u>3,348</u>	<u>3,464</u>	<u>3,756</u>	<u>9,482</u>
Energy Efficiency Programs	149	172	236	645
Total investments	<u>\$ 3,497</u>	<u>\$ 3,636</u>	<u>\$ 3,992</u>	<u>\$ 10,127</u>

(1) Includes sub-transmission.

(8) Relations with Japan

As of December 31, 2008, Hydro-Québec has outstanding yen denominated Notes under its Euro Medium Term Note Programme in the aggregate principal amount of ¥2.5 billion. Those Notes were issued in 1997 and 1999.

5. Financial Conditions

(1) Financial Statements

The financial year of Hydro-Québec is the calendar year.

The accounts of Hydro-Québec are audited by auditors appointed by the Government. The auditors' report must accompany the annual consolidated financial statements of Hydro-Québec. The auditors of Hydro-Québec for the fiscal year ended December 31, 2008 were KPMG LLP, Chartered Accountants and Ernst & Young LLP, Chartered Accountants.

The *Hydro-Québec Act* requires Hydro-Québec to present a detailed annual report to the Minister of Natural Resources and Wildlife and to submit it to the National Assembly of Québec.

The consolidated financial statements have been prepared on the basis of accounting principles generally accepted in Canada.

Auditors' Report

To the Minister of Finance of Québec:

We have audited the consolidated balance sheets of Hydro-Québec as at December 31, 2008 and 2007, and the consolidated statements of operations, retained earnings, cash flows and comprehensive income for the years then ended. These financial statements are the responsibility of Hydro-Québec's Management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Hydro-Québec as at December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in accordance with Canadian generally accepted accounting principles. As required by the *Auditor General Act* (R.S.Q., c. V-5.01), we report that, in our opinion, except for the application of changes in accounting policies described in Note 2 to the consolidated financial statements, these principles have been applied on a basis consistent with that of the preceding year.

/s/ KPMG LLP ^a
KPMG LLP

/s/ Ernst & Young LLP ^b
Ernst & Young LLP

Montréal, Québec
February 6, 2009

- a) CA auditor permit No. 6992
- b) CA auditor permit No. 13764

CONSOLIDATED FINANCIAL STATEMENTS
Consolidated Statements of Operations

Years ended December 31			
In millions of Canadian dollars	Notes	2008	2007
Revenue		12,717	12,330
Expenditure			
Operations		2,497	2,541
Electricity and fuel purchases		1,406	1,555
Depreciation and amortization	4	2,336	1,991
Taxes	5	1,093	820
Regulatory deferrals	3	(72)	29
		7,260	6,936
Operating income		5,457	5,394
Financial expenses	6	2,445	2,512
Income from continuing operations		3,012	2,882
Income from discontinued operations	7	129	25
Net income		3,141	2,907

Consolidated Statements of Retained Earnings

Years ended December 31			
In millions of Canadian dollars	Note	2008	2007
Balance, beginning of year		15,556	14,744
Net income		3,141	2,907
		18,697	17,651
Dividends declared	18	2,252	2,095
Balance, end of year		16,445	15,556

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

Consolidated Balance Sheets

As at December 31

In millions of Canadian dollars

	Notes	2008	2007
ASSETS			
Current assets			
Cash and cash equivalents		370	54
Short-term investments		3,545	3,073
Accounts receivable		1,961	1,751
Derivative instruments		659	992
Materials, fuel and supplies		290	360
		6,825	6,230
Property, plant and equipment	8	54,987	53,291
Investments	9	108	228
Derivative instruments		1,428	1,998
Intangible assets	10	865	903
Regulatory assets	3	1,167	1,074
Other assets	11	1,394	1,142
		66,774	64,866
LIABILITIES			
Current liabilities			
Borrowings		91	73
Accounts payable and accrued liabilities		1,948	1,877
Dividends payable	18	2,252	2,095
Accrued interest		915	890
Regulatory liabilities	3	56	97
Current portion of long-term debt	12	770	1,087
Derivative instruments		82	374
		6,114	6,493
Long-term debt	12	35,290	33,161
Derivative instruments		1,887	2,844
Asset retirement obligations	13	300	464
Regulatory liabilities	3	6	8
Other long-term liabilities	14	760	718
Perpetual debt	15	355	286
		44,712	43,974
EQUITY			
	18		
Share capital		4,374	4,374
Retained earnings		16,445	15,556
Accumulated other comprehensive income		1,243	962
		17,688	16,518
		22,062	20,892
		66,774	64,866
Commitments and contingencies	22		

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

Consolidated Statements of Cash Flows

Years ended December 31

In millions of Canadian dollars

	Notes	2008	2007
Operating activities			
Net income		3,141	2,907
Income from discontinued operations	7	(129)	(25)
Income from continuing operations		3,012	2,882
Adjustments			
Depreciation and amortization	4	2,336	1,991
Amortization of debt premiums, discounts and issue expenses	6	111	111
Difference between contributions paid and pension cost		(305)	287
Regulatory deferrals	3	(72)	29
Other		82	50
Change in non-cash working capital items	20	(149)	(191)
		5,015	5,159
Investing activities			
Property, plant and equipment and intangible assets		(3,756)	(3,464)
Investments		70	29
Disposal of investments, net of divested cash and cash equivalents		154	51
Costs related to Energy Efficiency Plan		(236)	(172)
Net (acquisition) disposal of short-term investments		(435)	155
Other		(7)	(5)
		(4,210)	(3,406)
Financing activities			
Issuance of long-term debt		2,027	2,026
Repayment of long-term debt		(2,734)	(993)
Inflows resulting from credit risk management	16	2,955	1,374
Outflows resulting from credit risk management	16	(676)	(1,855)
Net change in short-term borrowings		18	48
Dividends paid		(2,095)	(2,342)
Other		(2)	(2)
		(507)	(1,744)
Foreign currency effect on cash and cash equivalents		17	(14)
Cash flows from continuing operations		315	(5)
Cash flows from discontinued operations		1	2
Net change in cash and cash equivalents		316	(3)
Cash and cash equivalents, beginning of year		54	57
Cash and cash equivalents, end of year		370	54
Supplementary cash flow information	20		

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

Consolidated Statements of Comprehensive Income

Years ended December 31

In millions of Canadian dollars

	2008	2007
Net income	3,141	2,907
Other comprehensive income		
Change in deferred gains on items designated as cash flow hedges	389	693
Reclassification to operations of deferred gains on items designated as cash flow hedges	(111)	(207)
	278	486
Other	3	5
Comprehensive income	3,422	3,398

Notes to Consolidated Financial Statements

Years ended December 31, 2008 and 2007

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

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

Note 1 Significant Accounting Policies

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

Regulation

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

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

Transmission

Hydro-Québec's power transmission rates for 2008 and 2007 were determined in Régie decisions D-2008-027 and D-2007-34, respectively. The authorized return on the rate base was set at 7.84% in 2008 and 7.78% in 2007, assuming a capitalization with 30% equity.

Distribution

Hydro-Québec's electricity rates were determined in decisions D-2008-033 and D-2007-22, in which the Régie granted across-the-board rate increases of 2.90% and 1.92%, effective April 1, 2008, and April 1, 2007, respectively. The authorized return on the rate base was set at 7.81% in 2008 and 7.79% in 2007, assuming a capitalization with 35% equity.

Scope of consolidation

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

Use of estimates

The preparation of consolidated financial statements in accordance with GAAP requires that Management make estimates and assumptions that affect the amounts recognized as assets and liabilities, the disclosures regarding contingent assets and liabilities at the date of the consolidated financial statements and the amounts recognized as revenue and expenditure for the years at issue. The estimates relate to revenue, depreciation and amortization expenses, asset retirement obligations and employee future benefits, among other things. Actual results could differ from those estimates.

Note 1 Significant Accounting Policies (continued)

Revenue

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

Research and development (R&D) costs

R&D costs are charged to operations when incurred, except for capitalizable development costs. Capitalized development costs are amortized on a straight-line basis over a five-year period.

Foreign currency translation

Self-sustaining foreign operations

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

Integrated foreign operations and foreign currency transactions

In the case of foreign operations that are integrated in terms of financial and operational management, as well as foreign currency transactions, accounts stated in foreign currencies are translated according to the temporal method. Under this method, monetary assets and liabilities are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, and non-monetary items are translated at the historical rate. Revenue and expenditure resulting from foreign currency transactions are translated into Canadian dollars at the average exchange rates in effect during the period. The exchange gains or losses resulting from the translation of monetary items are included in the statement of operations, unless they relate to hedging items for future sales in U.S. dollars, in which case they are deferred to other comprehensive income until the year in which such sales are made.

Materials, fuel and supplies

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

Property, plant and equipment

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

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

Property, plant and equipment are depreciated over their useful life, primarily using the sinking fund method, at a rate of 3%. The depreciation periods for the principal categories of property, plant and equipment are as follows:

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

Note 1 Significant Accounting Policies (continued)

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

Maintenance and repair costs are charged to operations when incurred.

Investments

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

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

Intangible assets

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

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

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

Software and licences	3 to 10 years
Patents	20 years

Impairment of long-lived assets

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

Employee future benefits

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

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

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

- Past service costs arising from plan amendments and transitional balances relating to the pension plan and post-retirement benefits as at January 1, 1999, are amortized using the straight-line method over periods not exceeding active employees' average remaining years of service, which totaled 12 years as at January 1, 2008 and January 1, 2007.

Note 1 Significant Accounting Policies (continued)

- Amortization of actuarial gains or losses is recognized in operations for the year if the unamortized net actuarial gain or loss at the beginning of the year exceeds 10% of the value of the accrued benefit obligations or 10% of the market-related value of the plan assets, whichever is greater. The amortization corresponds to the excess divided by active employees' average remaining years of service.
- The expected return on pension plan assets is based on a market-related value determined by using a five-year moving average for equity securities and by valuing other asset classes at fair value.

Asset retirement obligations

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

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

Agreements with Aboriginal communities and regional county municipalities

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

Financial instruments

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

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

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

Note 1 Significant Accounting Policies (continued)

Financial assets and liabilities held for trading are recorded at fair value at the balance sheet date. Gains and losses arising from changes in fair value are recognized in operations for the period during which they occur, except in the case of derivative instruments designated as hedges in a cash flow hedging relationship.

Available-for-sale financial assets are recorded at fair value at the balance sheet date. Changes in fair value are recorded in other comprehensive income until they are realized, at which time they are reclassified to operations. Commodity futures that can be settled net in cash are recorded at the date of settlement if there is a probability of delivery or receipt in accordance with expected needs.

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

As part of its integrated enterprise risk management, Hydro-Québec uses various financial instruments to manage its market risk, consisting of currency risk, interest rate risk and risk resulting from fluctuating energy and commodity prices. Hydro-Québec applies cash flow or fair value hedge accounting to the eligible hedging relationships. It formally documents all relationships between hedging instruments and hedged items. This process involves associating all derivative instruments with specific assets and liabilities on the balance sheet, or with probable anticipated transactions. Hydro-Québec also measures the effectiveness of hedging relationships initially and then monthly thereafter.

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

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

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

Derivative instruments listed on a stock exchange are recognized at closing exchange rates as at the balance sheet date. The fair value of other derivative instruments is based on the spot rates or on the forward rates or prices in effect at market closing at the balance sheet date. In the absence of this information for a given instrument, Management uses the forward rate or price for an equivalent instrument. The valuation techniques used rely on recognized models commonly used by capital market players and make use of market observable data.

Note 2 Changes to Accounting Policies

Recent changes

2008

Financial instruments

On January 1, 2008, Hydro-Québec adopted two new disclosure and presentation standards of the *Canadian Institute of Chartered Accountants (CICA) Handbook*: Section 3862, "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments – Presentation", which superseded Section 3861, "Financial Instruments – Disclosure and Presentation". These new standards modify disclosure requirements regarding the nature and extent of risks arising from financial instruments as well as how Hydro-Québec manages these risks. The presentation rules remain unchanged. The adoption of these new standards has had no impact on the recognition or measurement of financial instruments. The required information is provided in Note 16, Financial Instruments.

Note 2 Changes to Accounting Policies (continued)

Capital disclosures

On January 1, 2008, Hydro-Québec adopted the recommendations of *CICA Handbook* Section 1535, “Capital Disclosures”, requiring disclosure of how capital is managed by Management. The required information is provided in Note 19, Capital Management.

Inventories

On January 1, 2008, Hydro-Québec adopted the recommendations of *CICA Handbook* Section 3031, “Inventories”, which establishes standards for the measurement of inventories, including determination of their cost. The adoption of these recommendations has not affected net income but required the reclassification of \$65 million as Property, plant and equipment on the balance sheet as at December 31, 2008.

2007

Financial instruments

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

The main impacts of adopting the new accounting policies were as follows as at January 1, 2007: Retained earnings increased by \$270 million, Accumulated other comprehensive income increased by \$479 million, Long-term debt increased by \$551 million, Other long-term liabilities decreased by \$2,051 million and the net value of derivative instruments decreased by \$701 million.

Equity

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

Accounting changes

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

Future changes

Goodwill and intangible assets

In 2008, the CICA issued Section 3064 of the *CICA Handbook*, “Goodwill and Intangible Assets”, which superseded Section 3062, “Goodwill and Other Intangible Assets”, and Section 3450, “Research and Development Costs”. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. It will apply to Hydro-Québec’s interim and annual financial statements for periods beginning on or after January 1, 2009. The adoption of these new standards is not expected to have any significant impact on the consolidated financial statements.

Regulated activities

On January 1, 2009, the temporary exemption provided for in *CICA Handbook* Section 1100, “Generally Accepted Accounting Principles”, which allows the recognition and measurement of regulatory assets and liabilities, was withdrawn. Pursuant to a practice allowed by Canadian GAAP, Hydro-Québec will, however, rely on *Statement of Financial Accounting Standard (SFAS) No. 71*, “Accounting for the Effects of Certain Types of Regulation,” issued by the U.S. Financial Accounting Standards Board (FASB), to maintain the current accounting treatment for regulatory assets and liabilities. Consequently, the withdrawal of the exemption should not have any impact on the consolidated financial statements.

Note 2 Changes to Accounting Policies (continued)

Credit risk and fair value of financial assets and financial liabilities

On January 20, 2009, the Emerging Issues Committee (EIC) of the CICA released *Abstract of Issue Discussed EIC-173*, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities". EIC-173 clarifies that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities, including derivative instruments. Hydro-Québec is currently assessing the impact of adopting the recommendations in this abstract on the consolidated financial statements.

International Financial Reporting Standards

On February 13, 2008, the Canadian Accounting Standards Board (AcSB) confirmed that the complete changeover to International Financial Reporting Standards (IFRS) would take effect for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011.

Hydro-Québec is currently examining the issues involved in the changeover from Canadian GAAP to IFRS.

Note 3 Effects of Rate Regulation on the Consolidated Financial Statements

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

Regulatory assets and liabilities

Costs related to the Energy Efficiency Plan (EEP)

The costs related to implementation of the EEP, such as specific energy conservation programs, are charged to a separate account and amortized over 10 years on a straight-line basis, except for the costs incurred prior to January 1, 2006, which are amortized over five years. This period begins in the year after the costs were recorded. Financial expenses arising from these costs are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. This accounting practice relates to Hydro-Québec's power distribution activities and was authorized by the Régie in decisions D-2002-25, D-2002-288, D-2003-93 and D-2006-56. Were these activities not regulated, certain costs not associated with intangible assets as defined in the accounting standards would be recognized in operations for the year in which they were incurred. If none of the costs incurred were related to an intangible asset, net income for 2008 would have been \$178 million lower (\$129 million in 2007).

Net costs related to retirement of property, plant and equipment and intangible assets

When property, plant and equipment or intangible assets are retired, the cost of such assets and of their dismantlement, net of accumulated amortization and salvage value, are charged to a separate account and amortized over a maximum period of 10 years, using the sinking fund method at a rate of 3%. The Régie authorized this accounting practice in decisions D-2002-95 and D-2003-93, which relate to Hydro-Québec's power transmission and distribution activities, respectively. Were these activities not regulated, the related costs would be recognized in operations for the year, and net income for 2008 would have been \$48 million lower (\$22 million higher in 2007).

Variances in revenue related to weather conditions

Variances between actual transmission and distribution revenue and the revenue forecasts established on the basis of weather normals for purposes of rate cases are recorded in a separate account. Financial expenses arising from the variances charged to this account are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base. This accounting practice was authorized by the Régie in decision D-2006-34, which relates to Hydro-Québec's power distribution activities, and led to a request for an amortization mechanism in the 2009 rate application. Were these activities not regulated, Hydro-Québec's expenditure would have been higher and net income would have been lower by \$141 million for 2008 (nil in 2007).

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

Variances in annual cost of transmission service for native load

Variances resulting from any modification of the annual cost of native load transmission service that has not been taken into account in the setting of electricity rates are recorded in a separate account and amortized according to conditions set by the Régie. Financial expenses arising from these variances are capitalized at the rate of return authorized by the Régie on the rate base until such time as they are included in the rate base and amortization begins. This accounting practice relates to Hydro-Québec's power distribution activities and was authorized by the Régie in decisions D-2003-93, D-2006-34, D-2007-12 and D-2008-024. Were these activities not regulated, Hydro-Québec's expenditure would have been lower and net income would have been higher by \$240 million for 2008 (\$11 million in 2007).

Costs incurred until the rescission of dual-energy Rate BT

The costs incurred until the rescission of dual-energy Rate BT were charged to a separate account and have been amortized on a straight-line basis over five years since the rescission date of April 1, 2006. These costs mainly include the deficit resulting from the variance between the supply cost recognized by the Régie and energy prices in effect, multiplied by the quantity of electricity delivered to customers at Rate BT between January 1, 2004, and March 31, 2006. Financial expenses arising from these costs were capitalized at the rate of return authorized by the Régie on the rate base until March 31, 2006. This accounting practice was authorized by the Régie in decisions D-2004-47, D-2004-170 and D-2006-34, which relate to Hydro-Québec's power distribution activities. Were these activities not regulated, the costs would have been recognized in operations for the year in which they were incurred, and net income for 2008 would have been \$29 million higher (\$30 million in 2007).

Costs related to the de-icing system at Lévis substation

Certain costs related to the Lévis substation de-icing system, a project designed in the wake of the 1998 ice storm to secure the transmission lines supplying the greater Québec area, were charged to a separate account. These costs have been depreciated using the sinking fund method at a rate of 3%, starting from the date of commissioning of the de-icing system, over a period corresponding to the average remaining useful life of the assets enhanced by the project. Financial expenses arising from these costs were capitalized at the rate of return authorized by the Régie on the rate base until such time as they were included in the rate base and amortization began. The Régie authorized this accounting practice in decision D-2004-175, which relates to Hydro-Québec's power transmission activities. Were these activities not regulated, the costs would have been recognized in operations for the year in which they were incurred, and net income for 2008 would have been \$5 million higher (\$6 million lower in 2007).

Cost variances related to electricity purchases in excess of the heritage pool

Volume and price variances recognized for a given year between the actual costs of electricity purchases in excess of the heritage pool and the costs forecasted in the rate cases and accepted by the Régie for rate-setting purposes are recorded in a separate account and amortized according to conditions set by the Régie. Financial expenses arising from these variances are capitalized at the rate of return authorized by the Régie on the rate base until such time as amortization begins. This accounting practice was authorized by the Régie in decisions D-2005-34, D-2005-132, D-2006-34, D-2007-12 and D-2008-024, which relate to Hydro-Québec's power distribution activities. Were these activities not regulated, the actual costs would be recognized in operations for the year in which they are incurred, and net income for 2008 would have been \$2 million lower (\$177 million in 2007).

Variances in revenue from point-to-point transmission services

Variances recognized for a given year between actual revenue from point-to-point transmission services and revenue forecasted in the rate cases and accepted by the Régie for rate-setting purposes are recorded in a separate account and amortized according to conditions set by the Régie. Financial expenses arising from these variances are capitalized at the rate of return authorized by the Régie on the rate base until such time as amortization begins. This accounting practice was authorized by the Régie in decisions D-2007-08 and D-2008-019, which relate to Hydro-Québec's power transmission activities. Were these activities not regulated, Hydro-Québec's expenditure would have been higher and net income would have been lower by \$41 million for 2008 (\$50 million higher in 2007).

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

Regulatory assets

	Expected years of amortization	2008	2007
Costs related to EEP	2009–2018	559	381
Net costs related to retirement of property, plant and equipment and intangible assets	2009 ^a	267	219
Variances in revenue related to weather conditions ^b	2009–2014	141	–
Variances in annual cost of transmission service for native load ^b	2009	104	344
Costs incurred until rescission of dual-energy Rate BT	2009–2011	66	95
Costs related to de-icing system at Lévis substation	2009–2047	13	18
Other	2009–2028	17	17
		1,167	1,074

Regulatory liabilities

	Expected years of amortization	2008	2007
Cost variances related to electricity purchases in excess of heritage pool ^b	2009–2010	(53)	(55)
Variances in revenue from point-to-point transmission services ^b	2009	(9)	(50)
		(62)	(105)
Current portion		(56)	(97)
		(6)	(8)

a) Except certain asset retirements.

b) The change in the variance accounts, net of an amortization expense of \$141 million (amortization credit of \$145 million in 2007) and capitalized financial expenses of \$13 million (\$1 million in 2007), corresponds to the Regulatory deferrals presented in the Consolidated Statements of Operations, namely, a decrease in expenditure of \$72 million (increase of \$29 million in 2007).

Risks and uncertainties

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

Other regulatory practices

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

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

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

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

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

In decision D-2007-134 issued in December 2007, the Régie approved an agreement whereby energy deliveries provided for in a power purchase contract with an independent power producer were suspended for 2008. In decision D-2008-114 issued on September 10, 2008, the Régie authorized the renewal of the agreement until the end of 2009. As at December 31, 2008, a \$57-million commitment (\$52 million as at December 31, 2007) was recorded on the balance sheet but had no impact on operating results.

Note 4 Depreciation and Amortization

	2008	2007
Property, plant and equipment ^a	1,819	1,857
Intangible assets	122	104
Regulatory assets and liabilities	286	(7)
Deferred charges	10	11
Write-offs	99	26
	<u>2,336</u>	<u>1,991</u>

a) Revision of the useful life of property, plant and equipment resulted in a \$71-million decrease in the depreciation and amortization expense for 2008 (\$13-million increase in 2007). In fiscal 2009, Hydro-Québec will revise the useful life of some property, plant, and equipment used for hydraulic generation, which could have a major impact on the depreciation and amortization expense.

Note 5 Taxes

	2008	2007
Water-power royalties	552	267 ^a
Public utilities tax	302	240
Capital tax	202	278
Municipal, school and other taxes	37	35
	<u>1,093</u>	<u>820</u>

a) The payment of water-power royalties results from the fact that Hydro-Québec is subject to the Watercourses Act. For this transition year, the half-rate rule applied.

Note 6 Financial Expenses

	2008	2007
Interest		
Interest on debt securities	2,585	2,584
Amortization of debt premiums, discounts and issue expenses	111	111
	<u>2,696</u>	<u>2,695</u>
Net exchange (gain) loss	(25)	18
Loan guarantee fees	167	169
	<u>142</u>	<u>187</u>
Less		
Capitalized financial expenses	306	283
Net investment income ^a	87	87
	<u>393</u>	<u>370</u>
	<u>2,445</u>	<u>2,512</u>

a) As at December 31, 2008, the weighted average interest rate on short-term investments was 2.33% (4.20% as at December 31, 2007).

Note 7 Discontinued Operations

In 2008, Hydro-Québec recognized a gain of \$121 million, net of \$26 million in related income taxes, for the price adjustment provided for in the contract for the sale of its interest in HQI Transelec Chile S.A. (Transelec). This adjustment was made following the ministerial order issued on January 15, 2008, establishing the value of the regulated trunk transmission asset base of Transelec. The retrospective effect of this revised valuation on Transelec's revenue for the period from March 13, 2004, to June 30, 2006, resulted in an additional \$5-million adjustment of the selling price, net of \$1 million in related income taxes.

Note 7 Discontinued Operations (continued)

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

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

Note 8 Property, Plant and Equipment

	2008			
	In service	Accumulated depreciation	Under construction	Total
Generation				
Hydraulic	33,829	8,832	3,458	28,455
Thermal, including nuclear	2,573	1,999	248	822
Other	750	332	25	443
	37,152	11,163	3,731	29,720
Transmission				
Substations and lines	21,393	6,932	931	15,392
Other	1,980	1,150	108	938
	23,373	8,082	1,039	16,330
Distribution				
Substations and lines	11,850	4,550	234	7,534
Other	1,863	1,019	101	945
	13,713	5,569	335	8,479
Construction	28	14	1	15
Corporate and Other Activities	1,023	642	62	443
	75,289	25,470	5,168	54,987
				2007
	In service	Accumulated depreciation	Under construction	Total
Generation				
Hydraulic	32,235	8,256	3,344	27,323
Thermal, including nuclear	2,715	1,933	158	940
Other	725	314	23	434
	35,675	10,503	3,525	28,697
Transmission				
Substations and lines	20,842	6,532	669	14,979
Other	1,916	1,085	87	918
	22,758	7,617	756	15,897
Distribution				
Substations and lines	11,434	4,270	191	7,355
Other	1,801	1,016	123	908
	13,235	5,286	314	8,263
Construction	31	14	2	19
Corporate and Other Activities	992	638	61	415
	72,691	24,058	4,658	53,291

Note 9 Investments

	2008	2007
At equity		
Churchill Falls (Labrador) Corporation Limited	87	77
CITEQ inc.	(5)	(5)
	82	72
At fair value		
Churchill Falls (Labrador) Corporation Limited		
Bonds	–	55
Venture capital ^a	19	40
	19	95
Other	7	61
	108	228

- a) The gross unrealized gains and losses on investments held by the venture capital company amounted to \$6 million and \$13 million, respectively, as at December 31, 2008 (\$12 million and \$13 million as at December 31, 2007). Net realized and unrealized losses in 2008 totaled \$1 million and \$6 million, respectively (realized and unrealized gains of \$12 million and \$2 million in 2007).

Note 10 Intangible Assets

	2008			2007		
	Cost ^a	Accumulated amortization	Net carrying amount	Cost ^a	Accumulated amortization	Net carrying amount
Subject to amortization						
Software and licences	1,260	744	516	1,322	763	559
Patents	10	4	6	9	4	5
	1,270	748	522	1,331	767	564
Not subject to amortization						
Servitudes			343			339
			865			903

- a) The intangible assets commissioned during the year totaled \$481 million as at December 31, 2008 (\$87 million as at December 31, 2007).

Note 11 Other Assets

	Note	2008	2007
Accrued benefit asset	21	1,133	828
Deferred charges		111	153
Government reimbursement for the 1998 ice storm ^a		90	107
Nuclear fuel waste management trust fund ^b		50	44
Goodwill ^c		10	10
		1,394	1,142

- a) Payable in quarterly installments of \$6 million until January 15, 2014, and a final installment of \$1 million on April 15, 2014. These installments include interest at the annual rate of 7.2%. The fair value of this financial asset was \$97 million as at December 31, 2008 (\$110 million as at December 31, 2007).
- b) On November 15, 2002, the Nuclear Fuel Waste Act came into force. Under this Act, nuclear energy corporations in Canada were required to set up a waste management organization whose role would be to propose a long-term approach for managing spent nuclear fuel to the Government of Canada. Nuclear energy corporations were also required to set up a trust fund to finance the costs of long-term nuclear fuel waste management. In November 2005, the Nuclear Waste Management Organization (NWMO) filed its report with the Government of Canada and recommended an approach which was adopted in June 2007.
- In October 2007, the members of the NWMO ratified an agreement that sets forth a formula for financing the costs of long-term nuclear fuel waste management. This formula will be used to determine each member's share for the next five years and will become effective only after approval by the Government of Canada. Each member's share will be determined according to the number of spent nuclear fuel bundles it had generated as at June 30, 2006. It will also take into account the date on which each member plans to send the spent nuclear fuel bundles to the future national repository.
- c) For purposes of segmented information, goodwill is classified under Generation.

Note 12 Long-Term Debt

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

	2008				2007			
			At time of issue	At time of repayment			At time of issue	At time of repayment
	In Canadian dollars and other currencies	At closing exchange rates as at the balance sheet date	%	%	In Canadian dollars and other currencies	At closing exchange rates as at the balance sheet date	%	%
Hydro-Québec's debt								
Canadian dollars	25,482	25,482	71	95	24,829	24,829	72	96
U.S. dollars	8,076	9,888	28	5^a	8,135	8,012	24	4 ^a
Other currencies								
Euros	59	101	–	–	671	968	3	–
Yen	2,506	34	–	–	2,508	22	–	–
Pounds sterling	238	425	1	–	237	465	1	–
Swiss francs	–	–	–	–	100	87	–	–
		35,930				34,383		
Plus								
Adjustment for fair-value hedged risk		98				(163)		
Subsidiaries' debt								
U.S. dollars	26	32	–	–	29	28	–	–
		36,060	100	100		34,248	100	100
Less								
Current portion		770				1,087		
		35,290				33,161		

a) Of this amount, 99.4% was used to hedge sales in U.S. dollars as at December 31, 2008 (99.3% as at December 31, 2007).

Interest rates

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

Maturity	2008				2007
	Canadian dollars	U.S. dollars	Other currencies	Weighted average	Weighted average
1 to 5 years	7.93	7.51	8.55	7.71	8.14
6 to 10 years	3.31	7.07	9.90	7.58	9.58
11 to 15 years	10.45	8.97	–	9.96	9.99
16 to 20 years	7.30	8.28	–	8.27	8.50
21 to 25 years	5.70	9.35	–	8.10	8.40
26 to 30 years	5.99	–	–	5.99	5.99
31 to 35 years	5.17	–	–	5.17	5.17
36 to 40 years	4.93	–	–	4.93	4.88
41 to 45 years	6.44	–	–	6.44	6.44
46 to 50 years	–	–	–	–	–
51 to 55 years	6.62	–	–	6.62	6.62
Weighted average	6.31	8.65	9.79	6.93	7.32

The variable-rate portion of Hydro-Québec's debt amounted to 10.1%, or 11.0% including perpetual debt, as at December 31, 2008 (6.8%, or 7.8% including perpetual debt, as at December 31, 2007).

Note 12 Long-Term Debt (continued)

Fair value

As at December 31, 2008, the fair value of Hydro-Québec's long-term debt, including the current portion, amounted to \$47,072 million (\$44,753 million as at December 31, 2007). Including debt-related swaps, total indebtedness stood at \$47,856 million (\$46,044 million as at December 31, 2007).

Fair value is obtained by discounting future cash flows, based on forward interest rates derived from interest rates at close of business on the balance sheet date for similar instruments available on capital markets. Changes in fair value reflect sensitivity to capital market interest rates. However, Management's primary intention is to hold these debt securities until maturity.

Standby credit

Hydro-Québec has undrawn standby credit facilities of US\$2,000 million, composed of two tranches, one of US\$360 million and the other of US\$1,640 million, which will expire in 2012 and 2013, respectively. Any borrowings will bear interest at a rate based on the London Interbank Offered Rate (LIBOR). A US\$750-million swing loan at the U.S. base rate is included in the US\$2,000-million credit facility.

Note 13 Asset Retirement Obligations

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

In 2008, the Board of Directors approved the project to refurbish Gentilly-2 nuclear generating station, which will extend its useful life by 28 years. Therefore, the main assumptions for calculating the obligation related to the dismantling of Gentilly-2 generating station at the end of its useful life had to be revised, resulting primarily in a 28-year deferral of the expected timing for the settlement of the obligation.

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

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

				2008
	Dismantling of nuclear generating station	Removal of spent nuclear fuel	Dismantling of other assets	Total
Balance, beginning of year	306	141	17	464
Liabilities incurred	–	2	–	2
Accretion expense	15	13	1	29
Liabilities settled	–	(1)	(2)	(3)
Revision of estimated cash flows and expected timing of payments	(192) ^a	–	–	(192)
Balance, end of year	129	155	16	300
				2007
	Dismantling of nuclear generating station	Removal of spent nuclear fuel	Dismantling of other assets	Total
Balance, beginning of year	288	127	16	431
Liabilities incurred	–	3	–	3
Accretion expense	18	12	1	31
Liabilities settled	–	(1)	(2)	(3)
Revision of estimated cash flows and expected timing of payments	–	–	2	2
Balance, end of year	306	141	17	464

a) The decrease in the obligation is mainly due to the deferral of the dismantling of Gentilly-2 generating station, since Hydro-Québec now has an additional 28 years to provide for its obligation.

Note 13 Asset Retirement Obligations (continued)

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

	Dismantling of nuclear generating station	Removal of spent nuclear fuel	Dismantling of other assets
Estimated cash flows (in constant dollars) required to settle the obligations ^a			
As at December 31, 2008	761	598	17
As at December 31, 2007	795	598	18
Expected timing of payment of the cash flows required to settle the obligations			
As at December 31, 2008	Between 2040 and 2071	Between 2009 and 2159	Between 2009 and 2031
As at December 31, 2007	Between 2011 and 2057	Between 2008 and 2159	Between 2008 and 2031
Credit quality-adjusted, risk-free rate at which the estimated cash flows have been discounted (%)			
Initial recognition of obligations	6.4	6.4	6.4
Subsequent recognition of obligations	5.5 and 5.2	5.5	5.7

a) Inflation rates varying between 1.8% and 3.6% were used to determine the asset retirement obligations.

Note 14 Other Long-Term Liabilities

	Note	2008	2007
Accrued benefit liability	21	663	601
Accounts payable		97	117
		760	718

Note 15 Perpetual Debt

Perpetual notes in the amount of \$355 million (US\$289 million) as at December 31, 2008, and \$286 million (US\$289 million) as at December 31, 2007, bear interest at a rate determined semiannually based on LIBOR, plus 0.0625%. They are redeemable at Hydro-Québec's option. No portion was redeemed in 2008 and 2007. Various derivative instruments recorded at fair value are used to mitigate currency risk associated with this debt.

As at December 31, 2008 and 2007, the rates applicable to the perpetual notes were 3.6% and 5.2%, respectively. As at December 31, 2008, the fair value of the perpetual notes was \$246 million (\$290 million as at December 31, 2007). Fair value is obtained by discounting future cash flows, based on forward interest rates derived from interest rates at close of business on the balance sheet date for similar instruments available on capital markets.

Note 16 Financial Instruments

As part of its operations, Hydro-Québec carries out transactions that expose it to financial risks such as market, liquidity and credit risks. Exposure to such risks and the impact on operating results are significantly reduced through careful monitoring and implementing strategies that include the use of derivative instruments.

Market risk

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

Management of long-term risk

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

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

Note 16 Financial Instruments (continued)

Management of risk associated with long-term debt

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

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

Maturity						2008 ^a	2007 ^a
	1 to 5 years	6 to 10 years	11 to 15 years	16 to 20 years	More than 20 years	Total	Total
Swaps							
Canadian dollars	(384)	(194)	(2,465)	(2,337)	(2,637)	(8,017)	(6,413)
U.S. dollars	(347)	(12)	2,030	1,950	2,039	5,660	5,418
Other currencies							
Yen	1,500	1,000	–	–	–	2,500	2,500
Euros	–	61	–	–	–	61	673
Pounds sterling	40	200	–	–	–	240	240
Swiss francs	–	–	–	–	–	–	97

a) Figures in parentheses represent amounts to be paid.

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

	2008	2007
Instruments designated as cash flow hedges for U.S.-dollar sales ^a	452	894
Instruments designated as cash flow hedges for debt	(36)	(2,451)
Instruments designated as fair value hedges for debt	104	(274)
	520	(1,831)
Instruments not designated as hedges ^b	(695)	1,548
	(175)	(283)

a) A portion of the long-term debt, with a nominal amount of US\$1,437 million as at December 31, 2008 (US\$1,504 million as at December 31, 2007), was also designated as a cash flow hedge for U.S.-dollar sales.

b) Transactions carried out as part of Hydro-Québec's risk management, including (\$852 million) in 2008 in consideration of amounts received or disbursed with respect to credit risk mitigation agreements (\$1,435 million in 2007).

Management of short-term risk

Currency risk – Hydro-Québec uses options and forward contracts to manage its foreign currency risk exposure over the short term. When designated as hedging items, these derivative instruments are recognized as cash flow hedges. The impact of currency risk hedging transactions on operating results is recorded in the line item corresponding to the hedged item, namely Revenue or Electricity and fuel purchases. The nominal amount of the open positions as at December 31, 2008, was US\$258 million, with US\$52 million in purchase contracts and US\$310 million in sales contracts (US\$563 million as at December 31, 2007, that is, US\$107 million in purchase contracts and US\$670 million in sales contracts).

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

Market risk – Hydro-Québec uses mainly options, swaps and commodity futures to manage risk resulting from fluctuations in energy and aluminum prices. When these derivative instruments are designated as hedging items, they are recognized as cash flow hedges. The impact on operating results of transactions to hedge the risk of variability in energy and aluminum prices is recorded in the line item corresponding to the hedged item, namely Revenue. Hydro-Québec regularly assesses the probability of realizing these transactions. To hedge exposure to variability in energy and aluminum prices, Hydro-Québec has traded derivative instruments for which open positions as at December 31, 2008, totaled 152,625 tonnes of aluminum (227,525 tonnes as at December 31, 2007) and in electricity swaps for which open positions as at December 31, 2008, were 3.5 TWh (8.0 TWh as at December 31, 2007).

Note 16 Financial Instruments (continued)

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

	2008	2007
Instruments designated as cash flow hedges	285	66
Instruments not designated as hedges	8	(11)
	293	55

Effect of hedges

Effect of hedges on operating results

EFFECT OF CASH FLOW HEDGES

As at December 31, 2008, the net loss related to the ineffectiveness of cash flow hedges recognized in operations totaled \$15 million (net gain of \$9 million as at December 31, 2007).

As at December 31, 2008, Hydro-Québec estimated at \$401 million the amount of net gains presented in Accumulated other comprehensive income that would be reclassified to operations in the next 12 months (\$222 million as at December 31, 2007).

In 2008, Hydro-Québec did not reclassify any amount from Accumulated other comprehensive income to operations (net gain of \$10 million reclassified in 2007) as a result of the discontinuance of cash flow hedges.

As at December 31, 2008, the maximum period over which Hydro-Québec hedged its exposure to the variability of future cash flows for anticipated transactions was 22 years (23 years as at December 31, 2007).

EFFECT OF FAIR VALUE HEDGES

As at December 31, 2008, the net loss related to the ineffectiveness of fair value hedges recognized in operations totaled \$25 million (net gain of \$3 million as at December 31, 2007).

EFFECT OF REVALUATION OF DERIVATIVE INSTRUMENTS NOT DESIGNATED AS HEDGES

As at December 31, 2008, the net gain recognized in operations as a result of the revaluation, at fair value, of derivative instruments not subject to hedge accounting totaled \$143 million (\$32 million as at December 31, 2007). These instruments are essentially related to risk management transactions.

Sensitivity analyses

Integrated management of risk associated with variability in foreign exchange rates, interest rates and aluminum prices aims to limit the impact of such risk on operating results. Most of the derivative instruments traded are designated as cash flow hedges or fair value hedges and therefore reduce the volatility in operating results, except for the ineffective portion of the hedges, which is insignificant. Derivative instruments which are not designated as hedges, but which nonetheless serve to hedge at-risk opposite positions, also reduce the volatility in operating results. The sensitivity of operating results is thus limited to net exposure to unhedged risks.

As at December 31, 2008, had the exchange rate (C\$/US\$) been 5% higher or lower, net income would have been \$17 million higher or \$7 million lower, respectively, taking into account the impact of hedged sales, while other comprehensive income would have been \$100 million higher or \$104 million lower, respectively.

For the year ended December 31, 2008, had interest rates been 50 basis points higher or lower, net income would have been \$2 million lower or higher, respectively, while other comprehensive income would have been \$3 million higher or \$4 million lower, respectively.

For the year ended December 31, 2008, had the price of aluminum been 5% higher or lower, net income would have been \$3 million higher or lower, respectively, taking into account the impact of hedged sales, and other comprehensive income would have been \$15 million lower or higher, respectively.

Note 16 Financial Instruments (continued)

Liquidity risk

Liquidity risk is the risk that Hydro-Québec will have difficulty meeting commitments related to its financial liabilities.

Hydro-Québec's exposure is reduced by a large volume of cash from operations, a diversified portfolio of highly liquid or readily convertible instruments traded with high-quality counterparties, preauthorized capital resources, the quality of Hydro-Québec's signature on financial markets, diversified capital resources and its management of the proportions of variable-rate debt and debt repayable in foreign currency.

In addition, as at December 31, 2008, \$34,881 million in long-term debt, perpetual debt and borrowings was guaranteed by the Québec government (\$33,402 million as at December 31, 2007).

Maturities of financial liabilities are presented in the following table. The amounts reported are contractual undiscounted cash flows, representing payments of principal and interest for financial liabilities as at December 31, 2008.

Maturity	Borrowings ^a	Accounts payable and accrued liabilities	Dividends payable	Long-term debt	Derivative instruments ^b
2009	92	1,527	2,252	3,228	148
2010	–	51	–	3,134	1,067
2011	–	20	–	4,903	124
2012 ^c	–	16	–	3,356	53
2013	–	2	–	3,270	115
1 to 5 years	92	1,616	2,252	17,891	1,507
6 to 10 years	–	–	–	11,160	270
11 to 15 years ^c	–	–	–	17,056	198
16 to 20 years	–	–	–	8,287	177
21 to 25 years	–	–	–	8,275	172
26 to 30 years	–	–	–	8,406	–
31 to 35 years	–	–	–	6,693	–
36 to 40 years	–	–	–	6,875	–
41 to 45 years	–	–	–	1,657	–
46 to 50 years	–	–	–	1,479	–
51 to 55 years	–	–	–	825	–
56 years and over	–	–	–	1,425	–
Total	92	1,616	2,252	90,029	2,324
Net carrying amount	91 ^d	1,616 ^{d,e}	2,252	36,060 ^f	1,969

a) As at December 31, 2008, the weighted average interest rate on short-term borrowings was 2.59% (4.38% as at December 31, 2007).

b) Agreements entered into with certain counterparties to limit the market value of these financial instruments could result in cash inflows or outflows at dates different from the initially scheduled maturity dates.

c) Certain debts carry sinking fund requirements.

d) Because of their short-term maturities, the carrying amount of these financial liabilities approximates their fair value.

e) Of this amount, \$1,527 million is recorded in Accounts payable and accrued liabilities and \$89 million in Other long-term liabilities.

f) Including the current portion.

Contractual maturities of perpetual debt result in biennial interest flows. Perpetual notes in the amount of \$355 million (US\$289 million) bear interest at a rate determined semiannually based on LIBOR, plus 0.0625%. As at December 31, 2008, the applicable rate was 3.6%.

Credit risk

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

Hydro-Québec is exposed to credit risk related to cash equivalents, short-term investments and derivative instruments traded with financial institutions. It is also exposed to credit risk related to accounts receivable arising primarily from its day-to-day energy sales in and outside Québec. It should be noted that sales in Québec are billed at rates that allow for recovery of costs based on conditions approved by the Régie. Credit risk is limited to the carrying amount presented under assets on the balance sheet, which approximates fair value.

Note 16 Financial Instruments (continued)

Cash equivalents, short-term investments and derivative instruments

In order to reduce its credit risk exposure, Hydro-Québec deals with Canadian and international issuers and financial institutions with high credit ratings. In addition, it applies policies to limit risk concentration as well as various monitoring programs and sets credit limits for each counterparty. Through prior agreements, it can also limit the market value of the main derivative instrument portfolios. Any variation in market value beyond the agreed-upon limit results in an inflow or outflow of cash. As at December 31, 2008, substantially all counterparties with whom Hydro-Québec dealt had a rating over A- and none of them had defaulted on their obligations to Hydro-Québec.

Customers – Energy sales (recorded in Accounts receivable)

Exposure to credit risk from energy sales is limited due to Hydro-Québec's large and diverse customer base. Management is of the opinion that Hydro-Québec is not exposed to a major credit risk. Moreover, Hydro-Québec holds as collateral customer deposits of \$39 million (\$30 million as at December 31, 2007), of which \$9 million is recorded in Accounts payable and accrued liabilities and \$30 million is in Other long-term liabilities.

The value of accounts receivable, by age and net of the related bad debt provision, is presented in the following table.

	2008
Under 30 days ^a	1,481
30 to 60 days	62
61 to 90 days	30
Over 90 days	140
	1,713

a) Including unbilled electricity deliveries.

In 2008, the bad debt provision increased by \$57 million to \$201 million as at December 31 (\$144 million as at December 31, 2007). The provision is based on account age and customer standing.

Note 17 Interests in Joint Ventures

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

	2008	2007
Operations		
Revenue	26	21
Expenditure and financial expenses	30	26
Income from discontinued operations	–	1
Net loss	(4)	(4)
Balance sheets		
Current assets	9	13
Long-term assets	35	29
Current liabilities	9	14
Long-term liabilities	35	30
Net liabilities	–	(2)
Cash flows		
Operating activities	–	(4)
Investing activities	(2)	(2)
Financing activities	(3)	(1)
Discontinued operations	–	(3)
Net change in cash and cash equivalents	(5)	(10)

Note 18 Equity

Share capital

The authorized share capital consists of 50,000,000 shares with a par value of \$100 each, of which 43,741,090 shares were issued and paid-up as at December 31, 2008 and 2007.

Note 18 Equity (continued)

Retained earnings

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

However, in respect of a given financial year, no dividend may be declared in an amount that would have the effect of reducing the capitalization rate to less than 25% at the end of the year. The Québec government declares the dividends for a given year within 30 days after Hydro-Québec has sent it the financial data related to the distributable surplus. Upon expiry of the prescribed period, all or a portion of the distributable surplus that has not been subject to a dividend declaration may no longer be distributed to the shareholder as a dividend.

For 2008, the Québec government declared dividends of \$2,252 million (\$2,095 million in 2007).

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

Accumulated other comprehensive income

	2008		
	Cash flow hedges	Other	Total
Balance, beginning of year	965	(3)	962
Change for the year	278	3	281
Balance, end of year	1,243	–	1,243

	2007		
	Cash flow hedges	Other	Total
Balance, beginning of year	479	(8)	471
Change for the year	486	5	491
Balance, end of year	965	(3)	962

Note 19 Capital Management

Hydro-Québec manages its capital in such a way as to meet its shareholder's expectations, safeguard its funds at all times and sustain its growth. It fosters a management environment allowing it to enhance the long-term value of its assets and equity, ensure its financial sustainability, preserve its financing capability and safeguard its funds and securities.

In addition to equity, capital includes long-term debt, perpetual debt, short-term borrowings and derivative instruments.

Hydro-Québec uses its capitalization rate to monitor its capital structure. It aims to maintain capitalization at no less than 25%.

Capitalization

	2008	2007
Equity	22,062	20,892
Long-term debt, including current portion	36,060	34,248
Perpetual debt	355	286
Short-term borrowings	91	73
Derivative instruments	(118)	228
Total	58,450	55,727
Capitalization rate (%) ^{a)}	37.7	37.5

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

In 2008, Hydro-Québec's capital management objectives were unchanged from those in 2007.

Note 20 Supplementary Cash Flow Information

	2008	2007
Change in non-cash working capital items		
Accounts receivable	(175)	(172)
Materials, fuel and supplies	6	5
Accounts payable and accrued liabilities	–	23
Accrued interest	20	(47)
	(149)	(191)
Investing activities not affecting cash		
(Decrease) increase in property, plant and equipment and intangible assets	(92)	90
Interest paid	2,093	2,131

Note 21 Employee Future Benefits

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

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

Hydro-Québec's employee benefit plans are defined-benefit plans. The accrued benefit obligations of these plans, valued by independent actuaries, and assets, at fair value, are valued as at December 31 of each year. The most recent actuarial valuation for funding purposes of the Pension Plan was as at December 31, 2007, and the next valuation must be performed no later than December 31, 2010.

The following table presents information concerning Hydro-Québec's employee future benefit plans:

	Pension Plan		Other plans	
	2008	2007	2008	2007
Accrued benefit obligations				
Balance, beginning of year	12,607	12,720	929	850
Current service cost	285	336	42	38
Employee contributions	84	66	–	–
Benefit payments and refunds	(510)	(460)	(51)	(49)
Interest on obligations	712	659	51	46
Actuarial (gains) losses	(3,138)	(714)	(198)	44
Amendments to the Pension Plan	168	–	–	–
Balance, end of year	10,208	12,607	773	929
Plan assets at fair value				
Balance, beginning of year	12,926	12,811	58	56
Actual return on plan assets	(2,434)	538	2	2
Employee contributions	84	66	–	–
Current contributions by Hydro-Québec	291	5	11	11
Special contribution by Hydro-Québec	149	–	–	–
Benefit payments and refunds	(510)	(460)	(11)	(12)
Administrative fees	(31)	(34)	–	–
Balance, end of year	10,475	12,926	60	57
Surplus (deficit), end of year	267	319	(713)	(872)
Unamortized past service costs	335	217	–	–
Unamortized net actuarial loss (gain)	1,292	1,205	(17)	190
Unamortized transitional (asset) obligation	(761)	(913)	67	81
Accrued benefit asset (liability)	1,133	828	(663)	(601)

Note 21 Employee Future Benefits (continued)

In 2008, some amendments were made to the Pension Plan following agreements reached between Hydro-Québec and its unions. These amendments, which came into force on January 1, 2009, concern temporary and permanent provisions. The main temporary provisions concern retirement without pension reduction and the bridging benefit, whereas the main permanent provisions apply to the cost of optional pension forms and the broadening of the definition of the surviving spouse upon a retiree's death. Amendments to the funding rules of the Pension Plan were also adopted under these agreements. As a result, the rates for employee and employer contributions have been 6.0% and 6.9%, respectively, since January 1, 2009. These rates will be increased annually by 0.5% and 0.9% until they reach up to 7.5% and 10.5% of the eligible base earnings in 2013.

Additional disclosures with respect to plan assets

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

%	Pension Plan		Other plans	
	2008	2007	2008	2007
Bonds	54	39	91	95
Equities	32	46	–	–
Real-estate investments	10	6	–	–
Short-term investments	4	9	–	–
Other	–	–	9	5
	100	100	100	100

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

	Pension Plan		Other plans	
	2008	2007	2008	2007
Bonds	1,359	1,266	56	55

Cash payments

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

	2008	2007
Contributions by Hydro-Québec		
Pension Plan	440	5
Other funded plans	11	11
Benefit payments		
Unfunded plans	41	38
Cash payments	492	54

In compliance with the actuarial valuation for funding purposes as at December 31, 2007, Hydro-Québec made a current contribution of \$291 million in 2008, including an additional contribution of \$208 million, to cover the current service cost, and a special contribution of \$149 million to cover the unfunded actuarial liability. In 2007, Hydro-Québec took a contribution holiday as of February 16, namely the filing date of the actuarial valuation with the Régie des rentes du Québec. Earlier in 2007, Hydro-Québec had made a contribution of \$5 million to the Pension Plan.

Note 21 Employee Future Benefits (continued)

Elements of accrued benefit cost recognized for the year

	Pension Plan		Other plans	
	2008	2007	2008	2007
Current service cost ^a	285	336	42	38
Administrative fees ^b	31	34	–	–
Interest on obligations	712	659	51	46
Actual return on plan assets	2,434	(538)	(2)	(2)
Actuarial (gains) losses	(3,138)	(714)	(198)	44
Amendments to the Pension Plan	168	–	–	–
Cost (credit) before adjustments required to recognize the long-term nature of employee future benefits	492	(223)	(107)	126
Difference between actual and expected return on assets	(3,237)	(201)	–	–
Difference between actuarial (gains) losses on accrued benefit obligations and actuarial losses recognized	3,150	829	207	(34)
Difference between amendments to the Pension Plan and amortization of past service cost	(118)	39	–	–
Amortization of transitional (asset) obligation	(152)	(152)	14	14
	(357)	515	221	(20)
Cost recognized for the year	135	292	114	106

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

b) Administrative fees billed to the Pension Plan by Hydro-Québec amounted to \$12 million for 2008 (\$13 million for 2007).

Significant actuarial assumptions

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

%	Pension Plan		Other plans	
	2008	2007	2008	2007
Accrued benefit obligations				
<i>Rate at end of year</i>				
Discount rate	7.49	5.53	7.49	5.53
Salary escalation rate ^a	2.86	3.26	–	–
Accrued benefit cost recognized				
<i>Rate at end of prior year</i>				
Discount rate	5.53	5.20	5.53	5.20
Expected long-term rate of return on plan assets	6.25	6.25	3.81	4.23
Salary escalation rate ^a	3.26	3.38	–	–

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

As at December 31, 2008, health care costs were based on an annual growth rate of 7.5% for 2009. Thereafter, based on the assumption used, this rate will gradually decrease until it ultimately reaches 4.6% in 2017. A change of 1% in this annual growth rate would have had the following impact for 2008:

	1% increase	1% decrease
Impact on current service cost and interest cost on accrued benefit obligations for the year	6	(5)
Impact on accrued benefit obligations at end of year	40	(33)

Note 22 Commitments and Contingencies

Electricity purchases

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

As at December 31, 2008, Hydro-Québec was committed under 115 contracts to purchase electricity from other power producers, for an installed capacity of about 5,792 MW. It expects to purchase approximately 22 TWh of energy annually over the terms of these contracts, which extend through 2045. The majority of these contracts include renewal clauses.

Hydro-Québec expects to make the following minimum payments on all its electricity purchase contracts over the next five years:

2009	690
2010	1,098
2011	1,158
2012	1,376
2013	1,596

Guarantees

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

As at December 31, 2008, the potential maximum amount Hydro-Québec could have had to pay under letters of credit or guarantees provided as security totaled \$405 million. Of this amount, \$326 million was related to energy purchases. Guarantees amounting to \$140 million will expire between 2009 and 2019, while others totaling \$265 million do not have maturity dates.

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

In accordance with the terms and conditions of certain debt securities issued outside Canada, Hydro-Québec has undertaken to increase the amount of interest paid to non-residents in the event of changes to Canadian tax legislation governing the taxation of non-residents' income. Hydro-Québec cannot estimate the maximum amount it might have to pay under such circumstances. Should an amount become payable, Hydro-Québec has the option of redeeming most of the securities in question. As at December 31, 2008, the amortized cost of these debts was \$4,769 million.

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

Investments

Hydro-Québec expects to invest approximately \$4.7 billion in property, plant and equipment and intangible assets in 2009.

Note 22 Commitments and Contingencies (continued)

Litigation

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

Note 23 Related Party Transactions

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

The main transactions and balances owing to related parties or owed by them are as follows:

	2008	2007
Québec government		
Accounts receivable	5	7
Accounts payable	26	45
Capital tax	202	278
Public utilities tax	302	240
Water-power royalties	546	263
Guarantee fees	167	169
Significantly influenced investees		
Accounts payable	9	14
Electricity purchases	98	106

Note 24 Segmented Information

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

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

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

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

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

Corporate and Other Activities: The corporate units support the divisions in the achievement of their business objectives. They include Groupe de la technologie, Groupe des affaires corporatives et du secrétariat général, Groupe des ressources humaines et des services partagés, Vice-présidence à la comptabilité et au contrôle and Vice-présidence au financement, à la trésorerie et à la caisse de retraite. The Centre de services partagés brings together internal services including goods and services procurement, real estate management, and material and transportation service management.

Note 24 Segmented Information (continued)

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

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

Other intersegment products and services are measured at full cost.

Hydro-Québec derives the bulk of its revenue in Québec, and substantially all its property, plant and equipment is located in the province. In 2008, revenue from outside Québec amounted to \$2,099 million, with \$1,776 million coming from the U.S. (\$1,780 million and \$1,483 million, respectively, in 2007).

Operations and assets by segment

							2008
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	2,066	52	10,540	–	32	27 ^a	12,717
Intersegment	4,931	2,733	62	2,416	1,156	(11,298)	–
Depreciation and amortization	777	611	828	5	127	(12)	2,336
Financial expenses	1,101	817	486	–	41	–	2,445
Income from continuing operations	2,137	481	421	–	(39)	12	3,012
Net income	2,137	481	421	–	90	12	3,141
Total assets	30,651	17,158	12,274	360	6,734	(403)	66,774
Investing activities							
Increase (decrease) in property, plant and equipment and intangible assets							
Affecting cash	1,894	1,097	664	5	96	–	3,756
Not affecting cash	(113)	17	4	–	–	–	(92)
2007							
	Generation	Transmission	Distribution	Construction	Corporate and Other Activities	Intersegment eliminations and adjustments	Total
Revenue							
External customers	1,649	37	10,452	–	49	143 ^a	12,330
Intersegment	5,103	2,785	56	2,150	1,163	(11,257)	–
Depreciation and amortization	837	636	446	7	77	(12)	1,991
Financial expenses	1,180	817	484	–	31	–	2,512
Income from continuing operations	2,077	396	395	–	2	12	2,882
Net income	2,077	396	395	–	27	12	2,907
Total assets	29,509	16,707	11,833	263	6,814	(260)	64,866
Investing activities							
Increase in property, plant and equipment and intangible assets							
Affecting cash	1,807	844	721	3	89	–	3,464
Not affecting cash	41	14	35	–	–	–	90

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

Note 25 Comparative Information

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

(2) Supplementary Information

As per Canadian accounting principles, long-term debt is shown at amortized cost (i.e. the nominal amount plus or minus unamortized discount and/or premium). Moreover, the sinking fund is not stated separately; instead each issue of Hydro-Québec's debt held in the sinking fund reduces the outstanding amount of such issue.

The following table sets forth the non-consolidated and outstanding long-term debt by issue of Hydro-Québec as of December 31, 2008, expressed in Canadian dollars and in currency units:

LONG-TERM DEBT BY ISSUE

Series	Maturity Date	Issue Date ⁽¹⁾	Interest Rate %	Canadian Dollars	CUSIP Number or ISIN Code	References ⁽²⁾
Payable in Canadian Dollars						
JH	2009-07-15	1999-06-30	6.000	\$ 284,516,000	448814 HA 4	
HN	2010-08-16	1990-08-16	—	112,591,726	448814 DH 3	
JK	2011-02-15	2000-06-12	6.500	1,130,000,000	448814 HG 1	
HF	2011-09-26	1989-09-26	10.000	262,949,143	448814 DD 2	
GU2	2012-07-16	1987-07-16	10.250	817,982,000	448814 CV 3	
HG	2019-11-22	1989-11-22	10.000	100,000,000	448814 DE 0	
II	2020-01-10	1993-07-27	10.250	163,058,123	448814 EF 6	
HL	2020-08-15	1990-08-15	11.000	1,110,000,000	448814 DG 5	
HM	2020-08-15	1990-08-15	—	515,866,860	448814 DK 6	
HX	2021-10-15	1991-10-15	10.500	1,100,000,000	448814 DW 0	
IC	2022-07-15	1992-07-15	9.625	1,950,000,000	448814 DZ 3	
IH	2031-02-26	1993-07-27	11.000	226,651,716	448814 EG 4	
JG	2031-08-15	1999-01-26	6.000	825,675,000	448814 GY 3	
JM	2045-02-15	2006-10-17	5.000	5,000,000,000	CA448814 HZ 92	
Medium-term notes issued under Canadian MTN program						
0054	2009-10-27	2005-01-27	Floating	404,397,667	44889Z EA 09	
0010	2010-02-15	1998-02-16	6.000	3,781,000	44889Z BG 0	
0055	2010-06-21	2005-12-21	Floating	495,818,544	44889Z EB 81	
0051	2011-03-03	2004-03-03	4.301	10,000,000	44889Z DW 3	
0006	2012-02-15	1997-02-14	7.000	15,000,000	44889Z DP 8	
0052	2014-03-03	2004-03-03	4.783	12,000,000	44889Z DX 1	
0049	2018-08-15	2003-09-04	5.500	150,000,000	44889Z DU 7	
0003	2021-08-15	1996-09-27	—	48,233,622	—	(b)
0005	2024-11-07	1996-11-07	7.500	25,000,000	44889Z DZ 6	
0017	2029-01-16	1999-02-02	6.500	75,000,000	44889Z CK 0	
0038	2031-08-15	2001-01-17	6.000	4,325,000	44889Z DG 8	
0009	2035-01-16	1998-02-03	6.500	686,500,000	44889Z BF 2	
0011	2035-01-16	1998-02-18	Various	22,127,572	44889Z BH 8	(c)
0016	2035-01-16	1998-07-27	3.529	100,851,630	44889Z CJ 3	(d)
0019	2035-02-15	1999-04-30	6.500	3,794,000,000	44889Z CM 6	
0012	2035-07-16	1998-06-05	Various	56,221,848	44889Z BJ 4	(e)
0014	2035-07-16	1998-07-15	—	20,326,674	—	(f)
0020	2040-02-15	1999-05-14	6.000	3,770,500,000	44889Z CN 4	
0032	2050-02-15	2000-08-01	6.000	50,000,000	44889Z DA 1	
0033	2060-02-15	2000-11-02	Various	321,298,862	44889Z DB 9	(g)
0037	2060-02-15	2001-01-12	Various	51,723,249	44889Z DF 0	(h)
0039	2060-02-15	2001-01-19	Various	192,322,452	44889Z DH 6	(i)
0040	2060-02-15	2001-01-24	Various	24,108,414	44889Z DJ 2	(j)
Present value of lease obligations for regional offices and service facilities.....				39,146,656		
Others				565,784,515		
Unamortized discount and/or premium.....				944,700,096		
Debt classified by currency of issue				25,482,458,369		
Debt classified by currency of repayment ⁽⁴⁾				34,240,044,911		

Series	Maturity Date	Issue Date ⁽¹⁾	Interest Rate %	Canadian Dollars ⁽³⁾	Currency Units	CUSIP Number or ISIN Code	References ⁽²⁾
Payable in U.S. Dollars							
JL	2011-05-11	2001-05-11	6.300	\$ 903,754,800	US\$ 738,000,000	448814 HR 7	
FU	2012-02-01	1985-02-01	11.750	244,920,000	200,000,000	448814 CF 8	(a)
IF2	2013-02-01	1993-02-03	8.000	1,157,997,680	945,613,000	448814 ED 1	
IU	2016-04-01	1996-04-01	7.500	489,840,000	400,000,000	448814 EK 5	
HS	2021-02-01	1991-02-12	9.400	1,102,140,000	900,000,000	448814 DM 2	
HY	2022-01-15	1992-01-30	8.400	1,224,600,000	1,000,000,000	448814 DX 8	
IO	2024-07-07	1994-07-07	8.050	1,224,538,770	999,950,000	448814 EJ 8	
GF	2026-03-01	1986-03-13	8.875	306,150,000	250,000,000	448814 CP 6	(a)
GH	2026-04-15	1986-04-30	8.250	306,150,000	250,000,000	448814 CS 0	(a)
GQ	2027-01-15	1987-01-29	8.250	306,150,000	250,000,000	448814 CT 8	
HE	2029-06-15	1989-06-22	8.625	306,150,000	250,000,000	448814 DB 6	
HH	2029-12-01	1989-12-07	8.500	612,300,000	500,000,000	448814 DC 4	
HK	2030-04-15	1990-04-18	9.375	612,300,000	500,000,000	448814 DF 7	
HQ	2030-11-15	1990-11-20	9.500	612,300,000	500,000,000	448814 DL 4	
Medium-term notes issued under U.S. MTN program							
B-123	2009-10-05	1994-10-05	9.125	30,615,000	25,000,000	44881H ES 9	
B-126	2010-04-20	1995-04-20	7.580	18,369,000	15,000,000	44881H EV 2	
B-30	2011-12-15	1991-12-06	8.620	48,984,000	40,000,000	44881H BD 5	
B-37	2011-12-15	1991-12-11	8.540	24,492,000	20,000,000	44881H BL 7	
B-7	2020-12-11	1990-12-10	9.400	12,246,000	10,000,000	44881H AF 1	
B-48	2021-12-20	1991-12-19	8.680	61,230,000	50,000,000	44881H BX 1	
B-49	2022-02-15	1992-02-15	9.800	61,230,000	50,000,000	44881H BY 9	
B-64	2022-05-10	1992-04-30	9.750	24,492,000	20,000,000	44881H CL 6	
B-124	2024-11-18	1994-11-18	8.910	30,615,000	25,000,000	44881H ET 7	
B-125	2025-03-28	1995-03-28	8.400	67,353,000	55,000,000	44881H EU 4	
B-127	2026-01-03	1996-01-03	6.270	61,230,000	50,000,000	44881H EW O	
B-63	2027-04-30	1992-04-30	9.500	24,492,000	20,000,000	44881H CK 8	
B-130	2028-07-13	1998-07-13	6.625	61,230,000	50,000,000	44881H EZ 3	
Conditional sale transaction (Turbines).....				70,750,779			
Unamortized discount and/or premium.....				(119,092,028)			
Debt classified by currency of issue				9,887,528,001			
Debt classified by currency of repayment ⁽⁴⁾				1,690,465,007			
Payable in Euro							
D15B	2016-05-01	1986-05-01	6.000	\$ 103,178,227	€ 60,529,289	DE0004780325	
Unamortized discount and/or premium.....				(1,924,746)			
Debt classified by currency of issue				101,253,481			
Debt classified by currency of repayment ⁽⁴⁾				—			
Payable in Japanese Yen							
Medium-term notes issued under Euro MTN program							
38	2009-10-20	1999-10-20	2.500	\$ 6,745,000	¥ 500,000,000	XS0102907085	
32	2012-03-05	1997-03-05	4.400	13,490,000	1,000,000,000	XS0074215830	
34	2017-03-17	1997-03-17	4.850	13,490,000	1,000,000,000	XS0074480319	
Unamortized discount and/or premium.....				86,188			
Debt classified by currency of issue				33,811,188			
Debt classified by currency of repayment ⁽⁴⁾				—			

<u>Series</u>	<u>Maturity Date</u>	<u>Issue Date</u> ⁽¹⁾	<u>Interest Rate %</u>	<u>Canadian Dollars</u> ⁽³⁾	<u>Currency Units</u>	<u>CUSIP Number or ISIN Code</u>	<u>References</u> ⁽²⁾
Payable in Pounds Sterling							
EG	2011-05-31	1981-05-20	15.000	\$ 71,584,000	£ 40,000,000	GB0004494109	
HI	2015-03-08	1990-03-08	12.625	268,440,000	150,000,000	XS0015132904	(k)
FA	2015-09-13	1982-09-13	12.750	<u>89,480,000</u>	50,000,000	GB0004494216	
Unamortized discount and/or premium.....				<u>(4,045,121)</u>			
Debt classified by currency of issue				<u>425,458,879</u>			
Debt classified by currency of repayment ⁽⁴⁾				<u>—</u>			
Total Long-Term Debt				<u>\$ 35,930,509,918</u>			

(1) If more than one issue date, the date of the first issue is indicated.

(2) Not redeemable unless otherwise specified.

(3) Translated at rates in effect at December 31, 2008.

(4) Takes into account swaps related to long-term debt (see "Notes 12 and 16 to the 2008 Consolidated Financial Statements").

(a) Sinking-fund debentures.

(b) Sold at deep discount maturing semi-annually from February 15, 2011 to August 15, 2021 in equal payments.

(c) From January 16, 2022, fixed coupon amounts of \$1.6 million payable semi-annually.

(d) From January 16, 1999 to January 16, 2014, interest coupons of \$3 million payable semi-annually. From July 16, 2024 to January 16, 2035, interest coupons of \$5.525 million payable semi-annually.

(e) Fixed rate coupon of 6.5% semi-annually commencing on January 16, 2026.

(f) Sold at deep discount maturing semi-annually from January 16, 2025 to July 16, 2035 in various payment amounts.

(g) No interest payment until February 15, 2030 exclusive. Commencing on February 15, 2030, fixed rate coupon of 45% payable semi-annually.

(h) No interest payment until February 15, 2041 exclusive. From February 15, 2041 to February 15, 2045, interest coupons of \$50 million payable annually. From February 15, 2046 to February 15, 2050, interest coupons of \$35 million payable annually. From February 15, 2051 to February 15, 2055, interest coupons of \$20 million payable annually. From February 15, 2056 to February 15, 2059, interest coupons of \$10 million payable annually.

(i) No interest payment until February 15, 2040 exclusive. Commencing on February 15, 2040, fixed rate coupon of 100% payable semi-annually.

(j) No interest payment until February 15, 2050 exclusive. From February 15, 2050 to February 15, 2052, interest coupons of \$45 million payable annually. From February 15, 2053 to February 15, 2055, interest coupons of \$40 million payable annually. From February 15, 2056 to February 15, 2058, interest coupons of \$35 million payable annually. On February 15, 2059, interest coupon of \$30 million is payable.

(k) Redeemable anytime at the highest of par or adjusted price as per the Fiscal Agency Agreement at the option of Hydro-Québec.

6. Other matters

- (1) No extraordinary material event has occurred since December 31, 2008.
- (2) Development Strategy

In September 2006, Hydro-Québec presented its five-year Strategic Plan (the “Strategic Plan”) for the 2006-2010 period. This Strategic Plan was discussed in a parliamentary commission in 2006.

The Strategic Plan sets forth three main priorities: (i) energy efficiency, (ii) complementary development of hydroelectric and wind power, the two main renewable energy sources in Québec, and (iii) technological innovation. More specifically, Hydro-Québec plans:

- to promote conservation of energy by investing in energy savings programs;
- to increase its hydroelectric generating capacity by accelerating project development, and by creating a portfolio of projects with a total generating capacity of 4,500 MW;
- the complementary development of its hydroelectric capacity and of up to 4,000 MW of wind power by 2015;
- to increase, with technological innovation, the productivity of its generating facilities, reduce losses on its transmission and distribution systems and make buildings more energy-efficient; and
- the development of innovative energy efficiency technologies.

In 2009, Hydro-Québec expects to earn net income of \$2.7 billion entirely from continuing operations. This projection is \$200 million higher than shown in the 2009 outlook of the Strategic Plan.

Hydro-Québec plans to invest \$5.0 billion in 2009. Some 60% of this amount will be devoted to development and growth activities as well as to the Energy Efficiency Plan, while 40% will be used to finance work to maintain and improve facilities.

Hydro-Québec Production will continue to work on major projects to develop its hydroelectric generating assets. The Eastmain-1-A/Sarcelle/Rupert project will achieve an important milestone, with the Rupert diversion scheduled to begin operation at the end of 2009. *Hydro-Québec Production* will start construction on the Romaine complex in the second quarter of 2009, subject to the requisite governmental approvals. It will also finish the commissioning of the Chute-Allard and Rapides-des-Coeurs generating stations. At the same time, *Hydro-Québec Production* will continue the engineering work and procurement activities for refurbishing the Gentilly-2 nuclear generating station.

Hydro-Québec TransÉnergie will invest a considerable amount in development to accommodate the increased capacity of the hydroelectric assets and to integrate wind power. It will therefore continue with projects aimed at connecting new hydroelectric and wind power facilities and bringing them onto the grid, in particular Eastmain-1-A and Sarcelle powerhouses and the wind farms built in response to *Hydro-Québec Distribution*'s first call for tenders. It will also commission the Outaouais substation – one of the main components in the new interconnection with Ontario – and the Mont-Tremblant substation. *Hydro-Québec TransÉnergie* will also continue to invest in maintenance and improvement activities in order to ensure the reliability and long-term operability of its transmission system and enhance service quality.

Hydro-Québec Distribution will continue to deliver reliable electricity and quality services to its Québec customers. It will pursue its investments to handle the growth of its Québec customer base and to maintain and improve its facilities, including those related to automating the distribution grid. It will also continue to implement the Energy Efficiency Plan, which includes measures for low-income households, to achieve the objective of 11 TWh in energy savings set for 2015. With regards to wind power supply, *Hydro-Québec Distribution* issued a call for tenders for two blocks of 250 MW on April 30, 2009.

Finally, Hydro-Québec expects to present its 2009-2013 Strategic Plan in Summer 2009.

(3) Regulatory Framework

Hydro-Québec Act

Under the *Hydro-Québec Act*, the Government is entitled to declare a dividend from Hydro-Québec when certain financial criteria are met (see “Note 18 to the 2008 Consolidated Financial Statements”). In its budget tabled in March 2008, the Government announced that Hydro-Québec’s dividend policy was revised and raised to its distributable surplus which is close to 75% of net income. This change of policy began with the dividend payable for Hydro-Québec’s fiscal year ending December 31, 2007.

Energy Board Act

The *Act respecting the Régie de l’énergie* (the “*Energy Board Act*”), enacted in 1996, grants the Energy Board exclusive authority to determine or modify Hydro-Québec’s rates and conditions under which electricity is transmitted and distributed by Hydro-Québec. *Hydro-Québec TransÉnergie* and *Hydro-Québec Distribution*’s activities in Québec are therefore regulated. Under this legislation, rates are set by reasoned decision of three commissioners after public hearings. Moreover, the Act stipulates that rates are determined on a basis that allows for recovery of the cost of service plus a reasonable return on the rate base.

The Energy Board consists of seven full-time members appointed by the Government and, in the exercise of its functions, is charged with reconciling the public interest, consumer protection and the fair treatment of the electric power carrier and of distributors. The *Energy Board Act* was amended in December 2006 to grant the Energy Board new powers regarding energy efficiency programs and actions as well as mandatory reliability standards.

Under the *Energy Board Act*, Hydro-Québec has been granted exclusive rights for the distribution of electric power throughout Québec, excluding the territories served by distributors operating a municipal or private electric system as of May 13, 1997.

The Energy Board has the authority to:

- fix, or modify, after holding public hearings, Hydro-Québec’s rates and conditions for the transmission and distribution of electric power;
- approve Hydro-Québec’s electric power supply plan;
- designate a reliability coordinator for Québec and adopt the standards of reliability proposed by the designated reliability coordinator;
- authorize Hydro-Québec’s transmission and distribution investment projects;
- approve Hydro-Québec’s distribution commercial programs; and
- rule upon complaints from customers concerning rates or service.

Generation

The Energy Board’s jurisdiction does not extend to generation.

Transmission

Transmission rates and service terms and conditions are subject to approval of the Energy Board. On March 5, 2009, the Energy Board approved an annual rate of \$72.00/kw/year for firm point-to-point service with a rate rider (a rate rider is a temporary credit or charge approved by a regulator) for 2009 of minus \$0.10/kW/year and an hourly rate of \$8.22/MWh, applicable retroactively as of January 1, 2009, and set the amount payable for transmission of the native load supply at \$2,575,008,000 per year with a rate rider for 2009 of minus \$3,576,400.

On August 14, 2007, the *Direction des mouvements d’énergie* (System Control unit) of *Hydro-Québec TransÉnergie* was designated the reliability coordinator for Québec by the Energy Board.

Distribution

Electricity required to meet Québec's needs in excess of the Heritage Pool Electricity must be purchased through a competitive bidding process. On October 20, 2008, the Energy Board approved Hydro-Québec's *Electricity Supply Plan 2008-2017*. Purchase contracts for electricity in excess of the Heritage Pool Electricity are subject to the approval of the Energy Board.

In August 2008, *Hydro-Québec Distribution* filed with the Energy Board an application to modify its rates and certain conditions regarding the distribution of electricity in Québec for the rate year beginning April 1, 2009. On March 6, 2009, the Energy Board granted an average rate increase of 1.22% to *Hydro-Québec Distribution*.

National Energy Board Act

The exports of electric power by Hydro-Québec are subject to the *National Energy Board Act* which provides that a permit or license must be obtained from the National Energy Board of Canada (the "National Board") for such exports. Hydro-Québec holds the following permits for short-term exports (contracts of five years or less):

- two permits expiring on December 31, 2010 authorizing Hydro-Québec to export annually, up to 30 TWh of interruptible energy, up to 20 TWh of firm energy and up to 4,300 MW of power to the United States;
- one permit granted to Hydro-Québec's subsidiary, HQEM, expiring on April 7, 2019. This permit authorizes HQEM, as a power marketer, to export annually up to 30 TWh of firm and interruptible energy and up to 6,000 MW of power from interconnections located in other provinces.

Each of these permits allows Hydro-Québec to take advantage of the spot market in the United States; however, long-term export contracts (more than five years) require prior issuance of specific permits or licenses by the National Board.

HQEM is authorized by an order of the National Board to export natural gas to the United States. This authorization will expire in 2011.

The National Board also regulates international power lines and Hydro-Québec operates its interconnections with the United States in accordance with the terms and conditions of *Certificates of Public Convenience and Necessity* issued by the National Board.

Environmental Regulation

Hydro-Québec's activities are subject to federal and provincial environmental laws and regulations and, to some extent, municipal by-laws.

Before beginning new construction, Hydro-Québec's projects are subject to environmental impact assessment studies as well as information and consultation processes. The studies are submitted for review and approval by government departments and agencies responsible for issuing governmental authorizations. In some instances, the approval process includes public hearings by an independent body.

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

The Government adopted the Sustainable Development Act (the "Sustainable Act") in April 2006 and the Government Sustainable Development Strategy 2008-2013 (the "Government Strategy"), which came into effect in January 2008. As a Government-owned corporation, Hydro-Québec is subject to the Sustainable Act and the Government Strategy and published its sustainable development action plan in March 2009.

(4) Litigation

Innus of Takuikan Uashat Mak Mani-Utenam

On December 30, 2003, representatives of the Innus of Takuikan Uashat Mak Mani-Utenam instituted an action against the Attorney-General of Canada, the Attorney-General of Québec and Hydro-Québec seeking judicial recognition of their aboriginal rights and of their unextinguished Indian title over certain areas of land in Québec. Plaintiffs who claim not to be parties to the 1975 *James Bay and Northern Québec Agreement* (the “Agreement”) allege that the Agreement and certain federal and provincial laws are illegal, inoperative, unconstitutional and not binding upon the plaintiffs. The plaintiffs seek various orders, including rendering of accounts and revenue sharing for the unlawful use and management of the lands, notably in respect of hydroelectric facilities on these lands, and awarding damages from Canada, Québec and Hydro-Québec, jointly and severally, in an amount of up to \$1.5 billion (subject to further increase by the plaintiffs). In June 2005, as requested by the parties, the Québec Superior Court suspended the legal action for five years. However on January 27, 2009, at the request of the Attorney-general of Canada, the suspension of the proceedings was lifted and the case has been reactivated. Québec and Hydro-Québec intend to contest this claim

Innus of Pessamit

In November 2006, the Innus of Pessamit re-activated an action which was filed in 1998 against the Attorney-General of Canada, the Attorney-General of Québec and Hydro-Québec seeking judicial recognition of their aboriginal rights and title over certain areas of land in Québec where Hydro-Québec’s Manicouagan-Outardes hydroelectric facilities are located. The Innus intend to seek various orders including an award of damages against Canada, Québec and Hydro-Québec, jointly and severally, in an amount of \$10.8 billion. In addition, the Innus of Pessamit are claiming compensatory annual payments of \$657 million from Hydro-Québec. Québec and Hydro-Québec intend to contest this claim.

7. Outline of Québec

1. Outline

(A) General

Québec is the largest by area of the ten provinces in Canada (1,541,000 square kilometers or 594,860 square miles, representing 15.4% of the geographical area of Canada) and the second largest by population (7.8 million, representing 23.2% of the population of Canada, as of January 2009).

Québec has a modern, developed economy, in which the service sector contributed 73.7%, the manufacturing industry 18.3%, the construction industry 6.0% and the primary sector 2.0% of real GDP at basic prices in chained 2002 dollars in 2008. The leading manufacturing industries in Québec are primary metal products (including aluminum smelting), food products, transportation equipment products (including aircraft and motor vehicles and associated parts), petroleum and coal products, paper products, chemical products and fabricated metal products. Québec also has significant hydroelectric resources, generating 31.3% of the electricity produced in Canada in 2008.

Montréal and Ville de Québec, the capital of Québec, are the centers of economic activity. Montréal is one of the main industrial, commercial and financial centers of North America and is Canada's second largest urban area as measured by population. Montréal is also Canada's largest port, situated on the St. Lawrence River, which provides access to the Atlantic Ocean and the inland navigation system of the Great Lakes.

French is the official language of Québec and is spoken by approximately 95% of its population.

(B) Politics and foreign relations

(i) Organization of Québec and political parties

Constitutional framework

Canada is a federation of ten provinces and three federal territories, with a constitutional division of responsibilities between the federal and provincial governments as set out in *The Constitution Acts, 1867 to 1982* (the "Constitution").

Under the Constitution, each provincial government has exclusive authority to raise revenue for provincial purposes through direct taxation within its territorial limits. Each provincial government also has exclusive authority to regulate education, health, social services, property and civil rights, natural resources, municipal institutions and, generally, to regulate all other matters of a purely local or private nature in its province, and to regulate and raise revenue from the exploration, development, conservation and management of natural resources.

The federal parliament is empowered to raise revenue by any method or system of taxation and generally has authority over matters or subjects not assigned exclusively to the provinces. It has exclusive authority over the regulation of trade and commerce, currency and coinage, banks and banking, national defense, naturalization and aliens, postal services, navigation and shipping, and bills of exchange, interest and bankruptcy.

The *Constitution Act, 1982* (the "Constitution Act"), enacted by the parliament of the United Kingdom, provides, among other things, that amendments to the Constitution be effected in Canada according to an amending formula. The Constitution Act also includes various modifications to the Constitution. The Constitution Act came into effect in 1982 notwithstanding the opposition of the National Assembly of Québec (the "National Assembly") and the government of Québec (the "Government") to certain clauses relating to provincial jurisdiction and the terms of the amending formula.

Since 1982, the federal and provincial governments have attempted to remedy this situation by signing two constitutional accords, neither of which was ratified. The first, signed in 1987 but not ratified by the legislative assemblies of two provinces, included a proposal to recognize Québec as a distinct society within Canada. The second, dated 1992, which was also signed by the federal territories and the national associations of native peoples, was rejected by a majority of voters in six provinces, including Québec.

On September 7, 1995, the Government, then formed by the Parti Québécois, which has as one of its principal objectives the sovereignty of Québec, presented a Bill entitled *An Act respecting the future of Québec* in the National Assembly. This act included, among other things, provisions authorizing the National Assembly to proclaim the sovereignty of Québec following a formal offer to the Government of Canada of a treaty of economic and political partnership. This act was to be enacted only after a favorable vote in a referendum. Such a referendum was held on October 30, 1995. The result was 49.4% in favor of this act and 50.6% against.

In 1996, the federal government, by way of a reference to the Supreme Court of Canada (the “Supreme Court”), asked the court to determine the legal position, both under Canadian constitutional law and public international law, of a unilateral secession of Québec from Canada. The reference before the Supreme Court was heard without Québec’s participation in the hearing. On August 20, 1998, the Supreme Court decided, among other things, that under the Constitution, Québec may not secede unilaterally from Canada without negotiation with the other participants in the Canadian Confederation within the existing constitutional framework; Québec does not have the right under international law to secede unilaterally from Canada; nonetheless, the clear repudiation by the people of Québec of the existing constitutional order and the clear expression of the desire to pursue secession would confer legitimacy on demands for secession, and place an obligation on the other provinces and the federal government to acknowledge and respect that expression of democratic will by entering into negotiations and conducting these negotiations in accordance with constitutional principles, including federalism, democracy, constitutionalism, the rule of law, and the protection of minorities; and Québec would have to negotiate in accordance with these constitutional principles. The Supreme Court recognized, however, that should Québec, having negotiated in conformity with constitutional principles and values, face unreasonable intransigence on the part of other participants at the federal or provincial level, Québec would be more likely to be recognized than if it did not itself act according to constitutional principles in the negotiation process.

The Québec Liberal Party, a federalist party, won a third consecutive mandate in December 2008. With regards to the constitutional issue, the Québec Liberal Party pursues a policy that emphasizes the values of Canadian federalism. In particular, its platform is focused on strengthening Québec’s place within the federation, on forming new alliances with the other provinces, and on promoting intergovernmental cooperation.

Government

Legislative power in Québec is exercised by the Parliament of Québec, which is comprised of the Lieutenant-Governor, who is appointed by the Governor General in Council of Canada, and the National Assembly. The National Assembly consists of 125 members elected by popular vote from single member districts. According to constitutional practice, the leader of the party with the largest number of elected members becomes Prime Minister and forms the Government.

Executive power in Québec is vested in the Lieutenant-Governor acting with, or on the recommendation of, the Conseil exécutif, which consists of the Prime Minister and the Cabinet (Conseil des ministres). The Conseil exécutif is accountable to the National Assembly.

The current National Assembly consists of 67 members of the Québec Liberal Party, 51 members of the Parti québécois, 6 members of the Action Démocratique du Québec and 1 member of Québec solidaire. Members are elected for a term of five years, subject to earlier dissolution of the National Assembly by the Lieutenant-Governor upon the recommendation of the Prime Minister or following the Government’s defeat on a vote of no confidence. The mandate of the current Government extends through the next election, which must be called no later than December 2013.

(ii) Foreign relations

Québec maintains government offices in Tokyo and in several major cities of the United States of America, South America, Europe and Asia to promote trade and to stimulate foreign investment in Québec.

(2) Economy

(A) Outline of recent economic trends

Canada. Gross domestic product (“GDP”) adjusted for inflation in chained 2002 dollars (“real GDP”), as published in the National Economic Accounts on June 1, 2009, increased at a rate of 0.4% in 2008, compared with a rate of 2.5% in 2007. This growth was mainly attributable to consumer spending and government investment. Final domestic demand increased by 2.6% in 2008, compared to 4.1% in 2007. Real consumer spending increased by 3.0% in 2008, compared to a 4.6% increase in 2007. International exports decreased by 4.7% in volume and increased by 5.2% in value in 2008 compared with increases of 1.1% and 1.9%, respectively, in 2007. International imports increased by 0.8% in volume and by 6.4% in value in 2008 compared with increases of 5.8% and 3.5%, respectively, in 2007.

Non-residential investment increased by 0.2% in 2008, due in particular to a 0.5% increase in machinery and equipment. Residential investment decreased by 2.7% in 2008, due to a 7.6% decrease in housing starts. Government investment increased by 12.2% in 2008. Government expenditure on goods and services increased by 3.7% in 2008.

The Consumer Price Index (“CPI”) increased by 2.3% in 2008. Overall employment rose 1.5% in 2008, while the unemployment rate increased to 6.1% from 6.0% in 2007.

Québec. Real GDP growth as published in the Provincial Economic Accounts on April 27, 2009 was 1.0% in 2008, compared to 2.6% in 2007. Final domestic demand increased by 3.3% in real terms in 2008, compared to 4.7% in 2007. Real consumer spending increased by 3.1% in 2008, compared to an increase of 4.3% in 2007. International exports decreased by 3.5% in volume and increased by 1.0% in value in 2008, compared with increases of 0.9% and 0.5%, respectively, in 2007. International imports increased by 2.4% in volume and by 10.2% in value in 2008, compared with increases of 5.8% and 3.9%, respectively, in 2007.

The value of non-residential investment increased by 12.0% in 2008, with a 29.8% increase in the public sector and a 1.5% increase in the private sector. The value of residential investment increased by 2.8% in 2008.

The CPI increased by 2.1% in 2008. Overall employment rose 0.8% in 2008, while the unemployment rate remained stable at 7.2%.

MAIN ECONOMIC INDICATORS OF QUÉBEC

	2004	2005	2006	2007	2008
	(dollar amounts in millions)				
GDP at current market prices.....	\$262,761	\$271,059	\$281,521	\$296,692	\$301,479
GDP in chained 2002 dollars.....	\$251,028	\$254,708	\$259,032	\$265,888	\$268,609
Personal income.....	\$217,925	\$225,944	\$236,091	\$250,077	\$258,915
Capital expenditures.....	\$ 49,767	\$ 49,470	\$ 51,809	\$ 57,055	\$ 62,132
Value of manufacturers' shipments.....	\$134,850	\$140,084	\$146,657	\$148,260	\$150,868
Retail trade.....	\$ 78,518	\$ 82,533	\$ 86,709	\$ 90,663	\$ 95,321
	(dollar amounts)				
GDP in chained 2002 dollars per capita (\$).....	\$ 33,311	\$ 33,594	\$ 33,942	\$ 34,594	\$ 34,657
	(in thousands of persons)				
Population (at July 1).....	7,536	7,582	7,632	7,686	7,751

Source: Statistics Canada.

**MAIN ECONOMIC INDICATORS
QUÉBEC - CANADA**

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(percentage changes)				
1. Québec					
GDP					
At current market prices	4.8%	3.2%	3.9%	5.4%	1.6%
In chained 2002 dollars.....	2.7%	1.5%	1.7%	2.6%	1.0%
Value of manufacturers' shipments.....	0.9%	3.9%	4.7%	1.1%	1.8%
CPI (2002=100).....	2.0%	2.3%	1.7%	1.6%	2.1%
Population (at July 1).....	0.7%	0.6%	0.7%	0.7%	0.8%
2. Canada					
GDP					
At current market prices	6.4%	6.4%	5.5%	5.8%	4.4%
In chained 2002 dollars.....	3.1%	3.0%	2.9%	2.5%	0.4%
Value of manufacturers' shipments.....	3.5%	3.0%	1.2%	0.0%	(0.4)%
CPI (2002=100).....	1.8%	2.2%	2.0%	2.2%	2.3%
Population (at July 1).....	1.0%	1.0%	1.0%	1.1%	1.2%

Source: Statistics Canada.

(B) Movements of net domestic income at basic prices and gross domestic product at market prices

The following table sets forth some data pertaining to net domestic income at basic prices and GDP at current market prices of Québec for each of the years indicated.

NET DOMESTIC INCOME AND GROSS DOMESTIC PRODUCT

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>% of Total 2008</u>
	(in millions of dollars)					
Salaries, wages, supplementary labor income and military pay and allowances.....	\$ 139,815	\$ 144,774	\$ 149,948	\$ 158,180	\$ 162,937	54.0%
Corporation profits and investment income.....	39,729	40,565	44,457	47,764	48,079	16.0
Net income of farm operators from production	635	327	225	284	261	0.1
Net income of non-farm unincorporated business, including rent	15,610	16,053	16,514	17,089	17,868	5.9
Inventory valuation adjustment	(360)	(267)	(583)	436	(1,269)	(0.4)
Indirect taxes less subsidies on production factors	15,920	16,306	16,716	17,476	17,767	5.9
Net domestic product at basic prices	<u>\$ 211,349</u>	<u>\$ 217,758</u>	<u>\$ 227,277</u>	<u>\$ 241,229</u>	<u>\$ 245,643</u>	<u>81.5%</u>
Indirect taxes less subsidies on products.....	18,772	19,408	18,732	18,725	18,262	6.0
Capital consumption allowances and miscellaneous, statistical discrepancy	32,640	33,893	35,512	36,738	37,574	12.5
GDP at market prices.....	<u>\$ 262,761</u>	<u>\$ 271,059</u>	<u>\$ 281,521</u>	<u>\$ 296,692</u>	<u>\$301,479</u>	<u>100.0%</u>

Source: Statistics Canada.

(C) Industrial structure and recent conditions of major industries

The table below shows the contribution of each economic activity to real GDP at basic prices in chained 2002 dollars of Québec in 2008.

Contribution to real GDP at basic prices in chained 2002 dollars⁽¹⁾	
	2008 (share in percentage)
Primary Sector:	
Agriculture, forestry, fishing and hunting	1.6%
Mining and oil and gas extraction	0.4
	<u>2.0</u>
Secondary Sector:	
Manufacturing	18.3
Construction	6.0
	<u>24.3</u>
Service Sector:	
Community, business and personal services.....	25.9
Finance, insurance and real estate	17.3
Wholesale and retail trade	12.1
Governmental services	6.4
Transportation and warehousing.....	4.2
Other utility services	3.9
Information and cultural services	3.9
	<u>73.7</u>
Real GDP	<u>100.0%</u>

⁽¹⁾ North American Industrial Classification System (NAICS) in chained 2002 dollars. For the chained 2002 dollars, the aggregate amounts are not equal to the sums of their components.

Source: Statistics Canada.

The following table sets forth total capital expenditures in Québec for each of the years indicated together with the percentage contribution of each sector in the total of 2007 and 2008 investment.

CAPITAL EXPENDITURES IN QUÉBEC⁽¹⁾							
	2004	2005	2006	2007	% of Total 2007	2008	% of Total 2008
	(dollar amounts in millions)						
Non-residential Investment:							
Governmental, educational, health and social services.....	\$ 6,959	\$ 7,735	\$ 8,076	\$ 9,672	17.0%	\$12,615	20.3%
Information, cultural and other utilities	5,977	5,787	5,478	6,302	11.0	7,154	11.5
Finance, insurance and real estate operators	6,170	5,969	7,203	6,876	12.1	5,596	9.0
Manufacturing	4,713	4,124	4,047	3,878	6.8	4,164	6.7
Mining and oil and gas extraction	635	724	984	1,505	2.6	3,077	5.0
Wholesale and retail trade	2,351	2,384	2,480	3,018	5.3	3,066	4.9
Business services, accommodation and other services	2,103	2,065	2,068	2,309	4.0	2,593	4.2
Transportation and warehousing.....	1,821	1,808	1,994	2,533	4.4	2,435	3.9
Construction	1,086	1,104	1,136	884	1.6	949	1.5
Agriculture, forestry, fishing and hunting	716	692	678	804	1.4	673	1.1
	<u>\$ 32,531</u>	<u>\$ 32,392</u>	<u>\$ 34,144</u>	<u>\$ 37,781</u>	<u>66.2%</u>	<u>\$ 42,322</u>	<u>68.1%</u>
Residential Investment.....	17,236	17,078	17,665	19,274	33.8	19,810	31.9
	<u>\$ 49,767</u>	<u>\$ 49,470</u>	<u>\$ 51,809</u>	<u>\$ 57,055</u>	<u>100.0%</u>	<u>\$ 62,132</u>	<u>100.0%</u>
Private sector	\$ 38,553	\$ 37,464	\$ 39,372	\$ 43,016	75.4%	\$43,911	70.7%
Public sector	11,214	12,006	12,437	14,039	24.6	18,221	29.3
	<u>\$ 49,767</u>	<u>\$ 49,470</u>	<u>\$ 51,809</u>	<u>\$ 57,055</u>	<u>100.0%</u>	<u>\$ 62,132</u>	<u>100.0%</u>

⁽¹⁾ North American Industrial Classification System (NAICS).

Source: Statistics Canada.

The following table shows the value of gross production for some goods producing sectors of the economy of Québec for each of the years indicated.

GROSS PRODUCTION FOR SOME GOODS PRODUCING SECTORS ⁽¹⁾

	2004	2005	2006	2007	2008
(in millions of dollars)					
Agriculture (farm cash receipts)	\$ 6,302	\$ 6,222	\$ 6,274	\$ 6,905	\$ 7,498
Mining and quarries (value of mineral production) ⁽²⁾	\$ 4,012	\$ 3,914	\$ 4,560	\$ 5,540	\$ 5,208
Manufacturing (value of shipments)	\$134,850	\$140,084	\$146,657	\$148,260	\$150,868
Construction (value of construction work purchased)	\$ 30,822	\$ 30,772	\$ 32,393	\$ 36,481	\$ 41,289
(in thousands of MWH)					
Electric energy generated	174,951	180,296	180,248	189,749	191,363

(1) The gross value of production represents the total value of the commodities produced at the producers' level and before the elimination of the value of the commodities used in production.

(2) Including oil and gas.

Source: Statistics Canada.

(D) Price trends and indices

The following table sets forth the CPI and average weekly earnings for Québec and Canada for each of the years indicated.

CONSUMER PRICES AND AVERAGE WEEKLY EARNINGS

	2004	2005	2006	2007	2008
(price index 2002 = 100)					
CPI					
Québec	104.5	106.9	108.7	110.4	112.7
	2.0%	2.3%	1.7%	1.6%	2.1%
Canada	104.7	107.0	109.1	111.5	114.1
	1.8%	2.2%	2.0%	2.2%	2.3%
(in dollars)					
Average weekly earnings					
Québec	\$673.70	\$695.60	\$708.40	\$739.40	\$751.20
	2.6%	3.3%	1.8%	4.4%	1.6%
Canada	\$709.40	\$737.30	\$755.50	\$788.20	\$810.50
	2.7%	3.9%	2.5%	4.3%	2.8%

Source: Statistics Canada.

(E) Labor situation

The table below sets forth labor force data for Québec for each of the years indicated.

LABOR FORCE

	2004	2005	2006	2007	2008
(in thousands of persons)					
Population of 15 years and over (A)	6,113	6,182	6,252	6,315	6,372
Labor Force					
Employed	3,681	3,717	3,765	3,852	3,882
Unemployed	343	336	329	298	303
Total (B)	4,024	4,053	4,094	4,150	4,185
(in percentage)					
Participation rate (B/A)	65.8	65.6	65.5	65.7	65.7
Unemployment rate	8.5	8.3	8.0	7.2	7.2

Source: Statistics Canada.

3. Public Finance

(A) Consolidated Financial Transactions ⁽¹⁾

The following table summarizes the consolidated financial transactions of the Government for the four years ended March 31, 2008, the preliminary results for Fiscal 2009 and the budget forecast for Fiscal 2010.

	Year ending March 31				Preliminary Results 2009	Budget Forecast 2010 ⁽¹⁾
	2005	2006	2007	2008		
	(dollar amounts in millions)					
Budgetary transactions of the						
Consolidated Revenue Fund						
Own-source revenue	\$44,381	\$45,743	\$49,651	\$49,464	\$48,555	\$47,371
Federal transfers ⁽²⁾	9,229	9,969	11,015	13,629	13,924	14,841
Total revenue	53,610	55,712	60,666	63,093	62,479	62,212
Program spending	(47,656)	(49,229)	(51,734)	(54,826)	(57,400)	(59,989)
Debt service	(6,853)	(6,875)	(7,039)	(7,021)	(6,589)	(6,104)
Total expenditure	(54,509)	(56,104)	(58,773)	(61,847)	(63,989)	(66,093)
Net results of Consolidated Revenue						
Fund	(899)	(392)	1,893	1,246	(1,510)	(3,881)
Net results of consolidated entities	235	429	100	404	205	355
Surplus for the purposes of the public						
accounts	(664)	37	1,993	1,650	(1,305)	(3,526)
Deposits in the Generations Fund	—	—	(584)	(649)	(701)	(715)
Budgetary reserve ⁽³⁾	—	—	(1,300)	(1,001)	2,006	295
Consolidated budgetary balance for the						
purposes of the <i>Balanced Budget Act</i>	(664)	37	109	0	0	(3,946)
Deposit of dedicated revenues in the						
Generations Fund ⁽⁴⁾	—	—	584	449	569	715
Consolidated budgetary balance	(664)	37	693	449	569	(3,231)
Consolidated non-budgetary						
transactions						
Investments, loans and advances	(979)	(1,182)	(2,157)	(2,410)	(17)	(1,345)
Fixed assets	(1,083)	(1,166)	(1,177)	(1,457)	(2,405)	(3,304)
Net investments in the networks	—	—	(1,002)	(487)	(815)	(1,004)
Retirement plans	2,134	2,310	2,559	2,458	2,300	2,490
Other accounts ⁽⁵⁾	174	(208)	(1,676)	740	242	120
Consolidated non-budgetary						
transactions	246	(246)	(3,453)	(1,156)	(695)	(3,043)
Consolidated net financial requirements ..	\$(418)	\$(209)	\$(2,760)	\$(707)	\$(126)	\$(6,274)
Consolidated financing transactions						
Change in cash position ⁽⁶⁾	(831)	49	(3,284)	2,965	(2,594)	5,984
Net borrowings ⁽⁷⁾	5,378	4,390	11,076	3,286	8,364	3,222
Retirement plans' sinking fund ⁽⁸⁾ and						
funds dedicated to employee's future						
benefits ⁽⁹⁾	(4,129)	(4,230)	(4,448)	(4,895)	(4,943)	(2,217)
Generations Fund ⁽⁴⁾	—	—	(584)	(649)	(701)	(715)
Total consolidated financing transactions	\$418	\$209	\$2,760	\$707	\$126	\$6,274

⁽¹⁾ The categories set forth reflect the presentation of the 2009-2010 Budget. The results for Fiscal 2005 and Fiscal 2006 have not been restated in accordance with the accounting reform implemented in Fiscal 2007. Under the 2006-2007 accounting reform, the health and social services and education networks were incorporated into the Government reporting entity and the Government's accounting policies have been changed to comply with Canadian generally accepted accounting principles (GAAP) applicable to the public sector. The impact of the accounting reform on the results for Fiscal 2008 was to reduce surplus for the purposes of the public accounts by \$853 million.

⁽²⁾ Federal transfers are presented on a cash basis until Fiscal 2005 and on an accrual basis thereafter.

⁽³⁾ A negative amount indicates an allocation to the reserve and a positive amount, a use of the reserve.

- (4) The Generations Fund was created in June 2006 by the adoption of the *Act to reduce the debt and establish the Generations Fund* and is a separate entity from the Consolidated Revenue Fund. This law establishes the fund as a permanent tool for reducing the debt burden. In addition, it stipulates that the monies accumulated in the Generations Fund are dedicated exclusively to repaying the debt.
- (5) Reflects notably year-to-year changes in accounts payable and receivable, cash on hand and outstanding bank deposits and checks.
- (6) A positive number indicates a net decrease in cash.
- (7) Represents mainly new borrowings of \$12,404 million, \$11,569 million, \$17,262 million, \$9,995 million, \$14,877 million and \$11,360 million for each of Fiscal 2005 through 2010, respectively, less repayment of borrowings.
- (8) This sinking fund receives amounts to be used to cover retirement benefits payable by the Government under the public and parapublic sector retirement plans.
- (9) These funds receive amounts used to cover employee's future benefits (accumulated sick leave and surviving spouse's pensions) payable to the Government's employees.

(B) Consolidated Revenue Fund Revenue

The following table sets forth own-source revenue and federal transfers by source for the Consolidated Revenue Fund.

	Year ending March 31				Preliminary Results 2009	Budget Forecast 2010	% of Total 2010
	2005	2006	2007	2008			
	(dollar amounts in millions)						
Income and property taxes							
Personal income tax.....	\$16,324	\$16,449	\$18,480	\$18,648	\$18,223	\$18,203	29.3 %
Contributions to the Health Services Fund	4,874	5,047	5,053	5,404	5,576	5,597	9.0
Corporate taxes	4,253	4,786	4,779	4,819	3,972	3,266	5.2
	25,451	26,282	28,312	28,871	27,771	27,066	43.5
Consumption taxes							
Retail sales.....	9,241	9,614	9,873	10,238	10,796	10,498	16.9
Fuel.....	1,711	1,657	1,678	1,656	1,629	1,653	2.7
Tobacco	901	752	678	647	628	593	0.9
Alcoholic beverages.....	403	415	422	421	439	440	0.7
	12,256	12,438	12,651	12,962	13,492	13,184	21.2
Duties and permits							
Motor vehicles	713	725	741	757	753	755	1.2
Natural resources	238	210	136	86	(61)	(74)	-0.1
Other	209	203	179	197	188	188	0.3
	1,160	1,138	1,056	1,040	880	869	1.4
Miscellaneous							
Sales of goods and services	371	383	396	399	401	396	0.6
Interest.....	355	463	541	562	622	588	1.0
Fines, forfeitures and recoveries.....	442	485	479	605	655	509	0.8
	1,168	1,331	1,416	1,566	1,678	1,493	2.4
Revenue from Government enterprises ⁽¹⁾							
Société des alcools du Québec ⁽²⁾	546	657	710	761	797	800	1.3
Loto-Québec ⁽²⁾	1,511	1,537	1,391	1,360	1,320	1,295	2.1
Hydro-Québec	2,140	2,323	4,043	2,926	2,863	2,700	4.3
Other	149	37	72	(22)	(246)	(36)	-0.1
	4,346	4,554	6,216	5,025	4,734	4,759	7.6
Total own-source revenue	44,381	45,743	49,651	49,464	48,555	47,371	76.1
Federal transfers ⁽³⁾							
Equalization.....	5,221	4,798	5,539	7,160	8,028	8,355	13.4
Health transfers.....	2,422	3,185	3,649	3,925	3,741	4,137	6.7
Transfers for post-secondary education and other social programs	926	1,034	1,070	1,516	1,267	1,413	2.3
Other programs	660	952	757	1,028	888	936	1.5
Total federal transfers.....	9,229	9,969	11,015	13,629	13,924	14,841	23.9
Total revenue.....	\$53,610	\$55,712	\$60,666	\$63,093	\$62,479	\$62,212	100.0%

(1) Includes the dividends declared and the changes in surpluses or deficits accumulated by Government enterprises, which are consolidated with a corresponding revaluation of the investment held by the Government. The declared dividends were \$3,406 million, \$3,320 million, \$4,442 million, \$4,218 million and \$4,369 million for each of Fiscal 2005 through 2009, respectively, and are budgeted to be \$4,031 million for Fiscal 2010.

(2) Since the publication of the 2009-2010 Budget Speech, the Société des alcools du Québec and Loto-Québec have released their financial results for fiscal year 2008-2009, reporting net earnings of \$807 million and \$1,375 million respectively.

(3) Federal transfers are presented on a cash basis until Fiscal 2005 and on an accrual basis thereafter.

(C) Consolidated Revenue Fund Expenditure

The following table sets forth program spending and debt service by mission for the Consolidated Revenue Fund.

	Year ending March 31				Preliminary Results 2009	Budget Forecast 2010	% of Total 2010
	2005	2006	2007	2008			
(dollar amounts in millions)							
Economy and Environment:							
Transports	\$1,634	\$1,776	\$1,953	\$2,148	\$2,347	\$2,771	4.2 %
Affaires municipales, Régions et occupation du territoire	856	950	999	1,152	1,128	1,159	1.8
Emploi et Solidarité sociale	804	803	839	875	959	935	1.4
Développement économique, Innovation et Exportation.....	543	689	519	706	833	915	1.4
Agriculture, Pêcheries et Alimentation	661	658	694	724	711	720	1.1
Other	857	893	950	1,102	1,038	1,043	1.5
	5,355	5,769	5,954	6,707	7,016	7,543	11.4
Education and Culture:							
Éducation, Loisir et Sport	11,220	11,567	11,901	12,559	13,165	13,639	20.6
Teachers Pension Plan	654	714	738	840	776	792	1.2
Culture, Communications et Condition féminine	526	536	593	623	647	656	1.0
Other	120	115	124	131	129	296	0.5
	12,520	12,932	13,356	14,153	14,717	15,383	23.3
Health and Social Services:							
Santé et Services sociaux ⁽¹⁾	15,346	15,817	16,783	17,931	18,783	19,649	29.7
Régie de l'assurance maladie du Québec ⁽²⁾	5,236	5,346	5,670	6,123	6,634	7,223	10.9
	20,582	21,163	22,453	24,054	25,417	26,872	40.6
Support for Individuals and Families:							
Emploi et Solidarité sociale	3,305	3,234	3,246	3,294	3,272	3,293	5.0
Famille et Aînés	1,515	1,604	1,718	1,836	1,947	2,066	3.1
Other	220	232	228	238	241	242	0.4
	5,040	5,070	5,192	5,368	5,460	5,601	8.5
Administration and Justice:							
Sécurité publique	941	942	987	1,054	1,060	1,082	1.6
Revenu ⁽³⁾	932	1,022	1,090	1,215	1,080	1,050	1.6
Affaires municipales, Régions et occupation du territoire	765	802	860	669	665	668	1.0
Justice	419	428	507	456	441	451	0.7
Pension and insurance plans	304	300	392	323	334	338	0.5
Other	798	801	943	827	1,210	1,247	1.9
	4,159	4,295	4,779	4,544	4,790	4,836	7.3
Anticipated lapsed appropriations	—	—	—	—	—	(150)	(0.2)
Deferred appropriations in 2009-2010	—	—	—	—	—	(96)	(0.1)
	—	—	—	—	—	(246)	(0.3)
Total program spending	47,656	49,229	51,734	54,826	57,400	59,989	90.8
Debt service:							
Direct debt service	4,067	4,044	4,357	4,548	4,421	3,760	5.7
Interest ascribed to the retirement plans	2,786	2,831	2,682	2,473	2,168	2,344	3.5
Total debt service	6,853	6,875	7,039	7,021	6,589	6,104	9.2
Total expenditure	\$54,509	\$56,104	\$58,773	\$61,847	\$63,989	\$66,093	100.0 %

(1) Includes the cost of benefits vested during the year for the retirement plans.

(2) The Québec health insurance plan.

(3) The department responsible for the administration of most tax laws and the collection of taxes in Québec.

(D) Consolidated Non-Budgetary Transactions

The following table sets forth the distribution of the consolidated non-budgetary transactions.

	Year ending March 31				Preliminary Results 2009	Budget Forecast 2010
	2005	2006	2007	2008		
	(dollar amounts in millions)					
Investments, loans and advances						
Consolidated Revenue Fund						
Government enterprises						
Shares and investments	\$77	\$27	\$(125)	\$—	\$(260)	\$(635)
Change in the equity value of investments ⁽¹⁾	(940)	(1,234)	(1,774)	(807)	(365)	(728)
Loans and advances	—	(45)	(42)	(82)	(49)	(72)
Total Government enterprises	(863)	(1,252)	(1,941)	(889)	(674)	(1,435)
Investment with the Caisse de dépôt et placement du Québec ⁽²⁾	—	—	—	(1,122)	805	295
Other	71	(231)	(18)	1	(2)	21
Consolidated entities	(792)	(1,483)	(1,959)	(2,010)	129	(1,119)
Total investments, loans and advances	(979)	(1,182)	(2,157)	(2,410)	(17)	(1,345)
Fixed assets						
Consolidated Revenue Fund						
Net investments	(178)	(160)	(188)	(222)	(382)	(436)
Depreciation	217	215	225	234	255	257
	39	55	37	12	(127)	(179)
Consolidated entities	(1,122)	(1,221)	(1,214)	(1,469)	(2,278)	(3,125)
Total fixed assets	(1,083)	(1,166)	(1,177)	(1,457)	(2,405)	(3,304)
Net investments in the networks						
Annual deficit	—	—	219	442	189	120
Loans and advances to the networks	—	—	(1,221)	(929)	(1,004)	(1,124)
Total net investments in the networks	—	—	(1,002)	(487)	(815)	(1,004)
Retirement plans and other employee future benefits						
Cost of vested benefits, amortizations and contributions ⁽³⁾	1,698	1,766	1,936	2,049	2,067	2,040
Interest on the actuarial obligation ⁽⁴⁾	3,714	4,061	4,157	4,398	4,365	4,510
Benefits, repayments and administrative expenses ⁽⁵⁾	(3,278)	(3,517)	(3,534)	(3,989)	(4,132)	(4,060)
Total retirement plans and other employee future benefits	2,134	2,310	2,559	2,458	2,300	2,490
Other accounts						
Consolidated Revenue Fund	56	(364)	(1,101)	682	(366)	(406)
Consolidated entities	118	156	(575)	58	608	526
Total other accounts	174	(208)	(1,676)	740	242	120
Total consolidated non-budgetary transactions..	\$246	\$(246)	\$(3,453)	\$(1,156)	\$(695)	\$(3,043)

(1) Change in accumulated surpluses or deficits (i.e., change in net income (loss) after declared dividends to the Government).

(2) Represents the deposit of the budgetary reserve fund.

(3) The Government covers costs at a rate of 50% for years of service since July 1, 1982 for the RREGOP and since January 1, 2001 for RRPE. For most of the other plans, the Government covers the difference between the cost of each plan and the contributions paid by participants (cost-balance pension plans). For years of service accumulated as of January 1, 2000, pension benefits will be adjusted based on the higher result from the following two calculations: inflation less 3% or half the inflation rate. Previously, pension benefits for years of service accumulated between 1982 and 1999 inclusive were adjusted by the inflation rate less 3%. Benefits for years of service accumulated before 1982 were adjusted by the inflation rate.

(4) Excludes impact of the income from the retirement plans sinking fund of \$927 million, \$1,230 million, \$1,440 million, \$1,887 million and \$2,216 millions for each of Fiscal 2005 through 2009, respectively. The income for Fiscal 2010 is expected to be \$2,166 million.

(5) The retirement plans liability, excluding the retirement plans sinking fund estimated at \$36.1 billion, is estimated at \$64.5 billion for Fiscal 2009, consisting of \$39.3 billion in respect of RREGOP and RRPE and \$25.2 billion in respect of the other public sector plans. These liabilities are estimated in accordance with the method recommended by the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants ("CICA") regarding the accounting of public sector pension plans.

(E) Government Enterprises and Agencies

The following table sets forth certain major Government enterprises and agencies and their respective areas of activity.

Major Enterprises and Agencies

	Area of Activity
Enterprises included in the Government's reporting entity	
Hydro-Québec	Energy production and distribution
Loto-Québec	Gaming
Société des alcools du Québec ("SAQ")	Wholesale and retail sale of alcoholic beverages
Société générale de financement du Québec ("SGF")	Economic development (Industrial sector)
Sociétés Innovatech (Grand Montréal, Québec et Chaudière-Appalaches, Sud du Québec, Régions ressources)...	Venture Capital (High technology sector)
Agencies whose reporting entity is included in the Government's reporting entity	
Corporation d'hébergement du Québec ("CHQ")	Construction, development and management of health care buildings
Financement-Québec	Financing public sector organizations
Immobilière-SHQ	Development and management of public housing
Investissement Québec	Economic development (SME-high technology and SME-industrial sectors)
Société immobilière du Québec ("SIQ")	Construction, development and management of public buildings
Société québécoise d'assainissement des eaux ("SQAE")	Water purification
Agencies which conduct fiduciary transactions that are not included in the Government's reporting entity	
Caisse de dépôt et placement du Québec ("Caisse")	Investment management
Commission administrative des régimes de retraite et d'assurances ("CARRA")	Public sector pension funds management
Régie des rentes du Québec ("RRQ")	Pension funds management

(F) Sinking Funds

The following table sets forth the sinking funds transactions as of the fiscal years indicated.

Sinking Funds Transactions

	2005	2006	2007	2008	2009
	(in thousands of dollars)				
Balance as at April 1	\$3,463,489	\$3,478,482	\$3,872,037	\$4,393,819	\$4,640,886
Receipts	321,383	393,555	521,782	247,067	384,366
Refunds	306,390	0	0	0	0
Balance as at March 31	\$3,478,482	\$3,872,037	\$4,393,819	\$4,640,886	\$5,025,252

4. Public Debt

(A) **Balance of Outstanding Debt**

(i) Government debt

The following table sets forth the Government internal and external funded and unfunded debt (indebtedness contracted for a maturity of one year or less) outstanding as of March 31, 2009 and the interest expense made thereon during the year then ended.

GOVERNMENT DEBT AND INTEREST EXPENSE FOR FISCAL 2009

	Amount outstanding as at March 31, 2009 ⁽¹⁾⁽²⁾	Annual interest expense April 1, 2008 to March 31, 2009 ⁽²⁾
(in millions of dollars)		
Borrowings – Government		
Internal:		
Funded.....	\$ 113,801	\$ 4,637
Unfunded ⁽³⁾	8,987	12
Total.....	<u>\$122,788</u>	<u>\$ 4,649</u>
External:		
Payable in United States Dollars.....	1,852	\$314
Payable in Japanese Yen.....	2,350	147
Payable in Swiss Francs.....	3,197	88
Payable in Euros.....	3,638	156
Payable in Pounds Sterling.....	(1)	16
Total ⁽⁴⁾	<u>\$ 133,824</u>	<u>\$ 5,370</u>
Borrowings – to finance Government Enterprises		
Internal:		
Funded.....	\$ 224	\$ 1
Total.....	<u>\$ 224</u>	<u>\$ 1</u>

(1) In Canadian dollars at the dates indicated after taking into account currency swap agreements and foreign exchange forward contracts.

(2) Preliminary estimates.

(3) Including unfunded debt - to finance Government Enterprises and Municipal Bodies.

(4) Net of sinking funds of \$5,025 million.

The following table sets forth the Government funded debt outstanding after deduction of sinking funds as of the fiscal years indicated.

GOVERNMENT FUNDED DEBT⁽¹⁾⁽²⁾

	Unadjusted 2005 ⁽³⁾	Unadjusted 2006 ⁽³⁾	2007	2008	2009
(in millions of dollars)					
Borrowings – Government					
Internal.....	\$ 66,831	\$ 72,328	\$ 101,006	\$ 101,933	\$113,801
External ⁽⁴⁾	11,092	9,667	8,708	10,653	11,036
Total.....	<u>\$ 77,923</u>	<u>\$ 81,995</u>	<u>\$ 109,714</u>	<u>\$ 112,586</u>	<u>\$124,837</u>
Borrowings – to finance Government Enterprises					
Internal.....	\$ 3,234	\$ 2,646	\$ 31	\$ 25	\$ 224
Total.....	<u>\$ 3,234</u>	<u>\$ 2,646</u>	<u>\$ 31</u>	<u>\$ 25</u>	<u>\$ 224</u>
Borrowings – to finance Municipal Bodies					
Internal.....	\$ 2,799	\$ 2,604			
Total.....	<u>\$ 2,799</u>	<u>\$ 2,604</u>			

(1) Excluding Treasury bills, Commercial paper and Discount notes.

(2) In Canadian dollar at the dates indicated after taking into account currency swap agreements and foreign exchange forward contracts.

(3) The figures for Fiscal 2005 and 2006 have not been restated in accordance with the accounting reform implemented in Fiscal 2007.

(4) Québec currently has credit agreements with various banks and financial institutions for a total of U.S.\$ 3.5 billion.

(ii) Guarantees and other contingent liabilities

The following table summarizes funded debt guaranteed by the Government (net of sinking fund balances) as of the dates indicated.

GUARANTEED FUNDED DEBT (NET OF SINKING FUND BALANCES)

	As of March 31					Average Interest Rate 2009	Average Term to Maturity 2009
	Unadjusted 2005 ⁽¹⁾	Unadjusted 2006 ⁽¹⁾	2007	2008	Preliminary Results 2009		
	(dollar amounts in millions) ⁽²⁾					(%)	(years)
Hydro-Québec	\$33,032	\$32,367	\$32,674	\$32,399	\$36,668	6.8	19.7
Financement-Québec	7,564	9,579					
Commission municipale du Québec	4	1					
	<u>\$40,600</u>	<u>\$41,947</u>	<u>\$32,674</u>	<u>\$32,399</u>	<u>\$36,668</u>		

⁽¹⁾ The figures for Fiscal 2005 and Fiscal 2006 have not been restated in accordance with the accounting reform implemented in Fiscal 2007, which resulted in the consolidation of additional entities into the Government reporting entity.

⁽²⁾ Canadian dollar equivalent at dates indicated for loans in foreign currencies issues after taking into account currency exchange agreements and foreign exchange forward contracts.

(B) Estimates of Next Five Years' External Debt Service Requirements

The following table sets forth the estimated external debt service requirements, net of sinking funds, for the next five years on the external bonds issued by the Government and outstanding as of March 31, 2009.

ESTIMATED EXTERNAL DEBT SERVICE REQUIREMENTS

	As of March 31				
	2010	2011	2012	2013	2014
	(in millions of dollars)				
Borrowings – Government					
Principal ⁽¹⁾					
Payable in U.S. Dollars	\$ 25	\$ 23	\$ 25	\$ 25	\$ 64
Payable in Japanese Yen	-	51	209	-	125
Payable in Swiss Francs	-	-	-	-	-
Payable in Euros	-	-	(3)	(4)	-
Payable in Pounds Sterling	-	-	-	-	-
Total Principal	<u>\$25</u>	<u>\$74</u>	<u>\$231</u>	<u>\$21</u>	<u>\$189</u>
Interest Expense ⁽²⁾	<u>\$444</u>	<u>\$451</u>	<u>\$549</u>	<u>\$652</u>	<u>\$696</u>
Total Debt Service	<u>\$ 469</u>	<u>\$ 525</u>	<u>\$ 780</u>	<u>\$ 673</u>	<u>\$ 885</u>

(1) Represents the Canadian dollar equivalent as of March 31, 2009 after taking into account currency swap agreements and foreign exchange forward contracts.

(2) Based on average interest rates and weighted average debt outstanding.

(C) Debt Record

Up to date, Québec has always paid the full amount of the principal of, and premium, if any, and interest on every obligation issued or assumed by it and every indirect obligation on which it has been required to implement its guarantees, all promptly when due in the currency stipulated, subject to any applicable laws and regulations forbidding trading with the enemy during wartime.

(D) Guarantee of Bonds

Québec having exclusive jurisdiction on the borrowing of money for its own purposes, its bonds or debentures are guaranteed by its sole credit and are not guaranteed in any way by any other government.

8. Outline of the country to which the issuer belongs

(A) General Information

(i) Area and Population

Canada is the second largest country in the world after the Community of Independent States and before People's Republic of China, by area (9,970,610 square kilometers or 3,85 million square miles) of which about 755,180 square kilometers or 291,580 square miles are covered by fresh water. The developed portion is about one-third of the total area, the occupied farm land is about 5% and the productive forest land is about 27% of the total area. The population on January 1, 2009 was estimated to be 33.5 million. Approximately 55% of Canada's population lives in metropolitan areas of which Toronto, Montréal and Vancouver are the largest. Most of Canada's population lives within 325 kilometers (200 miles) of the United States border.

(ii) Form of Government

Canada is a federal state composed of ten provinces and three territories. In 1867, the United Kingdom Parliament adopted the British North America Act, which established the Canadian federation comprised of, at that time, the provinces of Québec, Ontario, Nova Scotia and New Brunswick. Since then, six additional provinces (British Columbia, Prince Edward Island, Manitoba, Saskatchewan, Alberta and Newfoundland), along with the Yukon Territory, the Northwest Territories and the Nunavut Territory, have become parts of Canada.

The British North America Act (which has been renamed the Constitution Act, 1867) gave the Parliament of Canada legislative power in relation to a number of matters including all matters not assigned exclusively to the legislatures of the provinces. These powers now include matters such as defense, the raising of money by any method or system of taxation, the regulation of trade and commerce, the public debt, money and banking, interest, bills of exchange and promissory notes, navigation and shipping, extra-provincial transportation, aerial navigation and, with some exceptions, telecommunications. The provincial legislatures have exclusive jurisdiction in such areas as education, municipal institutions, property and civil rights, administration of justice, direct taxation for provincial purposes and other matters of purely provincial or local concern.

The executive power of the federal government is vested in the Queen, represented by the Governor General, whose powers are exercised on the advice of the federal Cabinet, which is responsible to the House of Commons. The legislative branch at the federal level, the Parliament, consists of the Crown, the Senate and the House of Commons. The Senate has 105 seats. There are 24 seats each for the Maritime Provinces, Québec, Ontario and Western Canada, 6 for Newfoundland and 1 each for the three territories. Senators are appointed by the Governor General on the advice of the federal Cabinet and hold office until age 75. The House of Commons has 308 members, elected by voters in single-member constituencies. The leader of the political party that gains the most seats in each general election is usually invited by the Governor General to be Prime Minister and to form the Government. The Prime Minister selects the members of the federal Cabinet from among the members of the House of Commons and the Senate (in practice almost entirely from the former). Under the May 2007 amendment to the *Canada Elections Act* (the "Elections Act"), the House of Commons' term is limited to four years, since the Elections Act requires that each general election take place on the third Monday in October, in the fourth calendar year after the previous poll. However, dissolution is possible, if the Government is defeated in the House of Commons on a vote of no confidence. Under the Elections Act, the Governor General has discretionary power to dissolve the Parliament and such power was exercised on September 7, 2008.

The most recent general election was held on October 14, 2008 and resulted in a minority government. The Conservative Party has 143 seats and forms the Government, the Liberal Party has 77 seats, the Bloc québécois has 48 seats, the New Democratic Party has 36 seats, 1 member sits as independent and 3 seats are vacant.

The executive power in each province is vested in the Lieutenant Governor, appointed by the Governor General on the advice of the federal Cabinet. The Lieutenant Governor's powers are exercised on the advice of the provincial Cabinet, which is responsible to the Legislative Assembly. Each provincial legislature is composed of a Lieutenant Governor and a Legislative Assembly made up of members elected for a period of five years. The practice of selecting the provincial Premier and the provincial Cabinet in each province follows that described for the federal level, as does the dissolution of a legislature.

The judicial branch of government in Canada is composed of an integrated set of courts created by federal and provincial laws. At the federal level, there are two principal courts, the Supreme Court of Canada, which is the highest appeal court in Canada, and the Federal Court of Canada which, among other things, deals with federal revenue laws and claims involving the Government. Judges of the two federally constituted courts and those of the provincial Superior and County Courts are appointed by the Governor General on the advice of the federal Cabinet and hold office during good behavior until age 70 or 75. Judges of the magistrates courts (commonly now known as Provincial Courts) are appointed by the provincial government and usually hold office until age 65 to 70.

(B) Canadian Economy

(i) Outline of Economic Trends

The following table sets forth selected components of GDP at market prices of Canada as published in the National Economic Accounts on June 1, 2009 for each of the years indicated.

SELECTED COMPONENTS OF GDP AT MARKET PRICES

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(in millions of dollars)				
Gross fixed capital formation	\$ 262,259	\$ 292,663	\$ 323,955	\$ 346,794	\$ 362,480
Personal consumption expenditure	\$ 719,917	\$ 758,966	\$ 801,211	\$ 850,921	\$ 891,197
Net domestic product at basic prices	\$ 1,033,888	\$ 1,104,878	\$ 1,168,900	\$ 1,237,844	\$ 1,296,477
GDP at market prices	\$ 1,290,906	\$ 1,373,845	\$ 1,449,215	\$ 1,532,944	\$ 1,600,081

Source: Statistics Canada.

(ii) Industrial structure

The following table provides the value of gross production for some goods producing sectors of the Canadian economy for each of the years indicated.

GROSS PRODUCTION FOR SOME GOODS PRODUCING SECTORS ⁽¹⁾

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(in millions of dollars)				
Agriculture (farm cash receipts)	\$ 36,338	\$ 36,744	\$ 36,950	\$ 40,736	\$ 45,946
Mining and quarries (value of mineral production) ⁽²⁾	\$ 24,382	\$ 28,036	\$ 34,233	\$ 40,522	\$ 45,278
Manufacturing (value of shipments)	\$ 583,082	\$ 600,350	\$ 607,380	\$ 607,344	\$ 604,744
Construction (value of construction work purchased)	\$ 154,125	\$ 171,965	\$ 195,763	\$ 214,227	\$ 231,057
	(in thousands of MWH)				
Electric energy generated	580,440	604,348	592,621	615,248	610,514

(1) The gross value of production represents the total value of the commodities produced at the producer's level and before the elimination of the value of the commodities used in production.

(2) Including oil and gas

Source: Statistics Canada

(iii) Foreign trade and the balance of payments

External trade plays an important role in the Canadian economy. Canada's adjusted merchandise exports and imports for each of the years indicated are shown below.

EXTERNAL TRADE

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(in millions of dollars)				
Exports	\$ 429,006	\$ 450,210	\$ 453,951	\$ 463,127	\$ 489,857
Imports	(363,158)	(387,838)	(404,345)	(415,229)	(442,988)
Goods Balance	\$ 65,848	\$ 62,372	\$ 49,606	\$ 47,898	\$ 46,869

Source: Statistics Canada, Balance of Payments Division.

The composition of Canada's adjusted merchandise trade for the years indicated has been as follows.

EXTERNAL TRADE BY COMMODITY

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(in millions of dollars)				
Exports					
Food, feed, beverages and tobacco ⁽¹⁾	\$ 27,715	\$ 27,247	\$ 27,848	\$ 30,159	\$ 34,602
Crude materials ⁽²⁾	69,594	85,699	88,541	95,729	128,038
Fabricated materials ⁽³⁾	118,842	124,525	128,846	133,814	141,180
Finished goods ⁽⁴⁾	198,762	198,148	193,380	189,470	172,247
Other	14,093	14,531	15,117	13,879	13,790
Total Exports	<u>\$ 429,006</u>	<u>\$ 450,150</u>	<u>\$ 453,732</u>	<u>\$ 463,051</u>	<u>\$ 489,857</u>
Imports					
Food, feed, beverages and tobacco ⁽¹⁾	\$ 20,000	\$ 20,810	\$ 22,219	\$ 24,258	\$ 27,002
Crude materials ⁽²⁾	27,950	34,391	35,828	38,994	52,184
Fabricated materials ⁽⁵⁾	74,913	82,220	87,135	86,940	96,840
Finished goods ⁽⁶⁾	229,178	238,793	246,527	251,428	252,110
Other	11,117	11,590	12,544	13,386	14,852
Total Imports	<u>\$ 363,158</u>	<u>\$ 387,804</u>	<u>\$ 404,253</u>	<u>\$ 415,006</u>	<u>\$ 442,988</u>

(1) Including live animals.

(2) Main items are mineral fuels and ores.

(3) Main items are pulp and paper, primary metals, chemicals and lumber.

(4) Main items are motor vehicles and parts, industrial machinery, other transportation equipment, telecommunication equipment and office machinery.

(5) Main items are chemicals, primary metals and textiles.

(6) Main items are motor vehicles and parts, industrial machinery, consumer goods, telecommunication equipment and office machinery.

Source: Statistics Canada, International Trade Division.

The geographic distribution of Canada's adjusted merchandise trade is shown below.

EXTERNAL TRADE BY REGION

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(share in percentage)				
Exports					
United States	81.7%	81.8%	79.6%	76.9%	75.5%
Mexico	0.9	0.9	1.1	1.2	1.3
United Kingdom	2.2	2.1	2.5	3.1	2.9
Other Western Europe	4.9	4.8	5.3	6.4	6.1
Japan	2.3	2.3	2.3	2.2	2.4
China (Mainland)	1.9	1.9	2.0	2.3	2.4
Other Asia	2.7	2.6	3.1	3.2	3.6
Other countries	3.4	3.6	4.1	4.7	5.8
Total Exports	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>
Imports					
United States	68.8%	66.9%	65.6%	65.0%	63.4%
Mexico	2.8	2.9	3.0	3.2	3.1
United Kingdom	2.6	2.3	2.4	2.4	2.6
Other Western Europe	7.9	8.3	8.3	8.1	8.4
Japan	2.8	2.9	2.9	2.9	2.6
China (Mainland)	5.0	5.9	6.6	7.1	7.5
Other Asia	4.4	4.1	4.2	4.2	4.2
Other countries	5.7	6.7	7.0	7.1	8.2
Total Imports	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Source: Statistics Canada, International Trade Division and Balance of Payments Division.

Trade with Japan

For each of the years indicated, the adjusted exports and imports of Canada in its trade with Japan were as follows.

EXTERNAL TRADE WITH JAPAN

	2004	2005	2006	2007	2008
	(in millions of dollars)				
Exports.....	\$ 9,846	\$ 10,168	\$ 10,279	\$ 9,989	\$ 11,872
Imports.....	(10,094)	(11,211)	(11,858)	(11,972)	(11,669)
Goods Balance.....	<u>\$ (248)</u>	<u>\$ (1,043)</u>	<u>\$ (1,579)</u>	<u>\$ (1,983)</u>	<u>\$ 203</u>

Source: Statistics Canada, Balance of Payments Division.

Major exports and imports between Canada and Japan in 2008 are shown below.

EXTERNAL TRADE WITH JAPAN MAJOR PRODUCTS

Exports	Imports	
	(in millions of dollars)	
Mineral fuels.....	\$2,328	Motor vehicles and parts \$6,481
Oil seeds	1,653	Machinery 3,297
Ores, slag and ash	1,045	Electrical and electronic products 2,120
Wood Products	1,001	Iron and steel products 599
Meat products	915	Photographic equipment..... 591
Cereals671	Aircraft and parts 412
Aluminum products	501	Rubber products 383
Pulp and paper products.....	434	Chemical products..... 298

Source: Statistics Canada, International Trade Division, custom basis.

(iv) Balance of payments and official international reserves

The following table sets forth a summary of the Canadian balance of international payments for each of the years indicated.

SUMMARY OF TRANSACTIONS BETWEEN CANADA AND ALL COUNTRIES ⁽¹⁾⁽²⁾

	2004	2005	2006	2007	2008
	(in millions of dollars)				
A. Current Account					
Exports of goods.....	\$ 429,006	\$ 450,210	\$ 453,951	\$ 463,127	\$ 489,857
Imports of goods.....	(363,158)	(387,838)	(404,345)	(415,229)	(442,988)
Goods balance	65,848	62,372	49,606	47,898	46,869
Services balance	(11,037)	(12,055)	(13,937)	(18,974)	(22,499)
Investment income balance	(24,304)	(22,917)	(13,907)	(11,334)	(15,223)
Transfers balance.....	(670)	(1,498)	(1,429)	(1,984)	(1,031)
Current account balance	<u>\$ 29,837</u>	<u>\$ 25,902</u>	<u>\$ 20,333</u>	<u>\$ 15,606</u>	<u>\$ 8,115</u>
B. Capital and Financial Accounts					
Capital account net flow	\$ 4,437	\$ 5,905	\$ 4,288	\$ 4,258	\$ 4,520
Financial account net flow.....	(37,246)	(29,255)	(26,840)	(23,819)	(11,641)
Capital and Financial accounts net flow.....	<u>\$ (32,809)</u>	<u>\$ (23,350)</u>	<u>\$ (22,552)</u>	<u>\$ (19,562)</u>	<u>\$ (7,122)</u>
C. Statistical discrepancy	<u>\$ 2,973</u>	<u>\$ (2,552)</u>	<u>\$ 2,220</u>	<u>\$ 3,955</u>	<u>\$ (994)</u>

(1) Revised balance of payments accounts according to the revised international reporting standards of the IMF as published in "Balance of Payments Manual", 5th edition 1993. These data may differ from the one published by the International Trade Division of Statistics Canada.

(2) Due to rounding in the original annual data from Statistics Canada, a slight discrepancy in the balancing of data is possible.

Source: Statistics Canada, Balance of Payments Division.

The following table shows the total of Canada's official international reserves, which consist of gold, U.S. dollars, other foreign convertible currencies, Special Drawing Rights and the reserve position in the International Monetary Fund ("IMF"), on December 31 for each of the years indicated.

OFFICIAL INTERNATIONAL RESERVES

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
	(in millions of U.S. dollars)				
U.S. dollars	\$ 14,426	\$ 16,842	\$ 15,608	\$ 19,257	\$ 22,804
Other foreign currencies	15,740	13,822	17,590	20,057	18,733
Reserve position in the IMF.....	3,327	1,401	833	661	1,249
Special Drawing Rights	925	897	963	1,015	991
Gold	48	56	69	91	95
Total.....	<u>\$ 34,466</u>	<u>\$ 33,018</u>	<u>\$ 35,063</u>	<u>\$ 41,081</u>	<u>\$ 43,872</u>

Source: Bank of Canada.

(v) Foreign Exchange

The high and low noon spot rates for the U.S. dollar in Canada for the period January 2004 through May 2009, as reported by the Bank of Canada, were 1.3968 dollar and 0.9170 dollar respectively.

On June 2, 2009, the noon spot rate for the U.S. dollar was 1.0827 dollar.

The annual average noon spot rates for the Japanese yen expressed in Canadian dollars were the following for each of the years indicated.

Japanese yen noon spot rate

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Annual average	0.0120	0.0110	0.0098	0.0091	0.0104

Source: Bank of Canada.

On June 2, 2009, the noon spot rate for the Japanese yen was 0.0113 dollar.