UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1997

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from -------------- to ---------------

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Commission file number 1-3187

HOUSTON INDUSTRIES INCORPORATED
(FORMERLY HOUSTON LIGHTING & POWER COMPANY)

(Exact name of registrant as specified in its charter)

Texas	74-0694415
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1111 Louisiana Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)

(713) 207-3000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No
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As of October 31, 1997, Houston Industries Incorporated had 295,070,776 shares of common stock outstanding, including 12,388,551 ESOP shares not deemed outstanding for financial statement purposes and excluding 70,652 shares held as treasury stock.

On August 6, 1997, Houston Industries Incorporated, the former parent corporation of the registrant (Former HI), merged with and into Houston Lighting & Power Company, which was renamed "Houston Industries Incorporated" on the date of the merger. Pursuant to the merger, each outstanding share of Former HI common stock was converted into one share of the registrant's common stock (including associated preference stock purchase rights).

HOUSTON INDUSTRIES INCORPORATED
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 1997

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME
(THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
REVENUES:				
Electric	$1,385,451	$1,230,298	$3,285,005	$3,142,234
Natural gas distribution	180,101		180,101	
Interstate pipelines	23,821		23,821	
Energy marketing and gathering	533,284		533,284	
International	21,458	16,906	61,386	38,201
Other	14,436	3,821	17,503	6,236
Total	2,158,551	1,251,025	4,101,100	3,186,671
EXPENSES:				
Electric and natural gas:				
Fuel	895,012	319,548	1,361,374	817,836
Purchased power	99,298	71,762	278,922	224,078
Operation and maintenance	405,793	206,748	850,249	637,561
Taxes other than income taxes	85,588	63,280	207,008	191,148
International	14,036	13,207	44,530	57,324
Depreciation and amortization	184,156	130,970	446,889	389,868
Other operating expenses	11,952	4,441	46,063	5,870
Total	1,695,835	809,956	3,235,035	2,323,685
OPERATING INCOME	462,716	441,069	866,065	862,986
OTHER INCOME (EXPENSE):				
Litigation settlements				(95,000)
Time Warner dividend income	10,313	10,403	31,028	31,208
Interest income	3,696	770	5,387	3,482
Other - net	11,028	(322)	8,244	(1,523)
Total	25,037	10,851	44,659	(61,833)
INTEREST AND OTHER CHARGES:				
Interest on long-term debt	91,874	68,610	217,513	208,861
Other interest	18,667	11,475	51,826	22,810
Distribution on trust securities	7,055		18,728	
Allowance for borrowed funds used during construction	(47)	(583)	(1,892)	(1,939)
Preferred dividends of subsidiary	33	5,373	2,255	17,318
Total	117,582	84,875	288,430	247,050
INCOME BEFORE INCOME TAXES	370,171	367,045	622,294	554,103
INCOME TAXES	126,209	127,021	197,249	185,485
NET INCOME	243,962	240,024	425,045	368,618
PREFERRED STOCK DIVIDEND	64		64	
NET INCOME AVAILABLE FOR COMMON STOCK	$ 243,898	$ 240,024	$ 424,981	$ 368,618
EARNINGS PER COMMON SHARE	$ 0.93	$ 0.98	$ 1.74	$ 1.49
DIVIDENDS DECLARED PER COMMON SHARE	$ 0.375	$ 0.375	$ 1.125	$ 1.125
WEIGHTED AVERAGE COMMON SHARES Outstanding (000)	263,373	245,889	243,769	247,664

See Notes to Consolidated Financial Statements.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

ASSETS

	September 30, 1997	December 31, 1996
PROPERTY, PLANT AND EQUIPMENT - AT COST:		
Electric plant:		
Plant in service	$ 12,576,498	$ 12,387,375
Construction work in progress	187,827	251,497
Nuclear fuel	253,998	241,001
Plant held for future use	48,631	48,631
Gas Plant and Pipelines:		
Natural gas distribution	1,287,648	
Interstate pipelines	1,291,202	
Energy marketing and gathering	161,546	
Other property	142,537	86,969
Total	15,949,887	13,015,473
Less accumulated depreciation and amortization	4,623,328	4,259,050
Property, plant and equipment - net	11,326,559	8,756,423
CURRENT ASSETS:		
Cash and cash equivalents	53,407	8,001
Accounts receivable - net	538,385	36,277
Accrued unbilled revenues	119,135	77,853
Time Warner dividends receivable	10,313	10,313
Fuel stock and petroleum products	118,998	61,795
Materials and supplies, at average cost	158,681	130,380
Prepayments and other current assets	62,719	19,301
Total current assets	1,061,638	343,920
OTHER ASSETS:		
Investment in Time Warner securities	990,000	1,027,500
Goodwill - net	1,955,788	
Deferred plant costs - net	571,641	587,352
Equity investments in and advances to foreign and non-regulated affiliates - net	677,565	501,991
Regulatory tax asset - net	356,580	362,310
Deferred debits	562,738	306,473
Recoverable project costs - net	113,634	163,630
Unamortized debt expense and premium on reacquired debt	215,498	153,823
Fuel-related debits	182,178	84,435
Total other assets	5,625,622	3,187,514
Total	$ 18,013,819	$ 12,287,857

See Notes to Consolidated Financial Statements.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

CAPITALIZATION AND LIABILITIES

	September 30, 1997	December 31, 1996
CAPITALIZATION:		
Common stock equity:		
Common stock, no par value	$ 3,097,299	$ 2,446,754
Treasury stock, at cost	(1,090)	(361,196)
Unearned ESOP shares	(233,437)	(251,350)
Retained earnings	2,141,326	1,997,490
Currency translation adjustment	(442)	
Unrealized gain (loss) on equity securities	3,809	(3,737)
Total common stock equity	5,007,465	3,827,961
Cumulative preferred stock, no par value, not subject to mandatory redemption	9,740	135,179
HL&P/NorAm obligated mandatorily redeemable securities of subsidiary trusts holding solely subordinated debentures of HL&P/NorAm	380,350	
Long-Term Debt:		
Automatic common exchange securities (ACES)	1,052,384	
Debentures	349,237	349,098
Long-term debt of HL&P and subsidiaries:		
First mortgage bonds	2,495,268	2,670,041
Debentures	405,600	
Notes payable	932,901	
Pollution control revenue bonds	118,000	5,000
Other	15,936	1,511
Total long-term debt	5,369,326	3,025,650
Total capitalization	10,766,881	6,988,790
CURRENT LIABILITIES:		
Notes payable	1,763,313	1,337,872
Accounts payable	592,717	157,682
Taxes accrued	287,709	191,011
Interest accrued	118,239	67,707
Dividends declared	92,549	92,515
Customer deposits	82,198	53,633
Current portion of long-term debt and preferred stock	190,385	254,463
Other	241,742	89,238
Total current liabilities	3,368,852	2,244,121
DEFERRED CREDITS:		
Accumulated deferred income taxes - net	2,757,698	2,265,031
Unamortized investment tax credit	354,109	373,749
Fuel-related credits	93,479	74,639
Benefit liabilities	354,214	243,375
Other	318,586	98,152
Total deferred credits	3,878,086	3,054,946
COMMITMENTS AND CONTINGENCIES		
Total	$18,013,819	$ 12,287,857

See Notes to Consolidated Financial Statements.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED CASH FLOWS

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

	Nine Months Ended September 30,	
	1997	1996
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 425,045	$ 368,618
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	446,889	389,868
Amortization of nuclear fuel	21,727	24,261
Deferred income taxes	23,973	(5,127)
Investment tax credit	(14,740)	(14,592)
Allowance for other funds used during construction	(171)	(3,093)
Contribution of marketable equity securities to charitable trust	19,463	
Fuel cost and over/(under) recovery - net	(67,171)	(119,442)
Changes in other assets and liabilities:		
Accounts receivable - net	75,006	19,604
Inventory	21,260	9,061
Other current assets	(13,584)	1,328
Accounts payable	(95,054)	(15,146)
Interest and taxes accrued	73,724	105,746
Other current liabilities	43,590	(73)
Other - net	(13,457)	17,673
Net cash provided by operating activities	946,500	778,686
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures (including allowance for borrowed funds used during construction)	(180,472)	(226,783)
Purchase of NorAm Energy Corp., net of cash acquired	(1,422,672)	
Non-regulated electric power project expenditures	(215,020)	(446,600)
Sale of Time Warner securities	25,043	
Other - net	(10,484)	(37,984)
Net cash used in investing activities	(1,803,605)	(711,367)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sale of ACES - net	1,020,770	
Proceeds from issuance of commercial paper	1,379,568	
Payment to retire commercial paper	(1,020,317)	
Proceeds from sale of HL&P obligated mandatorily redeemable securities of subsidiary trusts holding solely subordinated debentures of HL&P	340,785	
Purchase of treasury stock		(205,901)
Payment of matured bonds	(190,000)	(150,000)
Proceeds from issuance of pollution control revenue bonds	115,739	
Redemption of preferred stock	(153,628)	(51,400)
Payment of common and preferred stock dividends	(281,009)	(279,498)
Increase/(decrease)in notes payable - net	(214,486)	691,531
Extinguishment of long-term debt	(190,338)	(85,263)
Other - net	95,427	9,131
Net cash provided by/(used in) financing activities	902,511	(71,400)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	45,406	(4,081)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	8,001	11,779
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 53,407	$ 7,698

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED CASH FLOWS

INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS
(THOUSANDS OF DOLLARS)

CONT'D

	Nine Months Ended September 30, 1997	1996
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Payments:		
Interest (net of amounts capitalized)	$ 274,560	$ 221,641
Income taxes	113,128	91,867

The aggregate consideration paid to Former NorAm stockholders in connection with the Merger consisted of $1.4 billion in cash and 47.8 million shares of the Company's common stock valued at approximately $1.0 billion. The overall transaction was valued at $4.0 billion consisting of $2.4 billion for Former NorAm's common stock and common stock equivalents and $1.6 billion of NorAm debt.

See Notes to Consolidated Financial Statements.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED RETAINED EARNINGS
(THOUSANDS OF DOLLARS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
Balance at Beginning of Period	$2,003,194	$1,896,173	$1,997,490	$1,953,672
Net Income for the Period	243,962	240,024	425,045	368,618
Total	2,247,156	2,136,197	2,422,535	2,322,290
Preferred Stock Dividends	(64)		(64)	
Common Stock Dividends	(105,766)	(89,960)	(281,145)	(276,053)
Balance at End of Period	$2,141,326	$2,046,237	$2,141,326	$2,046.237

See Notes to Consolidated Financial Statements.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) BASIS OF PRESENTATION

On August 6, 1997, Houston Industries Incorporated (Former HI) merged with and into Houston Lighting & Power Company (HL&P), which was renamed "Houston Industries Incorporated" (Company), and NorAm Energy Corp., a natural gas gathering, transmission, marketing and distribution company (Former NorAm), merged with and into a subsidiary of the Company, HI Merger, Inc., which was renamed "NorAm Energy Corp." (NorAm). Effective upon the mergers (collectively, the Merger), each outstanding share of common stock of Former HI was converted into one share of common stock (including associated preference stock purchase rights) of the Company, and each outstanding share of common stock of Former NorAm was converted into the right to receive $16.3051 cash or 0.74963 shares of common stock of the Company. For additional information regarding the Merger, see Note 3 below.

The interim financial statements and notes (Interim Financial Statements) in this Form 10-Q (Form 10-Q) include the accounts of the Company and its wholly owned and majority owned subsidiaries including, effective as of August 6, 1997, the accounts of NorAm and its wholly owned and majority owned subsidiaries. The Interim Financial Statements are unaudited, omit certain information included in financial statements prepared in accordance with generally accepted accounting principles and should be read in combination with the Combined Annual Report on Form 10-K of Former HI and HL&P (Company's Form 10-K) for the year ended December 31, 1996 (File Nos. 1-7629 and 1-3187) and the Annual Report on Form 10-K of Former NorAm (NorAm's Form 10-K) for the year ended December 31, 1996 (File No. 1-3751). For additional information regarding the presentation of interim period results, see Note 10 below.

The following notes to the financial statements in the Company's Form 10-K and NorAm's Form 10-K relate to material contingencies. These notes, as updated by the notes contained in this Form 10-Q and the notes contained in the Quarterly Report on Form 10-Q of Former HI and HL&P for the quarter ended March 31, 1997 (Company's First Quarter Form 10-Q) and for the quarter ended June 30, 1997 (Company's Second Quarter Form 10-Q), and from the Quarterly Report on Form 10-Q of Former NorAm for the quarter ended March 31, 1997 (NorAm's First Quarter Form 10-Q) and for the quarter ended June 30, 1997 (NorAm's Second Quarter Form 10-Q) are incorporated herein by reference and include the following:

Company: Note 1(b) (System of Accounts and Effects of Regulation), Note 1(n) (Nature of Operations), Note 1(o) (Use of Estimates), Note 2 (Jointly-Owned Nuclear Plant), Note 3 (Rate Matters), Note 4 (Investments in HI Energy) and Note 11 (Commitments and Contingencies).

NorAm: Note 1 (Accounting Policies and Components of Certain Financial Statement Line Items) and Note 7 (Commitments and Contingencies).

(2) SIGNIFICANT ACCOUNTING POLICIES

For information regarding significant accounting policies of the Company and its wholly owned subsidiary, NorAm, see Note 1 to the Company's Form 10-K and Note 1 to NorAm's Form 10-K, which notes, as updated by the information contained in this note, are incorporated herein by reference.

Accounting for Energy Risk Management Activities. The Company, through NorAm and certain of its subsidiaries, utilizes a variety of derivative financial instruments, including swaps and exchange-traded futures and options (Derivatives) as part of its overall risk-management strategy and for limited trading purposes as discussed below. To reduce the risk from market fluctuations in the price of electric power, natural gas and related transportation, NorAm and certain of its subsidiaries enter into futures transactions, swaps and options (Energy Derivatives) in order to hedge certain natural gas in storage, as well as certain expected purchases, sales and transportation of natural gas and electric power (a portion of which are firm commitments at the inception of the hedge). NorAm also utilizes interest-rate derivatives (principally interest-rate swaps) in order to adjust the portion of its overall borrowings which are subject to interest-rate risk, and also has utilized such derivatives to effectively fix the interest rate on debt expected to be issued for refunding purposes. In addition, a subsidiary of NorAm maintains a portfolio of Energy Derivatives for trading purposes.

The Company's accounting for activities involving derivative financial instruments is in accordance with the concepts established in Statement of Financial Accounting Standards (SFAS) No. 80, "Accounting for Futures Contracts", American Institute of Certified Public Accountants Statement of Position 86-2, "Accounting for Options" and various pronouncements of the Emerging Issues Task Force of the Financial Accounting Standards Board (FASB).

Unrealized changes in the market value of Energy Derivatives utilized as hedges are not generally recognized in the Company's consolidated financial statements. The cash impacts associated with such derivatives are (i) recognized as an asset or liability in the case of options or other derivatives for which money is exchanged either (A) at the inception of the position or (B) as a result of margin calls, (ii) included in the measurement of the transaction that satisfies the commitment in the case of firm commitments and (iii) included in the measurement of the subsequent transaction in the case of anticipated transactions, whether or not the Energy Derivative position is closed out before the date of the anticipated transaction. Once it becomes probable that an anticipated transaction will not occur, deferred gains and losses are recognized. In general, the financial impact of transactions involving these Energy Derivatives is included in the Company's Statement of Consolidated Income under the caption (i) "Fuel expenses" in the case of natural gas transactions and (ii) "Operation and maintenance" in the case of electric power transactions. Cash flows resulting from these transactions in Energy Derivatives are included in the Company's Statements of Consolidated Cash Flows in the same category as the item being hedged.

In the case of interest-rate swaps associated with existing obligations, cash flows and expense associated with the interest-rate derivative transactions are matched with the cash flows and interest expense of the obligation being hedged, resulting in an adjustment to the effective interest rate. When interest-rate swaps are utilized to effectively fix the interest rate for an anticipated debt issuance, changes in the market value of the interest-rate derivatives are deferred and recognized as an adjustment to the effective interest rate on the newly-issued debt. If it is determined that the anticipated issuance of debt will not occur, or that the issuance will be for an amount or a term different from that anticipated at the inception of the hedge, either all or a pro rata portion (as applicable) of the deferred gain or loss is recognized concurrently with such determination.

For transactions involving either Energy Derivatives or interest-rate derivatives, hedge accounting is applied only if the derivative (i) reduces the risk of the underlying hedged item and (ii) is designated as a hedge at its inception. Additionally, the derivatives must be expected to result in financial impacts which are inversely correlated to those of the item(s) to be hedged. This correlation (a measure of hedge effectiveness) is measured both at the inception of the hedge and on an ongoing basis, with an acceptable level of variation from 80% to 125% for hedge designation. If and when correlation ceases to exist at an acceptable level, hedge accounting ceases and "mark-to-market" accounting (as described below) is applied.

A subsidiary of NorAm maintains a portfolio of Energy Derivatives for trading purposes, representing a small portion of the Company's overall derivative positions. In addition, the total underlying notional amounts of natural gas or electric power associated with these trading activities represents a small fraction of NorAm's total notional transaction volume in these energy commodities for any given period. This trading portfolio of Energy Derivatives is "marked-to-market" on a daily basis, with unrealized gains and losses included in income as they occur and reported in the Company's consolidated financial statements under the same line items as the impacts of the energy hedging transactions as described above.

(3) ACQUISITION OF NORAM

The aggregate consideration paid to Former NorAm stockholders in connection with the Merger consisted of $1.4 billion in cash and 47.8 million shares of the Company's common stock valued at approximately $1 billion. The overall transaction was valued at $4.0 billion consisting of $2.4 billion for Former NorAm's common stock and common stock equivalents and $1.6 billion of Former NorAm debt ($1.3 billion of which was long-term debt).

The Company has recorded the acquisition of NorAm under the purchase method of accounting with assets and liabilities of NorAm reflected at their estimated fair market values as of the date of the purchase. The Company has recorded the $2 billion excess of the acquisition cost over the fair value of the net assets acquired as goodwill and is amortizing this amount over 40 years. On a preliminary basis, the Company's fair value adjustments included increases in property, plant and equipment, long-term debt, and unrecognized pension and post retirement benefits liabilities plus related deferred taxes. The allocation of the purchase price is preliminary, since valuation and other studies have not been finalized.

The Company's results of operations incorporate NorAm's results of operations only for the period beginning August 6, 1997. The following table presents certain unaudited pro forma information for the three and nine month periods ended September 30, 1997 and 1996, as if the Merger had occurred on January 1, 1997 or 1996, as applicable.

Pro Forma Combined Results
of Operation
(In millions, except per share data)

	Three Months Ended September 30, 1997	Three Months Ended September 30, 1996	Nine Months Ended September 30, 1997	Nine Months Ended September 30, 1996
Revenues	$2,555	$2,150	$7,438	$6,395
Net Income Available for Common Stock	$ 215	$ 215	$ 431	$ 367
Earnings Per Share	$ 0.76	$ 0.73	$ 1.53	$ 1.24

These and other pro forma results appearing in this Form 10-Q are based on assumptions deemed appropriate by the Company's management, have been prepared for informational purposes only and are not necessarily indicative of the combined results that would have resulted had the Merger occurred at the beginning of the periods indicated.

(4) CAPITAL STOCK

(a) Common Stock. At September 30, 1997, the Company had 282,346,858 shares of common stock issued and outstanding (out of a total of 700,000,000 authorized shares). At December 31, 1996, the number of shares of outstanding Common Stock of Former HI was 233,335,481. Outstanding common shares excluded (i) shares pledged to secure a loan to the Company's Employee Stock Ownership Plan (12,388,551 and 13,370,939 at September 30, 1997 and December 31, 1996, respectively) and (ii) treasury shares (50,747 and 16,042,027 at September 30, 1997, and December 31, 1996, respectively).

(b) Earnings Per Share. The Company calculates earnings per common share by dividing net income by the weighted average common shares outstanding during the relevant period. For information regarding the adoption of SFAS No. 128, "Earnings Per Share" (Dual Presentation of Basic and Diluted Earnings per Share Calculations for Financial Statements) with respect to periods ending after December 15, 1997, see Note 5 to the Company's First Quarter Form 10-Q. The Company's current earnings per share calculation conforms to basic earnings per share. Diluted earnings per share are not expected to be materially different from basic earnings per share.

(c) Preferred Stock. At September 30, 1997 and December 31, 1996, the Company had 10,000,000 authorized shares of preferred stock, of which 97,397 shares were outstanding at September 30, 1997 and 1,604,397 shares were outstanding at December 31, 1996.

As of September 30, 1997, the Company's only outstanding series of preferred stock was its $4.00 Preferred Stock. The $4.00 Preferred Stock pays an annual dividend of $4.00 per share, is redeemable at $105 per share and has a liquidation price of $100 per share.

For information regarding the redemption during the first six months of 1997 of the Company's $6.72, $7.52, $8.12 and $9.375 cumulative preferred stock, see Note 7 to the Company's First Quarter Form 10-Q and Note 3 to the Company's Second Quarter Form 10-Q.

(d) Preference Stock. At September 30, 1997, the Company had 10,000,000 authorized shares of preference stock, of which 700,000 shares are classified as Series A Preference Stock and 27,000 shares are classified as Series B Preference Stock. As of September 30, 1997, there were no shares of Series A Preference Stock issued and outstanding (such shares being issuable in accordance with the Company's Shareholder Rights Agreement upon the occurrence of certain events). The number of shares of Series B Preference Stock issued and outstanding as of September 30, 1997 was 17,000. The sole holder of the Series B Preference Stock is a wholly owned financing subsidiary of the Company.

(5) LONG-TERM DEBT AND SHORT-TERM FINANCING

(a) Overview. At September 30, 1997 and December 31, 1996, the Company had $7.3 billion and $4.6 billion, respectively, in long-term and short-term debt outstanding. Of the amount of long-term and short-term debt outstanding as of September 30, 1997, $1.8 billion represents debt of NorAm.

Consolidated Long-Term Debt and Short-Term Borrowings
(In millions)

	September 30, 1997	December 31, 1996
Short-Term Borrowings:		
Commercial Paper	$1,288	$1,332
Current Portion of Long-Term Debt	190	259
Lines of Credit	180	
NorAm Sale of Receivables	295	
Long-Term Debt:		
Debentures(1)	756	350
First Mortgage Bonds(1)	2,510	2,685
Notes Payable	933	
Pollution Control Revenue Bonds	118	5
Automatic Common Exchange Securities	1,052	
Other	16	2

(1) Unamortized discount related to debentures was approximately $1 million at September 30, 1997 and December 31, 1996. Unamortized discount related to first mortgage bonds was approximately $15 million at September 30, 1997 and December 31, 1996.

Consolidated maturities of long-term debt for the Company (including NorAm) are approximately $87 million for the remainder of 1997, $238 million in 1998, $378 million in 1999, $1.4 billion in 2000 and $401 million in 2001.

(b) FinanceCo Credit Facility. In August 1997, a limited partnership special purpose subsidiary of the Company (FinanceCo), established a five-year, $1.644 billion revolving credit facility with a consortium of commercial banks (FinanceCo Facility). The FinanceCo Facility supported $1.288 billion in commercial paper borrowings by FinanceCo at September 30, 1997 recorded as notes payable in the Consolidated Balance Sheet. The weighted average interest rate of these borrowings at September 30, 1997, was 5.91%. Proceeds from the initial issuances of commercial paper were used to fund the cash portion of the consideration paid to Former NorAm stockholders under the terms of the Merger.

Borrowings under the FinanceCo Facility, which bear interest at a rate based upon either the London interbank offered rate (LIBOR) plus a margin or a base rate plus a margin or at a rate determined through a bidding process. The FinanceCo Facility may be used (i) to support the issuance of commercial paper or other short-term indebtedness of FinanceCo, (ii) subject to certain limitations, to finance repurchases of Company common stock and (iii) subject to certain limitations, to provide funds for general purposes of FinanceCo, including the making of intercompany loans to, or securing letters of credit for the benefit of, FinanceCo's affiliates.

The FinanceCo Facility requires the Company to maintain a ratio of consolidated indebtedness for borrowed money to consolidated capitalization that does not exceed 0.64:1.00 from October 1, 1997 through December 31, 1997; 0.62:1.00 from January 1, 1998 through December 31, 1998; and 0.60:1.00 from January 1, 1999 until termination of the FinanceCo Facility. The FinanceCo Facility also contains restrictions applicable to the Company with respect to, among other things, (i) liens, (ii) consolidations, mergers and dispositions of assets, (iii) dividends and repurchases of common stock, (iv) certain types of investments and (v) certain changes in its business. The FinanceCo Facility contains customary covenants and default provisions applicable to FinanceCo and its subsidiaries, including limitations on, among other things, additional indebtedness (other than certain permitted indebtedness), liens and certain investments or loans.

Subject to certain conditions and limitations, the Company is required to make cash payments from time to time to FinanceCo from excess cash flow (as defined in the FinanceCo Facility) to the extent necessary to enable FinanceCo to meet its financial obligations. Borrowings under the FinanceCo Facility are secured by pledges of (i) the shares of common stock of NorAm held by the Company, (ii) all of the limited and general partner interests of FinanceCo and all of the Company's interest in the general partner of FinanceCo, (iii) the capital stock of HI Energy, (iv) the capital stock of other significant subsidiaries of the Company, (v) the Series B Preference Stock and (vi) certain intercompany notes held by FinanceCo. The obligations under the FinanceCo Facility are not secured by the utility assets of the Company or NorAm or by the Company's investment in Time Warner Inc. (Time Warner).

(c) ACE Securities. The Company owns 11 million shares of non-publicly traded Convertible Preferred Stock of Time Warner (Time Warner Preferred Stock). In connection with the monetization of its investment in these securities, Former HI sold in July 1997, 22,909,040 of its unsecured 7% Automatic Common Exchange Securities due July 1, 2000 (ACE Securities), having a face amount of $45.9375 per security.

At maturity, the principal amount of the ACE Securities will be mandatorily exchangeable by the Company into either (i) a number of shares of common stock of Time Warner based on an exchange rate or (ii) cash having an equal value. Subject to adjustments that may result from certain dilution events, the exchange rate for each

ACE Security is determined as follows: (i) 0.8264 shares of Time Warner common stock if the price of Time Warner common stock at maturity (Maturity Price) is at least $55.5844 per share, (ii) a fractional share of Time Warner common stock such that the fractional share will have a value equal to $45.9375 if the Maturity Price is less than $55.5844 but greater than $45.9375 and (iii) one share of Time Warner common stock if the Maturity Price is not more than $45.9375.

Prior to maturity, the Company has the option of redeeming the ACE Securities if (i) changes in federal tax regulations require recognition of a taxable gain on the Company's Time Warner Preferred Stock and (ii) the Company could defer such gain by redeeming the ACE Securities. The redemption price is 105% of the closing sales price of the ACE Securities as determined over a period prior to the redemption notice. The redemption price may be paid in cash or in shares of Time Warner common stock or a combination of the two.

Former HI used the net proceeds of the sale of the ACE Securities (approximately $1.021 billion) to retire an equivalent amount of Former HI's then outstanding commercial paper. For a description of the Company's accounting treatment of the ACE Securities and its investment in Time Warner (including the potential adverse impact on earnings that may be caused by certain fluctuations in the market value of Time Warner securities), see "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Certain Factors Affecting Future Earnings -- Accounting Treatment of ACE Securities" in Item 2 of the Form 10-Q.

(6) COMPANY OBLIGATED MANDATORILY REDEEMABLE SECURITIES OF SUBSIDIARY TRUSTS HOLDING SOLELY JUNIOR SUBORDINATED DEBENTURES OF THE COMPANY AND NORAM

For information regarding (i) $250 million of preferred securities and $100 million of capital securities issued by statutory business trusts formed by HL&P and (ii) $177.8 million of convertible preferred securities issued by a statutory business trust formed by Former NorAm, of which $30.5 million were outstanding at September 30, 1997, see Note 7 to the Company's First Quarter Form 10-Q and Note 3 to the NorAm Form 10-K, respectively. The sole asset of each trust consists of subordinated debentures of the Company or NorAm (as the case may be) having principal amounts, interest rates and maturity dates corresponding to each issue of preferred or capital securities.

(7) DEPRECIATION

The Company calculates depreciation using the straight-line method. The Company's depreciation expense for the third quarter of 1997 and the nine months ended September 30, 1997 was $115 million and $296 million, respectively, compared with $91 million and $269 million for the same periods in 1996.

(8) CERTAIN RATE AND TAX MATTERS

(a) Rate Matters -- Company. For information about rate case proceedings affecting the Company's electric operations division, see Note 3 (Rate Matters) in the Company's Form 10-K, which note is incorporated herein by reference.

In September 1997, the Company received a judgment dismissing all outstanding appeals of the Public Utility Commission of Texas' (Utility Commission) order in Docket No. 6668. As a result of this judgment, all outstanding appeals of the Company's prior rate cases have now been dismissed and such action is final.

For information regarding the Company's electric operations division's proposed transition plan and price reduction agreement relating to the transition to retail access for utility customers (Proposed Transition Plan), see "Management's Discussion and Analysis of Financial Condition and Results of Operations--Certain Factors Affecting Future Earnings" in Item 2 of this Form 10-Q.

(b) Tax Refund Case. In July 1990, Former HI paid approximately $104.5 million to the Internal Revenue Service (IRS) following an IRS audit of Former HI's 1983 and 1984 federal income tax returns. In November 1991, Former HI filed a refund suit in the U.S. Court of Federal Claims seeking the return of $52.1 million of tax and $36.3 million of accrued interest, plus interest on both of those amounts accruing after July 1990. The major contested issue in the refund case involved the IRS allegation that certain amounts related to the over-recovery of fuel costs should have been included as taxable income in 1983 and 1984 even though HL&P had an obligation to refund the over-recoveries to its ratepayers.

In September 1997, the United States Court of Appeals for the Federal Circuit upheld a lower court ruling that the Company (as successor corporation to Former HI) was due a refund of federal income taxes assessed on fuel over-recoveries during 1983 and 1984 that subsequently were refunded to HL&P's customers. If the opinion is upheld in its current form, the Company estimates that it will receive a refund of approximately $82 million in taxes and interest paid by Former HI in July 1990, plus interest that has accrued since 1990 (approximately $138 million in total refund as of September 30, 1997). Based on the Company's deferred recognition of the 1990 tax payment and after giving effect to federal income taxes due on the accrued interest, the Company estimates that this refund would increase earnings by approximately $30 million. The IRS has not yet indicated whether it will ask the U.S. Supreme Court to review the Court of Appeals' decision.

(9) SUBSEQUENT EVENTS

The Company and the other three owners of the South Texas Project (South Texas Project) are executing agreements, to be effective in March 1997, to transfer the Company's responsibility for operation of the South Texas Project to a new Texas non-profit corporation formed by the four owners and known as the STP Nuclear Operating Company. That new operating company was formed exclusively for the purpose of operating the South Texas Project, and the Company's officers and employees who have been responsible for day-to-day operation and management of the South Texas Project were transferred to the operating company effective as of October 1, 1997. The operating company will be managed by a board of directors composed of one director from each of the four owners, along with the chief executive officer of the operating company. Formation of the operating company did not affect the underlying ownership of the South Texas Project, which continues as a tenancy in common among the four owners, with each owner retaining its undivided ownership interest in the two nuclear-fueled generating units and the electrical output from those units. The four owners will continue to provide overall oversight of the operations of the South Texas Project through an owners' committee composed of representatives of each of the owners and through the board of directors of the operating company. The formation of the operating company and the transfer of employees and operations to the operating company are not anticipated to have a material effect on the Company's earnings.

(10) INTERIM PERIOD RESULTS; RECLASSIFICATIONS

The Interim Financial Statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to present fairly the financial position and results of operation for the respective periods. Amounts reported in the Consolidated Statements of Income are not necessarily indicative of amounts expected for a full year period due to the effects of, among other things, (i) the acquisition of NorAm, (ii) seasonal temperature variations in energy consumption and (iii) the timing of maintenance and other expenditures. In addition, certain amounts from the prior year have been reclassified to conform to the Company's presentation of financial statements in the current year. Such reclassifications do not affect earnings.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion and analysis should be read in combination with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of the Company's Form 10-K and NorAm's Form 10-K, the financial statements and notes contained in Item 8 of the Company's Form 10-K and NorAm's Form 10-K and the Interim Financial Statements contained in this Form 10-Q.

Statements contained in this Form 10-Q that are not historical facts are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are based on management's beliefs as well as assumptions made by and information currently available to management. Because such statements are based on expectations as to future economic performance and are not statements of fact, actual results may differ materially from those projected. Important factors that could cause future results to differ include (i) the effects of competition in the electric power and natural gas industries, (ii) legislative and regulatory changes, (iii) fluctuations in the weather, (iv) fluctuations in energy commodity prices, (v) environmental liabilities, (vi) changes in the economy and (vii) other factors discussed in this and other filings by the Company with the Securities and Exchange Commission. When used in the Company's or NorAm's documents or oral presentations, the words "anticipate," "estimate," "expect," "objective," "projection," "forecast," "goal" or similar words are intended to identify forward-looking statements. The sections of Management's Discussion and Analysis of Financial Condition and Results of Operations captioned "Results of Operations by Business Segment" and "Certain Factors Affecting Future Earnings" contain or incorporate by reference forward-looking statements.

HOUSTON INDUSTRIES INCORPORATED

The Company is a diversified international energy services company. It operates the nation's tenth largest electric utility in terms of kilowatt-hour sales and its three natural gas distribution divisions together form the nation's third largest natural gas distribution operations in terms of customers served. The Company also invests in electric utility privatizations, gas distribution projects and the development of unregulated power generation projects. The Company's unregulated retail businesses provide energy-related products and services to consumers, small business customers and utilities. The Company is also a major interstate natural gas pipeline and energy services company, providing gas transportation, supply, gathering and storage, and wholesale natural gas and electric power marketing services.

The Company is exempt from regulation as a public utility holding company pursuant to Section 3(a)(2) of the Public Utility Holding Company Act of 1935, as amended (1935 Act), except with respect to (i) the acquisition of certain voting securities of other domestic public utility companies and utility holding companies and (ii) the provisions of Section 33 of the 1935 Act regarding the acquisition, ownership and financing of foreign utility companies.

CONSOLIDATED RESULTS OF OPERATIONS

On August 6, 1997, the Company completed its acquisition of NorAm, a natural gas gathering, transmission, marketing and distribution company. The acquisition was accounted for under the purchase method of accounting; accordingly, the Company's actual results of operations for the three and nine month periods ended September 30, 1997 incorporate NorAm's results of operations only for periods beginning effective as of August 6, 1997.

To enhance comparability between reporting periods, the Company is presenting consolidated results of operations data on both (i) an actual basis and (ii) a pro forma basis as if the acquisition of NorAm had occurred on January 1, 1996 or 1997, as applicable. Although pro forma results of operations are not necessarily indicative of the combined results of operations that actually would have occurred had the acquisition occurred on such dates, the Company believes that the presentation of pro forma data provides a more meaningful comparative standard for assessing changes in the Company's consolidated financial condition and results of operations.

CONSOLIDATED RESULTS OF OPERATIONS
(in thousands, except per share data)

	Actual Three Months Ended September 30, 1997	Actual Three Months Ended September 30, 1996	Percent Change	Pro Forma Three Months Ended September 30, 1997	Pro Forma Three Months Ended September 30, 1996	Percent Change
Revenues	$2,158,551	$1,251,025	73	$2,555,419	$2,150,308	19
Operating Expenses	1,695,835	809,956	109	2,122,712	1,700,240	25
Operating Income..........................	462,716	441,069	5	432,707	450,068	(4)
Other Expenses, Net.......................	218,754	201,045	9	217,615	235,127	(7)
Net Income from Continuing Operations	243,962	240,024	2	215,092	214,941	--
Preferred Dividends.......................	64			64		--
From Continuing Operations:						
Net Income for Common Stock............	243,898	240,024	2	215,028	214,941	--
Earnings Per Share.....................	.93	.98		.76	.73	
Weighted Average Number of						
Common Shares Outstanding.............	263,373	245,889		282,093	293,729	

	Actual Nine Months Ended September 30, 1997	Actual Nine Months Ended September 30, 1996	Percent Change	Pro Forma Nine Months Ended September 30, 1997	Pro Forma Nine Months Ended September 30, 1996	Percent Change
Revenues	$4,101,100	$3,186,671	29	$7,438,148	$6,394,942	16
Operating Expenses	3,235,035	2,323,685	39	6,439,525	5,355,972	20
Operating Income..........................	866,065	862,986	--	998,623	1,038,970	(4)
Other Expenses, Net.......................	441,020	494,368	(11)	567,131	668,078	(15)
Net Income from Continuing Operations	425,045	368,618	15	431,492	370,892	16
Preferred Dividends.......................	64			64	3,597	(98)
From Continuing Operations:						
Net Income for Common Stock............	424,981	368,618	15	431,428	367,295	17
Earnings Per Share.....................	1.74	1.49		1.53	1.24	
Weighted Average Number of						
Common Shares Outstanding.............	243,769	247,664		281,796	295,504	

Actual. The Company's actual consolidated earnings for the three months ended September 30, 1997, were $244 million compared with $240 million for the third quarter of 1996. The $4 million increase in actual consolidated earnings reflects (i) increased sales at the Company's electric utility division (reflecting customer growth and warmer weather) and (ii) improved earnings at the Company's international division, as described below. Partially offsetting these factors was $19 million ($13 million after-tax) in additional amortization of certain lignite reserves in the third quarter of 1997.

Although actual consolidated earnings increased by $4 million, the Company's earnings per share declined from $.98 per share in the third quarter of 1996 to $.93 per share in the third quarter of 1997. The decline in earnings per share was caused by the issuance of approximately 47.8 million additional shares of the Company's common stock as a portion of the consideration paid in the Merger.

The Company's actual consolidated earnings for the nine months ended September 30, 1997, were $425 million ($1.74 per share) compared with $369 million ($1.49 per share) for the same period in 1996. However, excluding non-recurring charges, earnings for the first nine months of 1996 would have been $436 million, resulting in an $11 million decrease in earnings between the two periods. This decrease is due in part to the effects of the NorAm purchase including seasonal losses at the gas distribution segment, amortization of goodwill and incremental interest costs related to the Merger. The non-recurring charges excluded from adjusted earnings relate to the settlement of South Texas Project litigation claims ($62 million recorded in the first quarter of 1996) and the suspension by a subsidiary of the Company of operations at two tire-to-energy plants in Illinois ($5 million recorded in the first quarter of 1996).

Pro Forma. The Company's pro forma consolidated earnings for the three months ended September 30, 1997, were $215 million ($.76 per share) compared with $215 million ($.73 per share) for the same period in 1996.

The Company's pro forma consolidated earnings for the nine months ended September 30, 1997, were $431 million ($1.53 per share) compared with $367 million ($1.24 per share) in the same period in 1996. Excluding the $67 million in non-recurring charges described above, the Company's pro forma consolidated earnings in 1996 would have been $434 million, resulting in a decrease of $3 million in pro forma earnings between the two periods (as compared to an $11 million decrease on an actual basis adjusted for non-recurring charges).

Pro forma consolidated earnings have been reduced by (i) additional interest expense associated with debt incurred by the Company to finance the Merger and (ii) purchase accounting adjustments associated with the Merger, including the amortization of goodwill and the revaluation, on a preliminary basis, of the fair market value of certain NorAm assets and liabilities.

For the nine months ended comparative results, pro forma consolidated earnings are greater than actual earnings due to the net income associated with NorAm operations for the period January 1, 1997 through August 5, 1997 (which is not part of the reported actual results for the same period). Pro forma consolidated earnings exceed actual consolidated earnings because merger related costs were more than offset on a pro forma basis by NorAm's earnings for the nine month period.

RESULTS OF OPERATIONS BY BUSINESS SEGMENT

In order to reflect the changes in the Company's business resulting from the acquisition of NorAm, the Company has elected to present selected results of operations and operational data for each of the following business segments: Electric Operations, Natural Gas Distribution, Interstate Pipelines, Energy Marketing and Gathering, International and Corporate. The business and operations of each of these segments are described below.

Purchase related adjustments, including amortization of goodwill and the revaluation on a preliminary basis of the fair market value of certain NorAm assets and liabilities, have been recorded at the business segment level. All business segment data (other than data relating to Electric Operations) is presented on a pro forma basis as if the acquisition of NorAm had occurred on January 1, 1996 or 1997, as applicable. Although pro forma results of operations are not necessarily indicative of the combined results of operations that actually would have occurred had the acquisition occurred on such date, the Company believes that the presentation of pro forma data provides a more meaningful comparative standard for assessing changes in the Company's consolidated results of operations.

The following table presents on (i) an actual basis and (ii) a pro forma basis operating income for each of the Company's business segments for the three and nine month periods ended September 30, 1997 and 1996, as if the acquisition of NorAm had occurred as of January 1, 1997 or 1996, as applicable.

OPERATING INCOME (LOSS)
BY BUSINESS SEGMENT
(in millions)

	Actual Three Months Ended September 30, 1997	Actual Three Months Ended September 30, 1996	Pro Forma Three Months Ended September 30, 1997	Pro Forma Three Months Ended September 30, 1996
Electric Operations	$ 456.6	$ 438.9	$ 456.6	$ 438.9
Natural Gas Distribution	(6.2)		(14.6)	(21.1)
Interstate Pipelines	13.7		19.3	24.0
Energy Marketing and Gathering	5.1		0.2	6.8
International	6.4	3.3	5.6	2.5
Corporate	(12.9)	(1.1)	(34.4)	(1.0)
Total Consolidated	$ 462.7	$ 441.1	$ 432.7	$ 450.1

	Actual Nine Months Ended September 30, 1997	Actual Nine Months Ended September 30, 1996	Pro Forma Nine Months Ended September 30, 1997	Pro Forma Nine Months Ended September 30, 1996
Electric Operations	$ 883.4	$ 883.7	$ 883.4	$ 883.7
Natural Gas Distribution	(6.2)		92.8	95.3
Interstate Pipelines	13.7		77.1	72.9
Energy Marketing and Gathering	5.1		3.8	34.8
International	14.4	(19.6)	12.5	(21.8)
Corporate	(44.3)	(1.1)	(71.0)	(25.9)
Total Consolidated	$ 866.1	$ 863.0	$ 998.6	$ 1,039.0

ELECTRIC OPERATIONS

The Company's domestic electric operations are conducted under the name "Houston Lighting & Power Company," an unincorporated division of the Company (Electric Operations). Electric Operations provides electric generation, transmission, distribution and sales to approximately 1.6 million customers in a 5,000 square mile area on the Texas Gulf Coast, including Houston (the nation's fourth largest city). Electric Operations constitutes the Company's largest business unit, representing 106% and 88%, respectively, of the Company's consolidated pro forma operating income for the three month and nine month periods ended September 30, 1997.

The following table provides summary data regarding the results of operations of Electric Operations for the three and nine month periods ended September 30, 1997 and 1996. Results of operations data for Electric Operations are presented on an actual basis.

ACTUAL
RESULTS OF OPERATION
(in millions)

	Three Months Ended September 30, 1997	1996	Percent Change	Nine Months Ended September 30, 1997	1996	Percent Change
Base Revenues	$ 916.2	$ 855.0	7	$ 2 ,160.2	$ 2,150.2	--
Transmission Revenues	21.5		--	64.4		--
Reconcilable Fuel Revenues	449.6	375.3	20	1,062.2	992.0	7
Operating Expenses:						
Fuel and Purchased Power	465.6	391.3	19	1,111.6	1,041.9	7
Operation and Maintenance	245.9	206.7	19	690.4	637.6	8
Depreciation and Amortization	151.2	130.1	16	412.2	387.9	6
Other Taxes	68.0	63.3	7	189.2	191.1	(1)
Operating Income	$ 456.6	$ 438.9	4	$ 883.4	$ 883.7	--

OPERATIONS DATA

	Three Months Ended September 30, 1997	1996	Percent Change	Nine Months Ended September 30, 1997	1996	Percent Change
Electric Sales (MWH):						
Residential	7,633,159	6,520,694	17	15,557,785	15,297,424	2
Commercial	4,558,281	4,288,243	6	11,826,003	11,251,882	5
Industrial	7,837,044	8,047,587	(3)	22,574,240	22,481,860	--
Average Cost of Fuel (Cents/MMBtu)	190.9	180.9	6	184.2	184.7	--

In the third quarter of 1997, operating income for Electric Operations increased by $17.7 million over operating income for the third quarter of 1996. Operating income for the first nine months of 1997 decreased slightly from operating income for the same period in 1996. The increase in operating income for the quarter is due to warmer weather in the third quarter of 1997 over the same period in 1996 and steady customer growth. Partially offsetting these effects were increased operation and amortization expense, as described below. The decrease in operating income between the nine month period ended September 30, 1997, compared to the same period last year was due to milder weather and increased amortization expense, partially offset by customer growth and increased usage.

ELECTRIC OPERATIONS -- REVENUES

Total operating revenues for Electric Operations increased by $157.0 million during the three month period ended September 30, 1997, and increased by $144.6 million for the nine months ended September 30, 1997 compared to the same periods in 1996.

Base Revenues. Base revenues include electric sales (excluding fuel), miscellaneous revenues (excluding transmission revenue), certain non-reconcilable fuel, and certain purchased power related revenues. Base revenues increased $61.2 million for the third quarter of 1997 and $10.0 million for the first nine months of 1997 (7.2% and 0.5%, respectively) compared to the same periods of 1996. The third quarter increase was primarily due to warmer weather as compared to the same period in 1996 and steady customer growth. Base revenues between the two nine month periods were relatively constant due to the net effect of milder weather offset by steady customer growth, as mentioned above.

Transmission Revenues. Transmission revenues include revenues collected through a pricing and billing mechanism implemented by the Utility Commission for wholesale transmission services. During the three and nine month periods ended September 30, 1997, Electric Operations recorded $21.5 million in revenues (offset by $22.1 million in expenses) and $64.4 million in revenues (offset by $66.3 million in expenses) associated with wholesale transmission services, respectively. For additional information, see "-- Electric Operations--Expenses--Operation and Maintenance Expense" below and "Management's Discussion and Analysis of Financial Condition and Results of Operations--Certain Factors Affecting Future Earnings of the Company and HL&P--Competition--Competition in Wholesale Market" in the Company's Form 10-K.

Fuel Revenues. Fuel revenues include revenues generated by a fixed fuel factor established by the Utility Commission and included in electric rates to permit the Company to recover certain fuel and purchased power costs. The fixed fuel factor is established during general rate proceedings or periodic fuel factor proceedings. The fixed fuel factor is generally effective for a minimum of six months. Since reconcilable fuel revenues are adjusted monthly to equal expenses, fuel revenues and expenses have no effect on earnings unless the Utility Commission subsequently determines that a utility's fuel costs are not recoverable.

In 1997, the Company implemented (i) a $70 million temporary fuel surcharge (inclusive of interest) effective for the first six months of 1997 and (ii) a $62 million temporary fuel surcharge (inclusive of interest) effective for the last six months of 1997. In October 1997, HL&P filed with the Utility Commission a request to implement a $102 million temporary fuel surcharge, inclusive of interest, beginning in January 1998 and extending from 8 months to 16 months depending on the customer class. HL&P requested the surcharge in order to recover its under-recovery of fuel expenses for the period March 1997 through August 1997. Fuel surcharges have no effect on earnings. At September 30, 1997, the Company's cumulative under-recovery of fuel costs was $154 million. The adjusted over/under recovery of fuel costs is recorded on the Company's Balance Sheets as fuel-related credits or fuel-related debits. For information regarding the recovery of fuel costs, see "Business of HL&P--Fuel--Recovery of Fuel Costs" in Item 1 of the Company's Form 10-K.

ELECTRIC OPERATIONS -- EXPENSES

Fuel and Purchased Power Expense. Electric Operations' fuel expenses for the three and nine month periods ended September 30, 1997 increased $46.8 million and $14.9 million, respectively, compared with the same periods in 1996. The third quarter increase is the result of an increase in kilowatt-hour (KWH) sales due to warmer weather and an increase in the per unit cost of fuel. The increase for the nine month period ended September 30, 1997 is primarily the result of an increase in KWH sales.

Purchased power expense for the third quarter of 1997 increased $27.5 million compared with the same period in 1996. Purchased power expenses for the nine month period ended September 30, 1997 increased $54.8 million compared with the same period in 1996. The overall increase in purchased power expenses was in part due to greater energy sales and a planned refueling outage at the South Texas Project.

Operation and Maintenance Expense. Operation expense increased 11% for the third quarter of 1997 and remained constant for the nine months ended September 30, 1997, compared to the same period in 1996, excluding $22.1 million in the third quarter 1997 and $66.3 million in the nine months ended September 1997 due to transmission tariffs within the Electric Reliability Council of Texas. As discussed above, in the nine months ended September 30, 1997, the Company recorded $66.3 million of expenses which is substantially offset by $64.4 million of revenue associated with wholesale transmission services. These additional expenses do not reflect a significant increase in HL&P's cost of providing transmission service.

Maintenance expense remained constant for the third quarter of 1997 and decreased $15 million (8%) for the nine months ended September 30, 1997 compared to the same periods in 1996. The decrease is primarily due to two outages at solid fuel plants in 1996 compared to no corresponding outages in 1997. One outage is planned for the fourth quarter of 1997.

Depreciation and Amortization Expense. Depreciation and amortization expense increased in the third quarter and first nine months of 1997 when compared to the same period in 1996 primarily because of $19 million of additional amortization of the Company's investment in lignite reserves associated with a canceled generation project. For additional information regarding these expenses, see Note 3(a) to the Financial Statements included in the Company's Form 10-K.

NATURAL GAS DISTRIBUTION

The Company's domestic natural gas distribution operations are conducted by NorAm (through its Arkla, Entex and Minnegasco divisions) and are included in the Company's actual consolidated results of operations from August 6, 1997, the effective date of the Merger. These operations consist of natural gas sales to, and natural gas transportation for, residential, commercial and a limited number of industrial customers in six states: Arkansas, Louisiana, Minnesota, Mississippi, Oklahoma and Texas.

The following table provides summary data regarding the pro forma financial results of operations of the Natural Gas Distribution segment, including operating statistics, for the three and nine month periods ended September 30, 1997 and 1996. Results of operations data are presented on a pro forma basis as if the Merger had occurred as of January 1, 1996 and 1997, as applicable.

PRO FORMA
RESULTS OF OPERATIONS
(in millions)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	1997	1996	Percent Change	1997	1996	Percent Change
Operating Revenues	$ 272.2	$ 256.5	6.1	$1,490.0	$1,417.5	5.1
Operating Expenses	286.8	277.6	3.3	1,397.2	1,322.2	5.7
Operating Income (Loss)	$ (14.6)	$ (21.1)	30.8	$ 92.8	$ 95.3	(2.6)

OPERATIONS DATA
(in Bcf)

	Three Months Ended September 30, 1997	1996	Percent Change	Nine Months Ended September 30, 1997	1996	Percent Change
Residential and Commercial Sales	31.7	31.3	1.3	219.7	230.5	(4.7)
Industrial Sales	14.0	13.7	2.2	42.6	41.8	1.9
Transportation	8.9	9.5	(6.3)	30.8	32.5	(5.2)
Total Throughput	54.6	54.5	0.2	293.1	304.8	(3.8)

For the third quarter of 1997, Natural Gas Distribution pro forma operating loss was $14.6 million compared with a loss of $21.1 million for the same period in 1996. The approximately $6.5 million increase in operating income in 1997 reflects the impact of rate increases, a small increase in sales volume and reduced operating expenses. For additional information on rate increases, see "Management Analysis--Material Changes in the Results of Continuing Operations--Regulatory Matters" in NorAm's Form 10-K.

For the nine months ended September 30, 1997, Natural Gas Distribution had pro forma operating income of $92.8 million compared with $95.3 million for the same period in 1996. The approximately $2.5 million decrease (2.6%) in pro forma operating income was principally due to a weather-related decline in residential and commercial sales volumes and a small increase in 1997 operating expenses. These negative factors were partially offset by an increased 1997 average margin per unit of sales, principally due to rate increases in certain jurisdictions.

INTERSTATE PIPELINE

The Company's interstate natural gas pipeline operations (Interstate Pipeline) are conducted through NorAm Gas Transmission Company (NGT) and Mississippi River Transmission Corporation (MRT), two wholly owned subsidiaries of NorAm. The NGT system consists of approximately 6,200 miles of natural gas transmission lines located in portions of Arkansas, Louisiana, Mississippi, Missouri, Kansas, Oklahoma, Tennessee and Texas. The MRT system consists of approximately 2,000 miles of pipeline serving principally the greater St. Louis area in Missouri and Illinois. The results of operations of Interstate Pipeline are included in the Company's actual consolidated results of operations from August 6, 1997, the effective date of the Merger.

The following table provides summary data regarding the pro forma results of operations of the Interstate Pipeline segment, for the three and nine month periods ended September 30, 1997 and 1996. Results of operations data are presented on a pro forma basis as if the Merger had occurred as of January 1, 1996, and 1997, as applicable.

PRO FORMA
RESULTS OF OPERATIONS
(in millions)

	Three Months Ended September 30, 1997	Three Months Ended September 30, 1996	Percent Change	Nine Months Ended September 30, 1997	Nine Months Ended September 30, 1996	Percent Change
Operating Revenues	$ 68.9	$ 84.9	(18.9)	$ 225.7	$ 266.4	(15.2)
Operating Expenses	49.6	60.9	(18.6)	148.6	193.5	(23.2)
Operating Income	$ 19.3	$ 24.0	(19.6)	$ 77.1	$ 72.9	5.7

OPERATIONS DATA
(million MMBtu)

	Three Months Ended September 30, 1997	Three Months Ended September 30, 1996	Percent Change	Nine Months Ended September 30, 1997	Nine Months Ended September 30, 1996	Percent Change
Natural Gas Sales:	4.4	7.7	(42.9)	13.8	28.0	(50.7)
Transportation:	205.3	198.4	3.5	667.2	714.2	(6.6)
Elimination	(4.2)	(7.3)	42.5	(12.9)	(26.4)	51.1
Total Throughput	205.5	198.8	3.4	668.1	715.8	(6.7)

Interstate Pipeline pro forma operating income for the third quarter of 1997 was $19.3 million compared with $24 million for the same period in 1996. The approximately $4.7 million decrease (19.6%) in pro forma operating income is primarily attributable to a decline in operating margins due to (i) the elimination of margins on sales by Interstate Pipeline to Natural Gas Distribution and (ii) a combination of lower electric generation load and reductions in price differentials between Gulf Coast and Mid-Continent gas supplies. The reduction in price differentials had the effect of increasing competitive pressures on transportation rates thereby reducing the average transportation margin.

The increase of approximately $4.2 million (5.7%) in pro forma Interstate Pipeline's operating income (before the charge for early retirement and severance) for the nine months ended September 30, 1997 in comparison to the corresponding period of 1996 was principally due to reduced 1997 operating expenses associated with cost reduction initiatives implemented in first quarter 1996, together with the 1996 incurrence of certain consulting and other non-recurring costs associated with these initiatives. Operating margins declined only modestly because (i) current year transportation revenues for Natural Gas Distribution are at higher rates due to removal in late 1996 of a rate cap and (ii) declines in transportation volume have a less than proportional impact on margins due to Interstate Pipeline's rate design. For additional information, see "Management Analysis--Material Changes in the Results of Continuing Operations--Interstate Pipeline" in NorAm's Form 10-K.

ENERGY MARKETING AND GATHERING

The Company's Energy Marketing and Gathering segment (Energy Marketing) includes the operations of the Company's wholesale and retail energy marketing businesses (conducted, respectively, by NorAm Energy Services, Inc. (NES) and NorAm Energy Management, Inc.) and natural gas gathering activities (conducted by NorAm Field Services Corp.).

The following table provides summary data regarding the pro forma results of operations of the Energy Marketing segment, including operating statistics, for the three and nine month periods ended September 30, 1997 and 1996. Results of operations data are presented on a pro forma basis as if the Merger had occurred as of January 1, 1997 and 1996, as applicable.

PRO FORMA
RESULTS OF OPERATIONS
(in millions)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	1997	1996	Percent Change	1997	1996	Percent Change
Operating Revenues	$ 842.0	$ 636.3	32.3	$ 2,535.3	$ 1,835.6	38.1
Operating Expenses	841.8	629.5	33.7	2,531.5	1,800.8	40.6
Operating Income	$ 0.2	$ 6.8	(97.1)	$ 3.8	$ 34.8	(89.1)

OPERATIONS DATA
(in Bcf)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	1997	1996	Percent Change	1997	1996	Percent Change
Natural Gas Sales Volume	266.8	264.3	.9	846.0	749.8	12.8
Transportation Volumes	4.9	5.0	(2.0)	17.3	19.7	(12.2)
Gathering Volumes	59.6	58.0	2.8	181.5	170.0	6.8
Total	331.3	327.3	1.2	1,044.8	939.5	11.2

For the third quarter of 1997, Energy Marketing pro forma operating income was $0.2 million compared with $6.8 million for the same period in 1996. The approximately $6.6 million decrease was primarily due to decreased margins and increased general and administrative costs associated with increased staffing levels.

Energy Marketing's pro forma operating income for the nine months ended September 30, 1997 decreased approximately $31.0 million compared with the same period in 1996. The decrease was principally due to (i) hedging losses associated with anticipated first-quarter 1997 sales under peaking contracts and (ii) losses from the sale of natural gas held in storage and unhedged in the first quarter of 1997 for a total of $17.4 million. For additional information, see "Management Analysis--Material Changes in the Results of Continuing Operations--Wholesale Energy Marketing" in NorAm's Form 10-K. In addition, Energy Marketing's general and administrative expenses for 1997 increased by approximately $8 million primarily due to increased staffing and marketing activities. Partially offsetting these unfavorable impacts were increased margins from natural gas gathering and products extraction activities.

INTERNATIONAL

The Company's international business segment (International) principally includes the results of operations of Houston Industries Energy, Inc. (HI Energy), a wholly owned subsidiary of the Company that participates in the development and acquisition of foreign independent power projects and the privatization of foreign generation and distribution facilities, and the international operations of Former NorAm.

The following table provides summary data regarding the results of operations of International for the three and nine month periods ended September 30, 1997 and 1996. Results of operations data for International are presented on a pro forma basis as if the Merger had occurred as of January 1, 1997 and 1996, as applicable.

PRO FORMA
RESULTS OF OPERATIONS
(in millions)

	Three Months Ended September 30,			Nine Months Ended September 30,		
	1997	1996	Percent Change	1997	1996	Percent Change
Equity Earnings	11.5	6.0	92	29.5	6.4	361
Operating Income (Loss)	5.6	2.5	124	12.5	(21.8)	--
Net Income (Loss)	7.2	3.9	85	13.3	(8.4)	--

During the third quarter and first nine months of 1997, International's pro forma operating income was $5.6 million and $12.5 million, respectively, compared to $2.5 million and a loss of $21.8 million in the same periods in 1996. Operating losses for the first nine months of 1996 included pre-tax non-recurring charges of approximately $8 million associated with an investment in two tire-to-energy plants in Illinois. Excluding non-recurring charges, International's losses for the first nine months of 1996 would have been $13.8 million. The increase in operating income is due primarily to increased equity earnings from entities in which HI Energy owns an interest.

Excluding the 1996 after-tax non-recurring charges related to the tire-to-energy plant ($5 million), the increase in net income compared to operating income each period is due to tax benefits related to International's corporate expenses.

As of September 30, 1997, HI Energy's consolidated debt equaled $167.5 million. Substantially all of the debt is non-recourse to the Company and limited recourse to HI Energy.

As disclosed in the Company's Form 10-K, HI Energy had expected to complete development in late 1997 of a 160 MW cogeneration facility in Argentina. The estimated cost of completion of the project was $100 million. In October 1997, certain components that comprise the generating unit for this project suffered extensive damage during testing. Based on current information, the delay in the commercial operation date for the project could be substantial. However, it is not anticipated that such delay will have a material adverse financial impact on HI Energy because payments due from the construction consortium pursuant to the construction contract relating to this project are expected to offset the cost of liquidated damages owed by HI Energy to the host plant and the project fuel supplier.

CORPORATE

Corporate. The Company's Corporate and other business segment (Corporate) includes the operations of HI Power Generation, Inc., which is engaged in the development and operation of domestic power generation projects (HIPG), the Company's unregulated retail electric services business, certain real estate investments, corporate costs, and inter-unit eliminations.

Corporate pro forma operating loss increased by $33.4 million and $45.1 million for the third quarter and nine months ended September 30, 1997, respectively, as compared to the same two periods in 1996. The increase in operating losses for the third quarter ended September 30, 1997 as compared to the same period last year was primarily due to merger related expenses incurred by NorAm which were not capitalized and development costs associated with the Company's utility services business; consumer services business; unregulated retail electric services business; and expenses related to the development and operation of domestic power generation projects. The increase in operating losses for the nine months ended September 30, 1997 as compared to the same period in 1996 was due to the same factors that affected the third quarter results. In addition, pre-tax operating expenses increased $19 million due to the establishment of a charitable foundation formed to fund certain charitable activities previously funded by the Company.

HIPG. HIPG was formed in March 1997 to pursue the acquisition of domestic electric generation assets as well as the development of new domestic independent power generation facilities. Since its formation, HIPG has participated in a number of sales of utility generation plants that have been conducted in connection with various state initiatives to restructure the electric utility industry. HIPG expects to spend approximately $200 to $260 million in 1997 pursuant to commitments entered into with respect to bids previously awarded to HIPG and bids previously submitted by HIPG but pending award. The bulk of this amount relates to bids already awarded to HIPG. The Company expects that HIPG will continue to participate in a number of future sales of generation assets. Depending on the timing and success of HIPG's future bidding efforts, expenditures resulting from these sales could be significant.

HIPG is also participating in the development of several independent power generation facilities, including, among others, the El Dorado Project located in Boulder City, Nevada (El Dorado Project). The El Dorado Project is an approximately 450 megawatt gas-fired power plant. Upon completion of construction and subject to the successful negotiation of various project development agreements, it is expected that the output of the El Dorado Project will be sold on the wholesale market. The El Dorado Project is being developed jointly with Enova Corp., the parent company of San Diego Gas & Electric Co. Based on current information, it is anticipated that HIPG will spend approximately $12 million in 1997 in connection with the El Dorado Project.

The Company believes that HIPG's efforts to develop or acquire generation assets will complement its other operations, including the trading and marketing activities of NES. For example, it is currently anticipated that NES will supply approximately 50% of the gas requirements of the El Dorado Project and will purchase approximately 50% of the electric output of the project.

The Company's estimates regarding HIPG expenditures are forward-looking statements and are based on numerous assumptions, some of which may prove to be incorrect. HIPG's actual capital requirements could vary because of changes in economic conditions, changes in governmental regulations and other factors. Although it is HIPG's intent to seek project financing where possible to fund its projects there can be no assurance given concerning the cost, amount and availability of such funding sources.

LIQUIDITY AND CAPITAL RESOURCES

The Company generated $947 million in cash flow from operations during the nine month period ended September 30, 1997. Substantially all of this cash flow was produced from $425 million of income from continuing operations and $447 million of depreciation and amortization expense. The Company used this cash flow to reinvest in its existing businesses, to meet its dividend requirements and to contribute to the financing of business expansion.

Overall, the Company's cash flow from operating activities in the nine month period ended September 30, 1997 exceeded its cash flow from non-acquisition investing activities by $781 million. With respect to acquisition activities, the Company invested $1.4 billion of cash in the acquisition of NorAm and $215 million of cash in non-regulated electric power project expenditures and advances during the nine month period ended September 30, 1997.

During the nine months ended September 30, 1997, the Company's financing activities included the issuance of $1.052 billion aggregate face amount of ACE Securities ($1.021 billion net of issuance costs). The Company used the proceeds of the sale of the ACE Securities for general corporate purposes, including the retirement of an equivalent amount of then outstanding Former HI commercial paper. For additional information regarding the ACE Securities, see Note 5(c) to the Interim Financial Statements.

In August 1997, FinanceCo, a limited partnership subsidiary of the Company, entered into the FinanceCo Facility, a five-year, $1.6 billion revolving credit facility. At September 30, 1997, the FinanceCo Facility supported $1.3 billion in commercial paper borrowings having a weighted average interest rate of 5.91%. Proceeds from the initial issuances of commercial paper by FinanceCo were used to fund the cash portion of the consideration paid to stockholders of Former NorAm under the terms of the Merger. For additional information regarding the FinanceCo Facility, see Note 5(b) to the Interim Financial Statements.

At September 30, 1997, the Company, exclusive of subsidiaries, had a revolving credit facility of $200 million with no borrowings outstanding. In addition, at September 30, 1997, the Company had shelf registration statements providing for the future issuance, subject to market and other conditions, of $230 million aggregate liquidation value of its preferred stock and $580 million aggregate principal amount of its debt securities.

At September 30, 1997, NorAm had (i) a $400 million revolving credit facility under which loans of $135 million were outstanding, (ii) uncommitted lines of credit under which loans of $45 million were outstanding, (iii) a trade receivables facility of $300 million under which receivables of $295 million have been sold and (iv) a shelf registration statement providing for the future issuance of debt and equity securities of up to $213.9 million.

For information regarding the Company's maturing long-term debt (including NorAm's long-term debt), see Note 5 to the Interim Financial Statements.

The Company believes that its current level of cash and borrowing capability along with future cash flows from operations are sufficient to meet the needs of its existing businesses. However, to achieve its objectives, the Company may, when necessary, supplement its available cash resources by seeking funds in the equity or debt markets.

The Company is currently evaluating its computer and software requirements in light of changes in the electric utility and energy services industries and the acquisition of NorAm and resulting expansions of the Company into energy trading activities. The Company is also evaluating various alternatives intended to permit its existing computer programs to accommodate the year 2000 and beyond, currently estimated to cost approximately $15 million. In September 1997, the Company entered into an agreement with SAP America, Inc. (SAP) to license SAP's proprietary R/3 enterprise software. The licensed software includes financial and accounting, human resources, materials management and service delivery components. Based on the current timetable for completion of the SAP implementation and integration project (Project), the Company estimates that the third party cost of the Project will be approximately $95 million (including software license fees, fees for consulting and other services and hardware acquisition costs). It is currently projected that these costs would be incurred over a three-year period. The Company is also considering installing a customer information system offered by SAP.

CERTAIN FACTORS AFFECTING FUTURE EARNINGS

For information on developments, factors, and trends that may have an impact on the Company's future earnings, reference is made to (i) Item 7 of the Company's Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations--The Merger" and"--Certain Factors Affecting Future Earnings of the Company and HL&P," Item 2 of the Company's First Quarter 10-Q, "Management's Discussion and Analysis of Financial Condition and Results of Operations--Recent Developments" and (ii) Item 7 of NorAm's Form 10-K "Management Analysis--Commitments and Contingencies."

RATE MATTERS

ELECTRIC OPERATIONS. The Utility Commission has jurisdiction (or, in some cases, appellate jurisdiction) over the electric rates of the Company's Electric Operations Division (also known as HL&P) and as such monitors HL&P's earnings to ensure that HL&P is not earning in excess of its permitted rate of return.

In October, 1997, HL&P announced a proposed transition plan and price reduction plan relating to retail access to electric services for its customers (Transition Plan).

Subject to the approval of the Transition Plan, HL&P would agree to support legislation providing (i) retail customer choice effective December 31, 2001; (ii) customer safeguards and rate reductions effective January 1, 2000 and January 1, 2001; and (iii) securitization and stranded cost determination and recovery provisions on terms substantially similar to those contained in the final bill on electric deregulation as considered in the 1997 Texas legislative session.

In addition, HL&P has proposed (i) granting residential customers a base rate reduction of 4% effective January 1, 1998, with an additional 2% base reduction effective January 1, 1999; (ii) granting commercial and small industrial customers a base rate reduction of 2% effective January 1, 1998; and (iii) implementing, subject to certain force majeure events, a freeze on HL&P's retail and wholesale base rate tariffs (excluding fuel and purchased power cost recovery). The rate freeze and rate credits would extend through the earlier of December 31, 1999 or the effective date of certain legislative or regulatory action resulting in amendments to Title 2 of the Utilities Code or HL&P's rates (Rate Freeze Period).

During the Rate Freeze Period, HL&P's overall regulated rate of return on invested capital would not exceed 10.03%. Any return above 10.03% would be applied to reduce potentially stranded costs. In addition, HL&P would be allowed to redirect depreciation expense from transmission and distribution investments to generation production investments.

The Transition Plan would be subject to the approval of the Utility Commission upon the plan's formal submission to the Commission. At present, the Company cannot predict what action the Utility Commission would take once the Transition Plan is submitted for approval or the ultimate terms that such plan might contain.

NorAm. A substantial portion of NorAm's earnings are derived from operations, such as Natural Gas Distribution and Interstate Pipeline, that are subject to state and federal rate regulation. For information regarding these and other regulations affecting NorAm and its subsidiaries, see "Management Analysis--Material Changes in the Results of Continuing Operations--Regulatory Matters" in NorAm's Form 10-K.

ACCOUNTING TREATMENT OF ACE SECURITIES

The Company accounts for its investment in Time Warner Convertible Preferred Stock under the cost method. As a result of the Company's issuance of the ACE Securities, certain increases in the market value of Time Warner common stock (the security into which the Time Warner Convertible Preferred Stock is convertible) could result in an accounting loss to the Company, pending the conversion of the Company's Time Warner Convertible Preferred Stock into Time Warner common stock.

If, prior to the conversion of the Time Warner Convertible Preferred Stock into Time Warner common stock, the market price of Time Warner common stock were to increase above $55.5844, the Company would record in Other Income (Expense) an accounting loss equal to (i) the aggregate amount of such increase as applicable to all ACE Securities multiplied by (ii) 0.8264. In accordance with generally accepted accounting principles, this accounting loss (which reflects the unrealized increase in the Company's indebtedness with respect to the ACE Securities) may not be offset by accounting recognition of the increase in the market price of the Time Warner common stock. Upon conversion of the Time Warner Convertible Preferred Stock, the Company would begin recording unrealized net changes in the market prices of the Time Warner common stock and the ACE Securities as a component of common stock equity.

If as of September 30, 1997, the market price of Time Warner common stock had been $57 11/16 (the closing market price of Time Warner common stock on October 31, 1997), the liability for the ACE Securities would have increased by approximately $40 million. This unrealized loss for the ACE Securities is more than economically hedged by the approximately $330 million unrecorded unrealized gain relating to the increase in the fair value of the Time Warner common stock underlying the investment in Time Warner Convertible Preferred Stock on the date of its acquisition.

NEW ACCOUNTING ISSUES

The Financial Accounting Standards Board recently issued SFAS No. 130, "Reporting Comprehensive Income" and SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" effective for financial statements issued for periods beginning after December 15, 1997. SFAS No. 130 requires that all items that meet the definition of a component of comprehensive income be reported in a financial statement for the period in which they are recognized and the total amount of comprehensive income be prominently displayed in that same financial statement. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Currently, the Company does not have any material items which require reporting of comprehensive income. SFAS No. 131 requires that companies report financial and descriptive information about reportable operating segments in financial statements. Segment information to be reported is to be based upon the way management organizes the segments for making operating decisions and assessing performance. The Company will adopt SFAS No. 130 and SFAS No. 131 beginning the first quarter of 1998.

For information regarding SFAS No. 128, "Earnings Per Share," which will be effective for the Company's 1997 fiscal year, see Note 4(b) to the Interim Financial Statements and Note 5 in the First Quarter 10-Q.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS.

Not Applicable.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting the Company and its subsidiaries, including NorAm and HI Energy, reference is made to the information set forth in the following items and notes:

With respect to the Company, Item 3 of the Company's Form 10-K and Notes 2(b), 3, 10 and 11(c) to the financial statements in the Company's Form 10-K, which information, as qualified and updated by the description of developments in regulatory and litigation matters contained in Note 8 to the financial statements in the Company's First Quarter Form 10-Q, Note 7 to the financial statements in the Company's Second Quarter Form 10-Q and Note 8 to the Interim Financial Statements in this Form 10-Q, is incorporated herein by reference.

With respect to NorAm and its subsidiaries, Item 3 of NorAm's Form 10-K, "Management Analysis--Material Changes in the Results of Continuing Operations--Regulatory Matters" in Item 7 of NorAm's Form 10-K and Note 7 to the financial statements in NorAm's Form 10-K, which information, as qualified and updated by the description of developments in regulatory and litigation matters contained in Notes G and H to the financial statements in NorAm's First Quarter Form 10-Q and Notes K and L to the financial statements in NorAm's Second Quarter Form 10-Q, is incorporated herein by reference.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits. (Exhibits designated by an asterisk (*) are incorporated herein by reference to a separate filing as indicated.)

Houston Industries Incorporated:

Exhibit 11 -	Computation of Earnings per Common Share and Common Equivalent Share.
Exhibit 27 -	Financial Data Schedule.
Exhibit 99(a)-	Notes 1-4, 10 and 11 to the Financial Statements included on pages 60-66 and 74-77 of the Company's Form 10-K and Item 3 included on page 21 of the Company's Form 10-K.
Exhibit 99(b)-	Note 8 to the Financial Statements included on pages 16 and 17 of the Company's First Quarter Form 10-Q.
Exhibit 99(c)-	Note 7 to the Financial Statements included on pages 15 and 16 of the Company's Second Quarter Form 10-Q.
Exhibit 99(d)-	Notes 1 and 7 to the Financial Statements included on pages 64-69 and 83-88 of NorAm's Form 10-K (File No. 1-3751), Item 3 included on page 14 of NorAm's Form 10-K and "Item 7. Management Analysis--Material Changes in the Results of Continuing Operations--Regulatory Matters" included on

pages 22-24 of NorAm's Form 10-K.

Exhibit 99(e)- Notes G and H to the Financial Statements included on pages 11 and 12 of NorAm's First Quarter Form 10-Q.

Exhibit 99(f)- Notes K and L to the Financial Statements included on pages 12-14 of NorAm's Second Quarter Form 10-Q.

(b) Reports on Form 8-K.

Report on Form 8-K of the Company and Former HI dated August 6, 1997 relating to the acquisition of NorAm (Item 2).

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HOUSTON INDUSTRIES INCORPORATED
(Registrant)

/s/ Mary P. Ricciardello

Mary P. Ricciardello
Vice President and Comptroller
(Principal Accounting Officer)

Date: November 14, 1997

INDEX TO EXHIBITS

Exhibit 11 -	Computation of Earnings per Common Share and Common Equivalent Share.
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Exhibit 99(c)-	Note 7 to the Financial Statements included on pages 15 and 16 of the Company's Second Quarter Form 10-Q.
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Exhibit 99(f)-	Notes K and L to the Financial Statements included on pages 12-14 of NorAm's Second Quarter Form 10-Q.

Exhibit 11

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

COMPUTATION OF EARNINGS PER COMMON SHARE
AND COMMON EQUIVALENT SHARE
(THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	1997	1996	1997	1996
Primary Earnings Per Share:				
(1) Weighted average shares of common stock outstanding..................	263,373	245,889	243,769	247,664
(2) Effect of issuance of shares from assumed exercise of stock options (treasury stock method)......	196	19	206	24
(3) Weighted average shares....................	263,569	245,908	243,975	247,688
(4) Net income................................	$ 243,898	$ 240,024	$ 424,981	$ 368,618
(5) Primary earnings per share (line 4/line 3)............................	$ 0.93	$ 0.98	$ 1.74	$ 1.49
Fully Diluted Earnings Per Share:				
(6) Weighted average shares per computation on line 3 above................	263,569	245,908	243,975	247,688
(7) Shares applicable to options included on line 2 above...................	(196)	(19)	(206)	(24)
(8) Dilutive effect of stock options based on the average price for the period or quarter-end price, whichever is higher, of $21.75 and $22.63 for the third quarter of 1997 and 1996, respectively, and $21.75 and $22.88 for the first nine months of 1997 and 1996, respectively (treasury stock method)....................	215	19	215	24
(9) Effect of issuance of shares from assumed conversion of debentures...........	946		946	
(10) Fully diluted weighted average shares....................	264,534	245,908	244,930	247,688
(11) Net income................................	$ 243,898	$ 240,024	$ 424,981	$ 368,618
(12) Add: Interest on Bonds, net tax...........	310		930	
(13) Fully diluted net income..................	$ 244,208	$ 240,024	$ 425,911	$ 368,618
(14) Fully diluted earnings per share (line 13/line 10)....................	$ 0.92	$ 0.98	$ 1.74	$ 1.49

Notes:

These calculations are submitted in accordance with Regulation S-K item 601(b) (11) although it is not required for financial presentation disclosure per footnote 2 to paragraph 14 of Accounting Principles Board (APB) Opinion No. 15 because it does not meet the 3% dilutive test.

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE
COMPANY'S FINANCIAL STATEMENTS AND IS QUALIFIED IN ITS ENTIRETY BY
REFERENCE TO SUCH FINANCIAL STATEMENTS.

1,000

9-MOS
DEC-31-1997
JUL-01-1997
SEP-30-1997
PRO-FORMA
11,188,741
1,805,383
1,061,638
3,958,057
0
18,013,819
2,866,139
0
2,141,326
5,007,465
0
9,740
5,353,390
0
475,000
1,288,313
189,240
0
15,936
1,145
5,673,590
18,013,819
4,101,100
197,249
3,235,035
3,235,035
866,065
44,659
910,724
286,175
427,300
2,319
424,981
281,145
164,066
946,500
1.74
1.74

Total annual interest charges on all bonds for year-to-date September 30, 1997.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE THREE YEARS ENDED DECEMBER 31, 1996

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) PRINCIPLES OF CONSOLIDATION. The consolidated financial statements include the accounts of the Company and its wholly owned and majority owned subsidiaries. Certain investments in joint ventures or other entities in which the Company or its subsidiaries have a 50 percent or less interest are recorded using the equity method or the cost method. For additional information regarding investments and advances, see Notes 1(j) and 4.

All significant intercompany transactions and balances are eliminated in consolidation.

(b) SYSTEM OF ACCOUNTS AND EFFECTS OF REGULATION. HL&P, the principal subsidiary of the Company, maintains its accounting records in accordance with the FERC Uniform System of Accounts. HL&P's accounting practices are subject to regulation by the Utility Commission, which has adopted the FERC Uniform System of Accounts.

As a result of its regulated status, HL&P follows the accounting policies set forth in SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," which allows a utility with cost-based rates to defer certain costs in concert with rate recovery that would otherwise be expensed. In accordance with this statement, HL&P has deferred certain costs pursuant to rate actions of the Utility Commission and is recovering or expects to recover such costs in electric rates charged to customers. The regulatory assets are included in other assets on the Company's Consolidated and HL&P's Balance Sheets. The regulatory liabilities are included in deferred credits on the Company's Consolidated and HL&P's Balance Sheets. The following is a list of significant regulatory assets and liabilities reflected on the Company's Consolidated and HL&P's Balance Sheets:

	December 31, 1996 (Millions of Dollars)
Deferred plant costs - net	$ 587
Malakoff and Trinity mine investments	164
Regulatory tax asset - net	362
Unamortized loss on reacquired debt	116
Deferred debits	102
Unamortized investment tax credit	(374)
Accumulated deferred income taxes-regulatory tax asset	(101)

If, as a result of changes in regulation or competition, HL&P's ability to recover these assets and/or liabilities would not be assured, then pursuant to SFAS Nos. 71, 101 (Accounting for the Discontinuation of Application of SFAS No. 71) and 121 (Accounting for the Impairment of Long- Lived Assets and for Long-Lived Assets to be Disposed of) and to the extent that such regulatory assets or liabilities ultimately were determined not to be recoverable, HL&P would be required to write off or write down such assets or liabilities.

(c) ELECTRIC PLANT. HL&P capitalizes at cost all additions to electric plant, betterments to existing property and replacements of units of property. Cost includes the original cost of contracted services, direct labor and material, indirect charges for engineering supervision and similar overhead items and AFUDC. AFUDC represents the estimated debt and equity cost of funds used to finance construction. Customer payments for construction reduce additions to electric plant.

HL&P computes depreciation using the straight-line method. The depreciation provision as a percentage of the depreciable cost of plant was 3.2 percent for 1994 through 1996.

(d) DEFERRED PLANT COSTS. Under a "deferred accounting" plan authorized by the Utility Commission, HL&P was permitted for regulatory purposes to accrue carrying costs in the form of AFUDC on its investment in the South Texas Project and defer and capitalize depreciation and other operating costs on its investment after commercial operation until such costs were reflected in rates. In addition, the Utility Commission authorized HL&P under a "qualified phase-in plan" to capitalize allowable costs (including return) deferred for future recovery as deferred charges.

In 1991, HL&P ceased all cost deferrals related to the South Texas Project and began amortizing such amounts on a straight-line basis. The accumulated deferrals for "deferred accounting" are being amortized over the estimated depreciable life of the South Texas Project. The accumulated deferrals for the "qualified phase-in plan" are being amortized over a ten-year phase-in period that commenced in 1991. The amortization of all deferred plant costs (which totaled $25.8 million for each of the years 1996, 1995 and 1994) is included on the Company's Statements of Consolidated Income and HL&P's Statements of Income as depreciation and amortization expense.

(e) REVENUES. HL&P records electricity sales under the full accrual method, whereby unbilled electricity sales are estimated and recorded each month. Other revenues include electricity sales of a majority owned foreign electric utility, which are also recorded under the full accrual method and the Company's equity income in unconsolidated investments of HI Energy. Also included in other revenues are management fees and other sales and services, which are recorded when earned.

(f) INCOME TAXES. The Company and its subsidiaries file a consolidated federal income tax return. The Company follows a policy of comprehensive interperiod income tax allocation. Investment tax credits were deferred and are being amortized over the estimated lives of the related property.

(g) EARNINGS PER COMMON SHARE. Earnings per common share for the Company are computed by dividing net income by the weighted average number of shares outstanding during the respective period. All earnings per common share amounts reflect the two-for-one common stock split effected in the form of a stock distribution on December 9, 1995.

(h) STATEMENTS OF CONSOLIDATED CASH FLOWS. For purposes of reporting cash flows, cash equivalents are considered to be short-term, highly liquid investments readily convertible to cash.

(i) DISCONTINUED OPERATIONS. In July 1995, the Company sold KBLCOM, its cable television subsidiary. The operations of KBLCOM are reflected as discontinued operations for all periods presented. See Note 13.

(j) INVESTMENTS IN DEBT AND EQUITY SECURITIES. The Company owns one million shares of Time Warner common stock and 11 million shares of non-publicly traded Time Warner convertible preferred stock. The Company has recorded its investment in these securities at a combined value of approximately $1 billion on the Company's Consolidated Balance Sheets. Investment in the Time Warner common stock is considered an "available-for-sale" equity security under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Consequently, the Company excludes unrealized net changes in the fair value of Time Warner common stock (exclusive of dividends and write downs) from earnings and, until realized, reports such changes as a net amount in the shareholders' equity section of the Company's Consolidated Balance Sheets. Investment in the Time Warner convertible preferred stock (which is not subject to the requirements of SFAS No. 115, since it is a non-publicly traded equity security) is accounted for under the cost method.

The securities held in the Company's nuclear decommissioning trust are classified as "available-for-sale" and, in accordance with SFAS No. 115, are reported at estimated fair value of $67 million as of December 31, 1996 and $44.5 million as of December 31, 1995 on the Company's Consolidated and HL&P's Balance Sheets under deferred debits. The liability for nuclear decommissioning is reported on the Company's Consolidated and HL&P's Balance Sheets under deferred credits. Any unrealized gains or losses are accounted for in accordance with SFAS No. 71 as a regulatory asset/liability and reported on the Company's Consolidated and HL&P's Balance Sheets as a deferred debit.

(k) FUEL STOCK. Gas inventory (at average cost) was $19.6 million at December 31, 1996. Coal, lignite, and oil inventory balances (using last-in, first-out) were $27.3 million, $11.8 million and $3.0 million, respectively.

(l) DEPRECIATION. The Company and HL&P compute depreciation using the straight-line method. The Company's depreciation expense for 1996 was $360 million compared to $349 million and $338 million for 1995 and 1994, respectively. HL&P's depreciation expense for 1996 was $358 million compared to $347 million and $338 million for 1995 and 1994, respectively.

(m) RECLASSIFICATION. Certain amounts from the previous years have been reclassified to conform to the 1996 presentation of financial statements. Such reclassifications do not affect earnings.

(n) NATURE OF OPERATIONS. The Company is a holding company operating principally in the electric utility business. HL&P is engaged in the generation, transmission, distribution and sale of electric energy. HL&P's service area covers a 5,000 square mile area in the Texas Gulf Coast, including Houston. Another subsidiary of the Company, HI Energy, participates in domestic and foreign power generation projects and invests in the privatization of foreign electric utilities. The business and operations of HL&P account for substantially all of the Company's income from continuing operations and common stock equity. For a description of the Merger, see Note 16 to the Financial Statements.

(o) USE OF ESTIMATES. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(p) LONG-LIVED ASSETS. Effective January 1, 1996, the Company and HL&P adopted SFAS No. 121. SFAS No. 121 requires that long-lived assets and certain identifiable intangibles to be held and used or disposed of by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company and HL&P have determined that no impairment loss need be recognized for applicable assets of continuing operations as of December 31, 1996. This conclusion, however, may change in the future as competition influences wholesale and retail pricing in the electric utility industry.

(2) JOINTLY-OWNED NUCLEAR PLANT

(a) HL&P INVESTMENT. HL&P is the project manager (and one of four co-owners) of the South Texas Project, which consists of two 1,250 MW nuclear generating units. HL&P has a 30.8 percent interest in the project and bears a corresponding share of capital and operating costs associated with the project. As of December 31, 1996, HL&P's investment in the South Texas Project was $2.0 billion (net of $503 million accumulated depreciation). HL&P's investment in nuclear fuel (including AFUDC) was $65 million (net of $176 million amortization) as of such date.

(b) REGULATORY PROCEEDINGS AND LITIGATION. All litigation and arbitration claims formerly pending between HL&P and the other co-owners of the South Texas Project have been settled and dismissed with prejudice.

On April 30, 1996, HL&P and the City of Austin (Austin), one of the four co-owners of the South Texas Project, agreed to settle a lawsuit in which Austin had alleged that outages occurring at the South Texas Project between early 1993 and early 1994 were due to HL&P's failure to perform certain obligations it owed Austin under a Participation Agreement relating to the project. Under the settlement, HL&P agreed to pay Austin $20 million in cash to resolve all pending disputes between HL&P and Austin, and Austin agreed to support the formation of a new operating company to assume HL&P's role as project manager for the South Texas Project. The Company and HL&P have recorded the $20 million ($13 million net of tax) payment to Austin on the Company's Statements of Consolidated Income and HL&P's Statements of Income as litigation settlements expense.

In July 1996, HL&P and the City of San Antonio, acting through the City Public Service Board of San Antonio (CPS), entered into a settlement agreement providing, among other things, for (i) the dismissal with prejudice of all pending arbitration claims and lawsuits between HL&P and CPS relating to the South Texas Project, (ii) a cash payment by HL&P to CPS of $75 million, (iii) an agreement to support formation of a new operating company to replace HL&P as project manager for the South Texas Project and (iv) the execution of a 10-year joint operations agreement under which HL&P and CPS will share savings resulting from the joint dispatching of their respective generating assets in order to take advantage of each system's lower cost resources. Under the terms of the joint operations agreement entered into between CPS and HL&P, HL&P guarantees CPS minimum annual savings of $10 million and a minimum cumulative savings of $150 million over the ten-year term of the agreement. Based on current forecasts and other assumptions regarding the combined operation of the two generating systems, HL&P anticipates that the savings resulting from joint operations will equal or exceed the minimum savings guaranteed under the joint operating agreement. In 1996, savings generated for CPS' account for a partial year of joint operations were approximately $14 million.

The operating company (OPCO) which is being formed to replace HL&P as project manager of the South Texas Project will be a Texas non-profit corporation. Regulatory and governmental approvals are being sought for the implementation of OPCO. Once this process is completed, HL&P's employees working at the South Texas Project will become employees of OPCO and OPCO will assume responsibility for managing the South Texas Project. Oversight will be provided by an Owners' Committee and OPCO's board of directors, under the direction of directors appointed by each of the co-owners.

In 1996, the capability factor at the South Texas Project improved to 93.9 percent from 87.7 percent in 1995 (the 1995 median capability factor for U.S. nuclear facilities was 75.9 percent).

In 1996, the Nuclear Regulatory Commission (NRC) graded the South Texas Project "superior" in the areas of maintenance and support and "good" in areas of operations and engineering in the NRC's most recent Systematic Assessment of Licensees Performance. Between June 1993 and February 1995, the South Texas Project had been listed on the NRC's "watch list" of plants with weaknesses that warrant increased NRC regulatory attention.

(c) NUCLEAR INSURANCE. HL&P and the other owners of the South Texas Project maintain nuclear property and nuclear liability insurance coverage as required by law and periodically review available limits and coverage for additional protection. The owners of the South Texas Project currently maintain $2.75 billion in property damage insurance coverage, which is above the legally required minimum, but is less than the total amount of insurance currently available for such losses. This coverage consists of $500 million in primary property damage insurance and excess property insurance in the amount of $2.25 billion. Under the excess property insurance (which became effective in November 1996), HL&P and the other owners of the South Texas Project are subject to assessments, the maximum aggregate assessment under current policies being $14.8 million during any one policy year. The application of the proceeds of such property insurance is subject to the priorities established by the NRC regulations relating to the safety of licensed reactors and decontamination operations.

Pursuant to the Price Anderson Act (Act), the maximum liability to the public of owners of nuclear power plants, such as the South Texas Project, was $8.92 billion as of December 1996. Owners are required under the Act to insure their liability for nuclear incidents and protective evacuations by maintaining the maximum amount of financial protection available from private sources and by maintaining secondary financial protection through an industry retrospective rating plan. The assessment of deferred premiums provided by the plan for each nuclear incident is up to $75.5 million per reactor, subject to indexing for inflation, a possible 5 percent surcharge (but no more than $10 million per reactor per incident in any one year) and a 3 percent state premium tax. HL&P and the other owners of the South Texas Project currently maintain the required nuclear liability insurance and participate in the industry retrospective rating plan.

There can be no assurance that all potential losses or liabilities will be insurable, or that the amount of insurance will be sufficient to cover them. Any substantial losses not covered by insurance would have a material effect on HL&P's and the Company's financial condition and results of operations.

(d) NUCLEAR DECOMMISSIONING. In accordance with the Rate Case Settlement, HL&P contributes $14.8 million per year to a trust established to fund HL&P's share of the decommissioning costs for the South Texas Project. For a discussion of securities held in the Company's nuclear decommissioning trust, see Note 1(j). In May 1994, an outside consultant estimated HL&P's portion of decommissioning costs to be approximately $318 million (1994 dollars). The consultant's calculation of decommissioning costs for financial planning purposes used the DECON methodology (prompt removal/dismantling), one of the three alternatives acceptable to the NRC, and assumed deactivation of Unit Nos. 1 and 2 upon the expiration of their 40-year operating licenses. While the current and projected funding levels currently exceed minimum NRC requirements, no assurance can be given that the amounts held in trust will be adequate to cover the actual decommissioning costs of the South Texas Project. Such costs may vary because of changes in the assumed date of decommissioning, changes in regulatory and accounting requirements, changes in technology and changes in costs of labor, materials and equipment.

(3) RATE MATTERS

The Utility Commission has original (or in some cases appellate) jurisdiction over HL&P's electric rates and services. In Texas, Utility Commission orders may be appealed to a District Court in

Travis County, and from that court's decision an appeal may be taken to the Court of Appeals for the 3rd District at Austin (Austin Court of Appeals). Discretionary review by the Supreme Court of Texas may be sought from decisions of the Austin Court of Appeals. In the event that the courts ultimately reverse actions of the Utility Commission, such matters are remanded to the Utility Commission for action in light of the courts' orders.

(a) 1995 RATE CASE. In August 1995, the Utility Commission unanimously approved the Rate Case Settlement, which resolved HL&P's 1995 rate case (Docket No. 12065) as well as a separate proceeding (Docket No. 13126) regarding the prudence of operation of the South Texas Project. Subject to certain changes in existing regulation or legislation, the Rate Case Settlement precludes HL&P from seeking rate increases until after December 31, 1997.

The Rate Case Settlement gives HL&P the option to write down up to $50 million per year of its investment in the South Texas Project through December 31, 1999, which write-downs will be treated under the terms of the Rate Case Settlement as reasonable and necessary expenses for purposes of reviews of HL&P's earnings and any rate review proceeding initiated against HL&P. In both 1995 and 1996, HL&P recorded a $50 million pre-tax write down of its investment in the South Texas Project as amortization expense. In 1996, HL&P also amortized $50 million (pre-tax) of its $153 million investment in certain lignite reserves associated with a canceled generating station. In accordance with the settlement, HL&P's remaining investment in the canceled generating station and certain lignite reserves ($164 million at December 31, 1996) will be amortized fully no later than December 31, 2002.

(b) RATE CASE APPEALS. The only HL&P rate order currently under appeal is Docket No. 6668 (the Utility Commission's inquiry into the prudence of the planning and construction of the South Texas Project). Review of the Utility Commission's order in Docket No. 6668 is pending before a Travis County district court. In that order, the Utility Commission determined that $375.5 million of HL&P's $2.8 billion investment in the South Texas Project had been imprudently incurred. That ruling was incorporated into HL&P's 1988 and 1991 rate cases. Unless the order is modified or reversed on appeal, the amount found imprudent by the Utility Commission will be sustained.

In June 1996, the Supreme Court of Texas unanimously upheld the decision of the Utility Commission in Docket No. 8425 (HL&P's 1988 rate case) to include in HL&P's rate base $93 million in construction costs relating to the canceled generating station. The Supreme Court also affirmed the Utility Commission's decision granting deferred accounting treatment for Unit No. 2 of the South Texas Project and the calculation of HL&P's federal income tax expenses without taking into account deductions for expenses paid by the Company's shareholders. As a result of this decision, HL&P's 1988 rate case has now become final.

(4) INVESTMENTS OF HI ENERGY

(a) GENERAL. HI Energy, a wholly owned subsidiary of the Company formed in 1993, participates primarily in the development and acquisition of foreign independent power projects and the privatization of foreign generating and distribution companies. The Company generally accounts for affiliate investments of HI Energy under the equity method of accounting where: (i) HI Energy's ownership interest in the affiliate ranges from 20 percent to 50 percent or (ii) HI Energy exercises significant influence over operating and financial policies of such affiliate. The Company's proportionate share of the equity in net income/(loss) in these affiliates for the years ended December 31, 1996, 1995 and 1994 was $17.0 million, $0.5 million and $(1.6) million, respectively. These amounts are included on the Company's Statement of Consolidated Income as "Other Revenues." The Company's equity investments in and advances to foreign and non-regulated affiliates at December 31, 1996 and 1995 were $502 million and $41 million, respectively.

(b) FOREIGN INVESTMENTS. In May 1996, a subsidiary of HI Energy acquired 11.35 percent of the common shares of Light, a publicly held Brazilian corporation, for $392 million. Light is the operator under a 30-year concession agreement of an integrated electric power and distribution system that serves a portion of the state of Rio de Janeiro, Brazil, including the city of Rio de Janeiro. HI Energy acquired the shares as a bidder in the government-sponsored auction of 60 percent of Light's outstanding shares. Subsequent to the auction, the winning bidders, including a subsidiary of HI Energy, formed a consortium whose aggregate ownership interest of 50.44 percent represents a controlling interest in Light.

The Company has accounted for this transaction under purchase accounting and has recorded its investment and its interest in Light's operations after June 1, 1996, using the equity method. The purchase price was allocated on the basis of the estimated fair market value of the assets acquired and the liabilities assumed as of the date of acquisition.

A subsidiary of HI Energy has entered into a $167.5 million loan agreement in order to refinance a portion of the acquisition costs of Light. The full proceeds of the loan, net of a $17.5 million debt reserve account to be established for the benefit of the lenders, will not be funded until the satisfaction of various conditions precedent, including the obtaining of political risk insurance. The loan is non-recourse to the Company and HL&P. The loan is secured by, among other things, a pledge of the shares of Light and a subsidiary of HI Energy that is the indirect holder of the shares of Light.

In addition to the investment in Brazil, HI Energy had total equity investments in and advances to affiliates in Argentina of $81 million and $36 million at December 31, 1996 and 1995, respectively, representing a 49 percent interest in the capital stock of an electric utility operating in the Province of Buenos Aires. In addition, HI Energy owns a 90 percent ownership interest in an Argentine electric utility distribution system and is constructing a 160 MW cogeneration facility in San Nicolas, Argentina. HI Energy's investment in these projects was approximately $68 million and $22 million at December 31, 1996 and 1995, respectively.

HI Energy also owns a 36 percent interest in a coke calcining and power generation facility in India with an investment of approximately $8 million and $5 million at December 31, 1996 and December 31, 1995, respectively.

(c) VALUATION ALLOWANCE. In 1995, the Company recorded a $28 million valuation allowance (resulting in an $18 million after-tax charge in that year) with respect to two waste tire-to-energy projects that were being developed in reliance on the terms of a state subsidy intended to encourage development of energy production facilities for the disposal of solid waste. In March 1996, the subsidy was repealed. In 1996, the Company recorded an additional valuation allowance of $7 million with respect to these projects, which resulted in a $5 million after-tax charge to 1996 earnings.

The valuation allowance reflects the combined amounts lent to the projects on a subordinated basis by HI Energy. HI Energy also is a party to two separate note purchase agreements committing it, under certain circumstances, to lend up to an additional $16 million. The Company has entered into a support agreement to enable HI Energy to honor its obligation under these note purchase agreements. In the Company's opinion, it is unlikely that additional loans would be required to be made under the note purchase agreements, unless construction activities with respect to these projects were recommenced at some future date. In March 1996, a subsidiary of HI Energy purchased from a senior lending bank all notes relating to one of the projects

SUBSEQUENT EVENTS

(8) In April 1997, HL&P redeemed all outstanding shares of its $9.375 cumulative preferred stock in satisfaction of mandatory sinking fund requirements.

In April 1997, a subsidiary of Houston Industries Energy, Inc. (HI Energy) borrowed

$167.5 million under a five-year term loan facility. The proceeds of the loan, net of a $17.5 million debt reserve account established for the benefit of the lenders, were used to refinance a portion of the acquisition costs of Light-Servicos de Eletricidade S.A. (Light). The loan, which is non-recourse to the Company and HL&P, restricts payments of dividends if Light fails to meet certain financial covenants. The loan is secured by, among other things, a pledge of the shares of Light. HI Energy acquired an 11.35 percent interest in Light in May 1996 for $392 million.

In February 1996, three Texas cities filed a lawsuit against HL&P and Houston Industries Finance, Inc., formerly a wholly-owned subsidiary of the Company, seeking recovery of unspecified damages relating to the alleged underpayment of municipal franchise fees. In April 1997, the plaintiffs amended their pleadings to assert damages alleged to exceed $250 million. The Company and HL&P believe that the lawsuit is without merit. The Company and HL&P cannot estimate a range of possible losses, if any, from this lawsuit, nor can any assurance be given as to its ultimate outcome. For additional information regarding this lawsuit, reference is made to Note 11(c) to the financial statements included in the Form 10-K, which Note is incorporated herein by reference.

In May 1997, the Company sold in open market transactions 550,000 shares of Time Warner Inc. (Time Warner) common stock for approximately $25 million, representing an average sales price of $45.49 per share, net of fees and other commissions . For information regarding the Company's investment in Time Warner securities, see Notes 1(j) and 13 to the financial statements included in the Form 10-K.

RATE CASE MATTERS AND OTHER PROCEEDINGS

(7) For information regarding the appeal of Docket No. 6668, an inquiry into the prudence of the planning and construction of the South Texas Project Electric Generating Station (South Texas Project), see Note 3(b) to the Form 10-K.

In July 1997, the one appellant remaining in the appeal of Docket No. 6668 voluntarily dismissed its appeal. Based on this action, HL&P is seeking entry of a judgment affirming the Public Utility Commission's of Texas (Utility Commission) order in Docket No. 6668. If the motions are granted, all appeals of HL&P's prior rate cases will be concluded.

Reference is made to Note 11(c) to the Form 10-K and Note 8 to the First Quarter 10-Q for information regarding a lawsuit against HL&P for recovery of allegedly unpaid franchise fees. In June 1997, the Texas Supreme Court ruled that it did not have jurisdiction, at this stage in the proceedings, to review the trial court's certification of the case as a class action. The case is scheduled for trial in April 1998 before the District Court of Harris County, Texas. For the reasons set forth in Note 11(c) to the Form 10-K, the Company regards the case as spurious and is aggressively contesting the lawsuit.

Exhibit 99(d)

[Excerpt from NorAm 1996 Form 10-K]

1. ACCOUNTING POLICIES AND COMPONENTS OF CERTAIN FINANCIAL STATEMENT LINE ITEMS

PRINCIPLES OF CONSOLIDATION

The accompanying consolidated financial statements include the accounts of NorAm Energy Corp. and its subsidiaries, all of which are wholly owned, and all significant affiliated transactions and balances have been eliminated. As used herein, "NorAm" and "the Company" refer to NorAm Energy Corp. and its consolidated subsidiaries. Certain prior period amounts have been reclassified to conform to current presentation.

MERGER WITH HOUSTON INDUSTRIES

On August 11, 1996, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Houston Industries Incorporated ("Houston Industries" or "HI"), Houston Lighting & Power Company ("HL&P") and a newly formed Delaware subsidiary of Houston Industries ("HI Merger, Inc."). Under the Merger Agreement, the Company would merge with and into HI Merger, Inc. and would become a wholly owned subsidiary of HII (as defined following). Houston Industries would merge with and into HL&P, which would be renamed Houston Industries Incorporated ("HII") (the term "Transaction" refers to the business combination between Houston Industries and the Company). Consideration for the purchase of the Company's common stock would be a combination of cash and shares of HI common stock, valued at approximately $3.8 billion, consisting of approximately $2.4 billion for the Company's common stock and equivalents and approximately $1.4 billion in assumption of the Company's debt. Additional information concerning the Merger Agreement is contained in the Joint Proxy Statement/Prospectus of Houston Industries, HL&P and the Company dated October 29, 1996 ("the Proxy/Prospectus").

The Merger Agreement was approved and adopted at Special Meetings of Houston Industries' and the Company's stockholders held on December 17, 1996. The Company and HI proceeded to obtain required state and municipal regulatory approvals, all of which have been obtained, and to request an exemption from the Securities and Exchange Commission ("the SEC") which would allow the Transaction to take place under its preferred structure without subjecting post-merger HII to the requirements of the Public Utility Holding Company Act. It is HI's and the Company's intention to defer the closing of the Transaction until the SEC issues its ruling on the exemption request although, as set forth in the Proxy/Prospectus, there are two alternative structures, one of which would not require SEC approval. Adoption of either of these structures, however, would require that the Company and HI make new filings to obtain the various state and municipal regulatory approvals.

In early February 1997, the Federal Energy Regulatory Commission ("the FERC" or "the Commission") issued an order ("the Order") advising the Company that the Transaction "...may require Commission approval pursuant to section 203 of the FPA" (the "FPA" refers to the Federal Power Act), and directing the Company to file a response within 30 days of the Order either "...(1) providing arguments as to why the transaction does not require Commission authorization under section 203 or (2) an application under section 203". In early March 1997, the Company filed a response to the Order stating its view that the FERC does not have jurisdiction over the Transaction. Although such response disclaimed any FERC jurisdiction over the Transaction, it also indicated that one option being considered was to file an application with the FERC for approval of the Transaction in anticipation of an expedited review under the FERC's newly-issued merger policy guidelines. On March 27, 1997, the Company filed an application under section 203 of the FPA seeking FERC approval of the Transaction, although continuing to assert its position that such approval is not required.

The Company continues to believe that the Transaction will be completed as contemplated although, in light of the pending regulatory issues as set forth preceding, the Company cannot predict with any degree of certainty when the Transaction will be consummated.

NATURE OF OPERATIONS

The Company's principal activities are in the natural gas industry (representing in excess of 90% of the Company's total revenues, income or loss and identifiable assets), primarily in the contiguous 48 states, with principal operations in Texas, Louisiana, Mississippi, Arkansas, Oklahoma, Missouri and Minnesota. The Company has operations in various phases of the natural gas industry, including distribution, transmission, marketing and gathering which, during 1996, provided approximately 50.5%, 34.2%, 11.5% and 3.8%, respectively, of the Company's consolidated operating income (exclusive of the net operating loss attributable to Corporate and certain miscellaneous activities). The Company's distribution operations are conducted by its Entex, Minnegasco and Arkla divisions, its interstate pipeline operations are conducted by NorAm Gas Transmission Company ("NGT") and Mississippi River Transmission Corporation ("MRT"), its marketing activities are conducted by NorAm Energy Services, Inc. ("NES") and NorAm Energy Management, Inc. ("NEM"), and its gathering activities are conducted by NorAm Field Services Corp. ("NFS"), in each case also including certain subsidiaries and affiliates. The Company's miscellaneous activities, whose collective results of operations currently are not material, principally consist of home care services, including (1) appliance sales and service, (2) home security services, (3) utility services, principally line locating and (4) resale of long distance telephone service. The Company expects to make an investment in international activities as discussed following.

During 1996, the Company had revenues of $55 million, approximately 1% of consolidated operating revenues, from sales to and transportation for Laclede Gas Company (the local natural gas distribution company which serves the greater St. Louis, Illinois area) pursuant to several long-term firm transportation and storage agreements which expire in 1999. The Company's interstate pipelines received revenues of approximately $163.8 million in 1996 from services provided to the Company's Arkla distribution division pursuant to several agreements, representing approximately 3.4% of consolidated operating revenues and approximately 47.2% of NGT's and MRT's combined operating revenues. With respect to services provided to Arkla in (1) Arkansas, the current service agreement is scheduled to expire in April 2002 and (2) Louisiana, Oklahoma and East Texas, the process of negotiation and regulatory approval has not yet been completed, but the Company currently expects to obtain revised agreements with a term similar to that currently in effect for Arkansas.

In early 1997, the Company learned that four consortiums ("the Consortiums"), each of which included the Company, were the apparent successful bidders for the right to build and operate natural gas distribution facilities in each of four defined service areas ("the Concessions") within Colombia. Contracts, which extend through the year 2014 and grant the exclusive right to distribute gas to consumers of less than 500 Mcf per day (and the right to compete for other customers), are expected to be awarded in April 1997. The Company estimates that the Concessions ultimately will have approximately 400,000 customers, connected over approximately a five-year period at a total cost of approximately $160 million, with construction expected to begin no later than the fourth quarter of 1997. The Company's ownership interest in the Consortiums, while subject to change through continuing negotiations with its existing and potential partners ranges from 15% to approximately 33% and, based on the expected number of customers, represents a weighted average ownership interest of approximately 23%.

In January 1997, the Company participated in a bid for a permit authorizing the construction, ownership and operation of a natural gas distribution system for the geographic area that includes the cities of Chihuahua, Delicias and Cuauchtemoc/Anahuac in North Central Mexico. In March 1997, the Company learned that its group was not the successful bidder. The Company had previously announced its intention to participate in a similar bidding process for a permit to provide natural gas distribution service to all or a portion of Mexico City, although no date has yet been set for submission of bids.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

RATE REGULATION

Methods of allocating costs to accounting periods in the portion of the Company's business subject to federal, state or local rate regulation may differ from methods generally applied by unregulated companies. However, when accounting allocations prescribed by regulatory authorities are used for rate-making, the resultant accounting follows the concept of matching costs with related revenues. The Company's rate-regulated divisions/subsidiaries bill customers on a monthly cycle billing basis. Revenues are recorded on an accrual basis, including an estimate for gas delivered but unbilled at the end of each accounting period.

All of the Company's rate-regulated businesses historically have followed the accounting guidance contained in Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). The Company discontinued application of SFAS 71 to NGT effective with year-end 1992 reporting. As a result of the continued application of SFAS 71 to MRT and the Company's distribution divisions, the accompanying consolidated financial statements contain certain assets and liabilities which would not be recognized by unregulated entities. In addition to regulatory assets related to postretirement benefits other than pensions (see Note 5), the Company's only other significant regulatory asset is related to anticipated environmental remediation costs, see "Accounting for Remediation Costs" following and "Environmental Matters" included in Note 7.

CHANGE IN ACCOUNTING ESTIMATE

Pursuant to a revised study of the useful lives of certain assets, in July 1995, the Company changed the depreciation rates associated with certain of its natural gas gathering and pipeline assets. This change had the effect of increasing 1995 "Income before extraordinary item" and "Net income" by approximately $3.2 million ($0.03 per share).

ACCOUNTING FOR PRICE RISK MANAGEMENT ACTIVITIES

To reduce the risk from market fluctuations in the price of natural gas and related transportation, the Company enters into futures transactions, swaps and options (collectively, "financial instruments") in order to hedge certain natural gas in storage, as well as certain expected purchases, sales and transportation of natural gas, a portion of which are firm commitments at the inception of the hedge. Some of these financial instruments carry off-balance-sheet risk, see "Credit Risk and Off-Balance-Sheet Risk" included in Note 7. Changes in the market value of these financial instruments utilized as hedges are (1) recognized as an adjustment of the carrying value in the case of existing assets and liabilities, (2) included in the measurement of the transaction that satisfies the commitment in the case of firm commitments and (3) included in the measurement of the subsequent transaction in the case of anticipated transactions, whether or not the hedge is closed out before the date of the anticipated transaction. In cases where anticipated transactions do not occur, deferred gains and losses are recognized when such transactions were scheduled to occur.

ACCOUNTING FOR REMEDIATION COSTS

Environmental remediation costs are accrued when the Company determines that it is probable that it will incur such costs and the amount is reasonably estimable. To the extent that potential environmental remediation costs are quantified within a range, the Company establishes reserves equal to the most likely level of costs within the range and adjusts such accruals as better information becomes available. In determining the amount of the liability, future costs are not discounted to their present value and the liability is not offset by expected insurance recoveries. If justified by circumstances within the Company's business subject to SFAS 71, corresponding regulatory assets are recorded in anticipation of recovery through the ratemaking process, see "Environmental Matters" included in Note 7.

EARLY RETIREMENT AND SEVERANCE

During the first quarter of 1996, the Company instituted a reorganization plan affecting its NGT and MRT subsidiaries, pursuant to which a total of approximately 275 positions were eliminated, resulting in expense for severance payments and enhanced retirement benefits. Also during the first quarter of 1996, (1) the Company's Entex division instituted an early retirement program which was accepted by approximately 100 employees and (2) the Company's Minnegasco division reorganized certain functions, resulting in the elimination of approximately 25 positions. Collectively, these programs resulted in a non-recurring pre-tax charge of approximately $22.3 million (approximately $13.4 million or $0.10 per share after tax), which pre-tax amount is reported in the accompanying Statement of Consolidated Income as "Early retirement and severance".

INTEREST EXPENSE

Interest expense includes, where applicable, amortization of debt issuance cost and amortization of gains and losses on interest rate hedging transactions related to the Company's debt financing activities, see Note 3. "Interest expense, net" as presented in the accompanying Statement of Consolidated Income is net of an allowance for borrowed funds used during construction of $1.6 million, $1.1 million and $1.3 million in 1996, 1995 and 1994, respectively. Beginning in 1997, amounts previously reported as "Loss on sale of receivables" will be reported as a component of interest expense, see "Sale of Receivables" included in Note 3.

DISCONTINUED OPERATIONS

"Loss from discontinued operations, less taxes" as presented in the accompanying Statement of Consolidated Income for 1994 represents a pre-tax loss of $3.3 million (the associated tax benefit was $1.2 million) resulting from litigation associated with the discontinued operations of University Savings Association, a former subsidiary of Entex.

EARNINGS PER SHARE

Primary earnings per share is computed using the weighted average number of shares of the Company's Common Stock ("Common Stock") actually outstanding during each period presented. Outstanding options for purchase of Common Stock, the Company's only "common stock equivalent" as that term is defined in the authoritative accounting literature, have been excluded due to either (1) the fact that the options would have been anti-dilutive if exercised or (2) the immaterial impact which would result from the exercise of those options which are currently exercisable and would be dilutive if exercised. Fully diluted earnings per share, in addition to the actual weighted average common shares outstanding, assumes the conversion, as of its issuance date of June 17, 1996, of the 3,450,000 shares of the Trust Preferred (see Note 3) at a conversion rate of 4.1237 shares of Common Stock for each share of the Trust Preferred (resulting in the assumed issuance of a total of 14,226,765 shares of Common Stock), and reflects the increase in earnings from the cessation of the dividends on the Trust Preferred (net of the related tax benefit) which would result from such assumed conversion. For 1996, this assumed earnings increase was approximately $3.5 million, net of related tax benefits of approximately $2.3 million. The Company's 6% Convertible Subordinated Debentures due 2012 (see "Other Long-Term Financing" included in Note 3) and the Company's $3.00 Series A Preferred Stock (prior to its June 1996 exchange, see "Other Long-Term Financing" included in Note 3), due to their exchange rates, are anti-dilutive and are therefore excluded from all earnings per share calculations. During the periods in which the Company's $3.00 Convertible Exchangeable Preferred Stock, Series A was outstanding, earnings per share from continuing operations is calculated after reduction for the preferred stock dividend requirement associated with such security.

In February 1997, the Financial Accounting Standards Board issued Statement of Financial Accounting

Standards No. 128, "Earnings per Share" ("SFAS 128"), which is required to be implemented for fiscal years ending after December 15, 1997 and earlier application is not permitted. SFAS 128 replaces the current "primary earnings per share" ("primary EPS") and "fully diluted earnings per share" ("fully diluted EPS") with "basic earnings per share" ("basic EPS") and "diluted earnings per share" ("diluted EPS"). Unlike the calculation of primary EPS which includes, in its denominator, the sum of (1) actual weighted shares outstanding and (2) "common stock equivalents" as that term is defined in the authoritative literature, basic EPS is calculated using only the actual weighted average shares outstanding during the relevant periods. Diluted EPS is very similar to fully diluted EPS, differing only in technical ways which do not currently affect the Company.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment, in general, is carried at cost and depreciated or amortized on a straight-line basis over its estimated useful life. Additions to and betterments of utility property are charged to property accounts at cost, while the costs of maintenance, repairs and minor replacements are charged to expense as incurred. Upon normal retirement of units of utility property, plant and equipment, the cost of such property, together with cost of removal less salvage, is charged to accumulated depreciation. Costs of individually significant internally developed and purchased computer software systems are capitalized and amortized over their expected useful life.

INVESTMENTS AND OTHER ASSETS

Goodwill, none of which is being recovered in regulated service rates, is amortized on a straight-line basis over 40 years. Approximately $14.2 million of goodwill was amortized each year during 1996, 1995 and 1994. Accumulated amortization of goodwill was $103.4 million and $89.2 million at December 31, 1996 and 1995, respectively. The Company periodically compares the carrying value of its goodwill to the anticipated undiscounted future operating income from the businesses whose acquisition gave rise to the goodwill and, as yet, no impairment is indicated or expected.

Itron, Inc. ("Itron") is a publicly-traded Spokane, Washington company which manufactures and markets automated meter-reading devices and provides related services. The Company accounts for its investment in Itron utilizing the cost method (its ownership of approximately 1.5 million Itron common shares at December 31, 1996 represented an ownership interest of approximately 11.2%), revalues its investment to market value as of each balance sheet date and reports any unrealized gain or loss, net of tax, as a separate component of stockholders' equity, which unrealized gain was immaterial at December 31, 1996. During 1996, the market value of the Company's Itron investment (based on closing share prices on the NASDAQ) varied from a high of approximately $88.3 million to a low of approximately $22.5 million. At March 14, 1997, the market value of the Company's investment in Itron was approximately $29.3 million and the unrealized gain was approximately $1.7 million (net of tax benefit of $1.0 million).

ALLOWANCE FOR DOUBTFUL ACCOUNTS

"Accounts and notes receivable, principally customer" as presented in the accompanying Consolidated Balance Sheet are net of an allowance for doubtful accounts of $13.0 million and $11.1 million at December 31, 1996 and 1995, respectively.

INVENTORIES

Inventories principally follow the average cost method and all non-utility inventories held for resale are valued at the lower of cost or market.

ACCOUNTS PAYABLE

Certain of the Company's cash balances reflect credit balances to the extent that checks written have not yet been presented for payment. Such balances included in "Accounts payable, principally trade" in the accompanying Consolidated Balance Sheet were approximately $53.5 million and $44.4 million at December 31, 1996 and 1995, respectively.

STATEMENT OF CONSOLIDATED CASH FLOWS

The accompanying Statement of Consolidated Cash Flows reflects the assumption that all highly liquid investments purchased with original maturities of three months or less are cash equivalents. Cash flows resulting from the Company's risk management (hedging) activities are classified in the accompanying Statement of Consolidated Cash Flows in the same category as the item being hedged.

In September 1994, the Company sold all of its Kansas distribution properties, serving approximately 23,000 customers in 14 communities, together with certain related pipeline assets, for approximately $23 million in cash, approximately its carrying value, shown in the accompanying Statement of Consolidated Cash Flows as "Sale of distribution properties".

In June 1996, the Company exercised its right to exchange its $3.00 Convertible Exchangeable Preferred Stock, Series A for its 6% Convertible Subordinated Debentures due 2012 in a non-cash transaction. The Company issues its common stock in conjunction with certain compensation plans. For additional information on these matters, see Note 6 and "Other Long-Term Financing" included in Note 3. Following is certain supplemental cash flow information:

The caption "Changes in certain asset and liabilities, net of noncash transactions" as shown in the accompanying Statement of Consolidated Cash Flows includes the following:

(1) Beginning with January 1, 1997, cash flows associated with the Company's sale of receivables facility will be included with "Cash Flows from Financing Activities", see "Sale of Receivables" included in Note 3.

7. COMMITMENTS AND CONTINGENCIES

LEASE COMMITMENTS

Following is certain information concerning the Company's obligations under operating leases:

(1) Principally consisting of rental agreements for building space, data processing equipment and vehicles (including major work equipment).

Lease payments related to assets transferred under the Company's leasing arrangements (see "Other Long-Term Financing" included in Note 3) are included in the preceding table for only their primary (non-cancelable) term. Subsequent to the primary term, the Company could terminate its obligations under these arrangements by electing to purchase the relevant assets for an amount approximating fair market value. Total rental expense for all leases was $33.4 million, $48.9 million and $36.8 million in 1996, 1995 and 1994, respectively.

LETTERS OF CREDIT

At December 31, 1996, the Company was obligated under letters of credit incidental to its ordinary business operations totalling approximately $21.7 million.

INDEMNITY PROVISIONS

In June 1993, the Company completed the sale of Louisiana Intrastate Gas Corporation ("LIG"), its former subsidiary engaged in the intrastate pipeline and liquids extraction business, to Equitable Resources, Inc. In December 1992, the Company completed the sale of Arkla Exploration Company ("AEC"), its former subsidiary engaged in oil and gas exploration and production activities, to Seagull Energy Corporation. In June 1991, the Company completed the sale of Dyco Petroleum Company ("Dyco"), the oil and gas exploration and production company acquired in conjunction with the Company's acquisition of Diversified Energies Inc., to Continental Drilling Company, Inc., a subsidiary of Samson Investment Company. In each instance, the relevant sale agreement required the Company to indemnify the purchaser against certain exposures, for which the Company has established reserves based on, among other factors, its estimates of potential claims. These reserves are included in the Company's Consolidated Balance Sheet under the caption "Estimated obligations under indemnification provisions of sale agreements".

SALE OF RECEIVABLES

Certain of the Company's receivables are collateral for receivables which have been transferred pursuant to a sale of receivables facility, see "Sale of Receivables" included in Note 3.

GAS PURCHASE CLAIMS

In conjunction with settlements of "take-or-pay" claims, the Company has prepaid for certain volumes of gas, which prepayments have been recorded at their net realizable value and, to the extent that the Company is unable to realize at least the carrying amount as the gas is delivered and sold, the Company's earnings will be adversely affected, although such impact is not expected to be material. In addition to these prepayments, the Company is a party to a number of agreements which require it to either purchase or sell gas in the future at prices which may differ from then-prevailing market prices or which require it to deliver gas at a point other than the expected receipt point for volumes to be purchased. As discussed under "Credit Risk and Off-Balance-Sheet Risk" following, the Company operates an ongoing risk management program designed to eliminate or limit the Company's exposure from its obligations under these purchase/sale commitments. To the extent that the Company expects that these commitments will result in losses over the contract term, the Company has established reserves equal to such expected losses.

TRANSPORTATION AGREEMENT

The Company had an agreement ("the ANR Agreement") with ANR Pipeline Company ("ANR") which contemplated a transfer to ANR of an interest in certain of the Company's pipeline and related assets, representing capacity of 250

MMcf/day, and pursuant to which ANR had advanced $125 million to the Company. The ANR Agreement has been restructured as a lease of capacity and, after refunds of $50 million and $34 million in 1995 and 1993, respectively, the Company currently retains $41 million (recorded as a liability) in exchange for ANR's use of 130 MMcf/day of capacity in certain of the Company's transportation facilities. The level of transportation will decline to 100 MMcf/day in the year 2003 with a refund of $5 million to ANR and the ANR Agreement will terminate in 2005 with a refund of the remaining balance.

CREDIT RISK AND OFF-BALANCE-SHEET RISK

The Company's gas supply, marketing, gathering and transportation activities subject the Company's earnings to variability based on fluctuations in both the market price of natural gas and the value of transportation as measured by changes in the delivered price of natural gas at various points in the nation's natural gas grid. In order to mitigate the financial risk associated with these activities both for itself and for certain customers who have requested the Company's assistance in managing similar exposures, the Company routinely enters into natural gas swaps, futures contracts and options, collectively referred to in this discussion as "derivatives". The use of derivatives for the purpose of reducing exposure to risk is generally referred to as hedging and, through deferral accounting, results in matching the financial impact of these derivative transactions with the cash impact resulting from consummation of the transactions being hedged, see "Accounting for Price Risk Management Activities" included in Note 1.

The futures contracts are purchased and sold on the NYMEX and generally are used to hedge a portion of the Company's storage gas, manage intra-month and inter-month actual and anticipated short or long commodity positions and provide risk management assistance to certain customers, to whom the cost of the derivative activity is generally passed on as a component of the sales price of the service being provided. Futures contracts are also utilized to fix the price of compressor fuel or other future operational gas requirements, although usage to date for this purpose has not been material. The options are entered into with various third parties and principally consist of options which serve to limit the year-to-year escalation from January 1998 to April 1999 in the purchase price of gas which the Company is committed to deliver to a distribution affiliate. These options covered 2.4 Bcf, 13.2 Bcf and 30.5 Bcf at December 31, 1996, 1995 and 1994, respectively and, due to their nature and term, have no readily determinable fair market value. The Company previously established a reserve equal to its projected maximum exposure to losses during the term of this commitment and, accordingly, no impact on earnings is expected. The Company also utilizes options in conjunction with meeting customers' needs for custom risk management services and for other limited purposes. The Company had an immaterial amount of such options outstanding at December 31, 1996. The impact of such options was to decrease 1996 earnings by approximately $2.6 million and the effect on prior periods was not material. The swaps, also entered into with various third parties, are principally associated with the Company's marketing and transportation activities and generally require that one party pay either a fixed price or fixed differential from the NYMEX price per MMBtu of gas while the other party pays a price based on a published index. These swaps allow the Company to (1) commit to purchase gas at one location and sell it at another location without assuming unacceptable risk with respect to changes in the cost of the intervening transportation, (2) effectively set the value to be received for transportation of certain volumes on the Company's facilities in the future and (3) effectively fix the base price for gas to be delivered in conjunction with the commitment described preceding. None of these derivatives are held for speculative purposes and the Company's risk management policy requires that positions taken in derivatives be offset by positions in physical transactions (actual or anticipated) or in other derivatives.

In the table which follows, the term "notional amount" refers to the contract unit price times the contract volume for the relevant derivative category and, in general, such amounts are not indicative of the cash requirements associated with these derivatives. The notional amount is intended to be indicative of the Company's level of activity in such derivatives, although the amounts at risk are significantly smaller because, in view of the price movement correlation required for hedge accounting, changes in the market value of these derivatives generally are offset by changes in the value associated with the underlying physical transactions or in other derivatives. When derivative positions are closed out in advance of the underlying commitment or anticipated transaction, however, the market value changes may not offset due to the fact that price movement correlation ceases to exist when the positions are closed. Under such circumstances, gains or losses are deferred and recognized when the underlying commitment or anticipated transaction was scheduled to occur. Following is certain information concerning the Company's derivative activities:

(1) The financial impact of these swaps was to increase(decrease) earnings by $(1.0) million, $1.0 million and $2.8 million during 1996, 1995 and 1994, respectively, as swap transactions were matched with hedged transactions during these periods.

(2) Represents the estimated amount which would have been realized upon termination of the relevant derivatives as of the date indicated. The amount which is ultimately charged or credited to earnings is affected by subsequent changes in the market value of these derivatives and, in the case of certain commitments described preceding, no earnings impact is expected due to existing accruals. Swaps associated with these commitments and included in the above totals had fair market values of $2.8 million, $(1.0) million and $(17.6) million at December 31, 1996, 1995 and 1994, respectively.

(3) There was no material financial impact from these futures contracts in 1994 and the effect during 1996 and 1995 was to decrease earnings by $9.3 million and $4.1 million, respectively, as futures transactions were matched with hedged transactions during these periods. At December 31, 1996, the Company had deferred losses of approximately $11.9 million associated with expected sales under "peaking" contracts with certain customers which, in effect, give the customer a "call" on certain volumes of gas. All such losses were recognized in January 1997 when the anticipated transactions were scheduled to occur.

While, as yet, the Company has experienced no significant losses due to the credit risk associated with these arrangements, the Company has off-balance-sheet risk to the extent that the counterparties to these transactions may fail to perform as required by the terms of each such contract. In order to minimize this risk, the Company enters into such transactions solely with firms of acceptable financial strength, in the majority of cases limiting such transactions to counterparties whose debt securities are rated "A" or better by recognized rating agencies. For long-term arrangements, the Company periodically reviews the financial condition of such firms in addition to monitoring the effectiveness of these financial contracts in achieving the Company's objectives. Should the counterparties to these arrangements fail to perform, the Company would seek to compel performance at law or otherwise, or to obtain compensatory damages in lieu thereof, but the Company might be forced to acquire alternative hedging arrangements or be required to honor the underlying commitment at then-current market prices. In such event, the Company might incur additional loss to the extent of amounts, if any, already paid to the counterparties. In view of its criteria for selecting counterparties, its process for monitoring the financial strength of these counterparties and its experience to date in successfully completing these transactions, the Company believes that the risk of incurring a significant loss due to the nonperformance of counterparties to these transactions is minimal.

LITIGATION

On August 14, 1996, an action styled Shaw vs. NorAm Energy Corp., et al. was filed in the District Court of Harris County, Texas by a purported NorAm stockholder against the Company, certain of its officers and directors and Houston Industries to enjoin the merger between the Company and Houston Industries (see "Merger With Houston Industries" included in Note 1) or to rescind such merger and/or to recover damages in the event that the Transaction is consummated. The complaint alleges, among other things, that the merger consideration is inadequate, that the Company's Board of Directors breached its fiduciary duties and that Houston Industries aided and abetted such breaches of fiduciary duties. In addition, the plaintiff seeks certification as a class action. The Company believes that the claims are without merit and intends to vigorously defend against the lawsuit. Management believes that the effect on the Company's results of operations, financial position or cash flows, if any, from the disposition of this matter will not be material.

The Company is a party to litigation (other than that specifically noted) which arises in the normal course of business. Management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. Management believes that the effect on the Company's results of operations, financial position or cash flows, if any, from the disposition of these matters will not be material.

ENVIRONMENTAL MATTERS

The Company and its predecessors operated a manufactured gas plant ("MGP") adjacent to the Mississippi River in Minnesota known as the former Minneapolis Gas Works ("FMGW") until 1960. The Company is working with the Minnesota Pollution Control Agency to implement an appropriate remediation plan. There are six other former MGP sites in the Company's Minnesota service territory. Of the six sites, the Company believes that two were neither owned nor operated by the Company; two were owned at one time but were operated by others and are currently owned by others; and one was operated by the Company and is now owned by others. The Company believes it has no liability with respect to the sites it neither owned nor operated.

At December 31, 1996, the Company has estimated a range of $10 million to $170 million for possible remediation of the Minnesota sites. The low end of the range was determined using only those sites presently owned or known to have been operated by the Company, assuming the Company's proposed remediation methods. The upper end of the range was determined using the sites once owned by the Company, whether or not operated by the Company, using more costly remediation methods. The cost estimates for the FMGW site are based on studies of that site. The remediation costs for other sites are based on industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites remediated, the participation of other potentially responsible parties, if any, and the remediation methods used.

In its 1993 rate case, Minnegasco was allowed $2.1 million annually to recover amortization of previously deferred and ongoing clean-up costs. Any amounts in excess of $2.1 million annually were deferred for future recovery. In its 1995 rate case, Minnegasco asked that the annual allowed recovery be increased to approximately $7 million and that such costs be subject to a true-up mechanism whereby any over or under recovered amounts, net of certain insurance recoveries as described following, plus carrying charges, would be deferred for recovery or refund in the next rate case. Such accounting was approved by the Minnesota Public Utilities Commission ("MPUC") and was implemented effective October 1, 1995. The amount of insurance recoveries to be flowed back to ratepayers is determined by multiplying insurance recoveries received by the ratio of total costs incurred to-date as a percentage of the probable total costs of environmental remediation. At December 31, 1996 and 1995, the Company had under-collected, through rates, net environmental clean-up costs of $1.4 million and $1.3 million, respectively. In addition, at December 31, 1996 and 1995, the Company had received insurance proceeds that will be refunded through rates in the future as clean-up expenditures are made of $4.3 million and $3.3 million, respectively. At December 31, 1996 and 1995, the Company had recorded a liability of $35.9 million and $45.2 million, respectively, to cover the cost of future remediation. In addition, the Company has receivables from insurance settlements of $5.2 million at December 31, 1996. These insurance settlements will be collected through 1999. The Company expects that the majority of its accrual as of December 31, 1996 will be expended within the next five years. In accordance with the provisions of SFAS 71, a regulatory asset has been recorded equal to the liability accrued. The Company is continuing to pursue recovery of at least a portion of these costs from insurers. The Company believes the difference between any cash expenditures for these costs and the amounts recovered in rates during any year will not be material to the Company's overall cash requirements.

In addition to the Minnesota MGP sites described above, the Company's distribution divisions are investigating the possibility that the Company or predecessor companies may be or may have been associated with other MGP sites in the service territories of the distribution divisions. At the present time, the Company is aware of some plant sites in addition to the Minnesota sites and is investigating certain other locations. While the Company's evaluation of these other MGP sites remains in its preliminary stages, it is likely that some compliance costs will be identified and become subject to reasonable quantification. To the extent that such potential costs are quantified, as with the Minnesota remediation costs for MGP described preceding, the Company expects to provide an appropriate accrual and seek recovery for such remediation costs through all appropriate means, including regulatory relief.

On October 24, 1994, the United States Environmental Protection Agency advised the Company that MRT and a number of other companies have been named under federal law as potentially responsible parties for a landfill site in West Memphis, Arkansas and may be required to share in the cost of remediation of this site. However, considering the information currently known about the site and the involvement of MRT, the Company does not believe that this matter will have a material adverse effect on its financial position, results of operations or cash flows.

On December 18, 1995, the Louisiana Department of Environmental Quality advised the Company that the Company, through one of its subsidiaries and together with several other unaffiliated entities, had been named under state law as a potentially responsible party with respect to a hazardous substance site in Shreveport, Louisiana and may be required to share in the remediation cost, if any, of the site. However, considering the information currently known about the site and the involvement of the Company and its subsidiaries with respect to the site, the Company does not believe that the matter will have a material adverse effect on its financial position, results of operations or cash flows.

In addition, the Company, as well as other similarly situated firms in the industry, is investigating the possibility that it may elect or be required to perform remediation of various sites where meters containing mercury were disposed of improperly, or where mercury from such meters may have leaked or been disposed of improperly. While the Company's evaluation of this issue remains in its preliminary stages, it is likely that compliance costs will be identified and become subject to reasonable quantification.

At December 31, 1996 and 1995, the Company had recorded an accrual of $3.3 million (with a maximum estimated exposure of approximately $18 million) and an offsetting regulatory asset for environmental matters in connection with a former fire training facility and a landfill for which future remediation may be required. This accrual is in addition to the accrual for MGP sites as discussed preceding.

While the nature of environmental contingencies makes complete evaluation impracticable, the Company currently is aware of no other environmental matter which could reasonably be expected to have a material impact on its results of operations, financial position or cash flows.

MATERIAL CHANGES IN THE RESULTS
OF CONTINUING OPERATIONS

GENERAL

In recognition of the manner in which the Company manages its portfolio of businesses, and in order to facilitate a more detailed understanding of the various activities in which the Company engages, the Company has segregated its results of operations into (1) Natural Gas Distribution, (2) Interstate Pipelines, (3) Wholesale Energy Marketing, (4) Natural Gas Gathering, (5) Retail Energy Marketing and (6) Corporate and Other. The Company's results of operations are seasonal due to weather-related fluctuations in the demand for and price of natural gas although, as discussed following and elsewhere herein, (1) the Company has obtained rate design changes in its rate-regulated businesses which generally have reduced the sensitivity of the Company's earnings to seasonal weather patterns (further such changes may occur) and (2) the Company is seeking to derive a larger portion of its earnings from businesses which exhibit less earnings seasonality.

Since the Company's December 1992 sale of its oil and gas exploration and production business, the substantial majority of the Company's earnings have been attributable to operations which are rate regulated. While these businesses have been subjected to varying levels of competition through changes in the form of regulation (further such changes may occur), in general, they continue to be regulated on a cost-of-service basis and the potential for growth in earnings and increased rates of return is limited. The Company seeks to improve its returns from these businesses through increased efficiency, aggressive marketing and by rate initiatives which allow these businesses to compete more effectively and retain more of the value added through improved operations and expanded services.

The Company continues to believe that its greatest potential for significant increases in overall profitability lies in those businesses which are, in some instances, subject to regulation as to the nature of services offered, the manner in which services are provided or the allocation of joint costs between cost-of-service regulated and other operations, but generally are not subject to direct regulation as to the rates which may be charged. Such operations are sometimes referred to herein for convenience as "unregulated". The Company has separated its strategically significant unregulated activities into discrete management units and formulated plans for increasing the future financial contribution from these businesses. The Company has and expects to continue to (1) expand both the range of products and services offered by these businesses and the geographic areas served and (2) increase the percentage of the Company's overall earnings derived from these activities.

In addition, the Company is investigating opportunities for international investment. To date, the Company's efforts have focused on opportunities emerging in Latin America due to privatization initiatives currently underway in a number of countries, as well as broad-based efforts to encourage international investment. While such investments involve increased risks such as political, economic or regulatory instability and foreign currency exchange rate fluctuations, the Company believes that, together with carefully selected partners (both within the target countries and otherwise), it can effectively apply its natural gas industry expertise to selected projects in Latin America, thereby increasing its overall returns on invested capital while keeping the increased risk within acceptable limits. In general, the international investment is expected to build up gradually over a period of years as the Company (1) identifies and creates working relationships with strategic business partners, (2) selects projects which meet its risk/return requirements, (3) develops specific country experience and (4) in some cases, increases its investment in specific projects as facilities are constructed, see the following discussion and "Capital Expenditures - Continuing Operations" under "Net Cash Flows from Investing Activities" elsewhere herein.

In early 1997, the Company learned that four consortiums ("the Consortiums"), each of which included the Company, were the apparent successful bidders for the right to build and operate natural gas distribution facilities in each of four defined service areas ("the Concessions") within Colombia. Contracts, which extend through the year 2014 and grant the exclusive right to distribute gas to consumers of less than 500 Mcf per day (and the right to compete for other customers), are expected to be awarded in April 1997. The Company estimates that the Concessions ultimately will have approximately 400,000 customers, connected over approximately a five-year period at a total cost of approximately $160 million, with construction expected to begin no later than the fourth quarter of 1997. The Company's ownership interest in the Consortiums, while subject to change through continuing negotiations with its existing and potential partners ranges from 15% to approximately 33% and, based on the expected number of customers, represents a weighted average ownership interest of approximately 23%. Depending upon, among other factors, its ownership percentage and success in finalizing financing arrangements at estimated levels and with expected terms (see the discussion following), the Company currently estimates that the net cash outflows to support its investment in the Concessions will not exceed approximately $4 million in any year, and that its investment in the Concessions will become a net source of cash in approximately year four.

Debt is currently expected to make up a significant portion of the financing for the Concessions in the early years of the project, reaching a maximum level of approximately $90 million and declining thereafter. While such debt is expected to be without direct recourse to members of the Consortiums ("the Partners"), the terms of the debt will likely require that each Partner enter into an agreement which commits it to make pro rata capital contributions as funds are borrowed to finance construction, and that lenders will be granted a security interest in such agreements. The Company is considering extending an offer of support to its Partners such that, in the event that any Partner fails to make capital contributions as required, the Company would make such contributions and assume the underlying ownership interest. The Company currently estimates that, in the event this arrangement is agreed to by all parties and finalized, and the Company is required to assume all such interests, the Company's maximum investment in the Concessions will not exceed $50 million and its net cash outflows in support of the Concessions will not exceed $18 million in any year.

In January 1997, the Company participated in a bid for a permit authorizing the construction, ownership and operation of a natural gas distribution system for the geographic area that includes the cities of Chihuahua, Delicias and Cuauchtemoc/Anahuac in North Central Mexico. In March 1997, the Company learned that its group was not the successful bidder. The Company had previously announced its intention to participate in a similar bidding process for a permit to provide natural gas distribution service to all or a portion of Mexico City, although no date has yet been set for submission of bids.

REGULATORY MATTERS

In general, the Company's interstate pipelines are subject to regulation by the FERC, while its natural gas distribution operations are subject to regulation at the state or municipal level. Historically, all of the Company's rate-regulated businesses have followed the accounting guidance contained in Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" ("SFAS 71"). The Company discontinued application of SFAS 71 to its NorAm Gas Transmission Company subsidiary ("NGT") effective with year-end 1992 reporting, see "Interstate Pipelines" elsewhere herein. As a result of the continued application of SFAS 71 to Mississippi River Transmission Corporation ("MRT") and the Company's natural gas distribution operations, the Company's consolidated financial statements contain certain assets and liabilities which would not be recognized by unregulated entities. In addition to regulatory assets related to postretirement benefits other than pensions, the Company's only other significant regulatory asset is related to anticipated environmental remediation costs, see Note 5 of the accompanying Notes to Consolidated Financial Statements and "Environmental Matters" under "Commitments and Contingencies" elsewhere herein. Following are recent significant regulatory actions and developments.

NGT's Negotiated Rate Filing (Docket No. RP96-200), accepted by the FERC on April 25, 1996, allowed NGT's rates to exceed the maximum cost-based rates set forth in its filed tariff and/or to deviate from the current FERC-mandated rate design. NGT has negotiated certain transactions which provide for shippers' rates to be based on various factors such as gas price differentials between the east and west sides of the NGT system. Therefore, in some instances, NGT will charge and collect a negotiated rate which exceeds its then-current maximum filed tariff rate. Appeals of the FERC's negotiated rate policy, as well as the specific authorization granted to NGT to charge negotiated rates, have been filed with the U.S. Court of Appeals, D.C. Circuit. Until such time as these appeals are resolved, some uncertainty will exist as to whether the Company may be required to refund any amounts associated with transactions billed at above the maximum tariff rate. The Company currently believes that any such refund will not be material. The FERC accepted NGT's 4th annual FERC Order 528 filing (Docket No. RP96-167) effective April 1, 1996, which retained the $0.03 per MMBtu commodity surcharge for continued recovery of 75% of eligible take-or-pay costs, to the extent that collection of such costs is supported by market conditions. The recovery of these costs, which commenced in 1992, will continue through the year 2002 although, as a result of the discontinuance of the application of SFAS 71 to NGT as described preceding, no asset has been recorded in anticipation of recovery. Additionally, in April 1996, the FERC issued certificate orders granting (1) abandonment of NGT's Collinson Storage Facility and associated facilities and equipment (Docket No. CP95- 250), which will not result in a material gain or loss upon abandonment and will not be abandoned until all gas has been recovered and (2) abandonment and transfer of NGT's Line O West facilities to NorAm Field Services Corp. ("NFS") (Docket No. RP96-105), allowing NGT to divest itself of certain non-core facilities which supported the gas supply function in a time when NGT was principally a merchant of natural gas.

NGT's certificated Line F Project, constructed at a total cost of approximately $17 million, replaced a 30 mile section of the existing Line F from Ruston to Sterlington, Louisiana, and upgraded the maximum allowed operating pressure of the line to 1200 psig. This replacement project was placed in service on October 31, 1996 and allows NGT to receive gas from an interconnect with MRT located near NGT's Ruston Compressor Station. Finally, on November 1, 1996, both MRT and NGT filed to revise their FERC tariffs, incorporating the Gas Industry Standards Board standards in compliance with FERC Order 587 (Docket No. RM96-1). These filings set forth each company's standard procedures for business practices supporting nominations, allocations, balancing, measurement, invoicing, capacity release, and standardization of electronic communications between pipelines and their customers. Pursuant to a FERC acceptance order, both NGT and MRT revised and refiled specified sections of these tariffs in February 1997.

In April 1996, MRT filed a FERC Section 4 rate case (Docket No. RP96-199) pursuant to the settlement entered into in MRT's last rate case (Docket No. RP93-4). MRT's proposed tariff rates would increase revenues derived from jurisdictional service by $14.7 million annually. Motion rates, subject to refund, were implemented October 1, 1996. As a result of a prehearing conference in December 1996, another procedural schedule was established, setting a hearing date of July 29, 1997.

MRT filed an application (Docket No. CP95-376) requesting spindown of all of its gathering facilities. In May 1996, the FERC issued an order approving MRT's abandonment of its off-system gathering facilities to NFS and further declaring such facilities exempt from FERC jurisdiction. In March 1996, MRT filed a second application (Docket No. CP96- 268), which is now pending, seeking (1) FERC approval to abandon its remaining gathering facilities by transfer and sale to NFS and (2) a FERC declaration that these facilities are exempt from FERC jurisdiction.

Entex was granted annualized rate increases totaling $5.4 million during 1996. In addition to annual cost-of- service adjustments in three Texas operating divisions (approximately $0.6 million on an annualized basis), performance- based rates were approved and implemented in Louisiana (approximately $2.7 million on an annualized basis, effective in June) and Mississippi (approximately $2.1 million on an annualized basis, effective in October). In both Louisiana and Mississippi, Entex will be allowed to earn a return on equity ("ROE") within an approved range. Earnings will be monitored by the public service commissions of the respective states and, while the provisions in each state differ slightly, to the extent that Entex's ROE falls below the lower bounds or exceeds the upper bounds of the approved range, adjustments will be made to either adjust rates upward or refund excess earnings to customers.

In April 1996, the Minnesota Public Utilities Commission (the "MPUC") voted to approve Minnegasco's Performance-Based Gas Purchasing Plan (the "PBR"), effective from September 1, 1995 to June 30, 1998. To the extent that Minnegasco's actual purchased gas cost is either significantly higher or lower than specified benchmarks, the PBR will require that Minnegasco and its customers share in the savings or additional cost, resulting in a maximum reward or penalty of up to 2% of annual gas cost (e.g. approximately $10 million using Minnegasco's 1996 gas cost) for Minnegasco during any year. Minnegasco made a compliance filing with the MPUC on November 1, 1996, the first year of the PBR, which filing was approved for approximately $1 million in March 1997.

In June 1996, the MPUC issued its order in Minnegasco's August 1995 rate case. The MPUC granted an annual increase of $12.9 million as compared to the requested increase of $24.3 million. Interim rates reflecting an increase of $17.8 million had been put into effect in October 1995 subject to refund. As a part of its decision, the MPUC granted Minnegasco full recovery of its ongoing net environmental costs through the use of a true-up mechanism whereby any amounts collected in rates which differ from actual costs incurred, plus carrying charges, will be deferred for recovery or refund in the next rate case. Minnegasco requested reconsideration on several issues. Among them were (1) a request to give effect, in this rate case, to the Minnesota Supreme Court's (the "Court") recent rulings (see the discussion following), and (2) a request to deduct from any interim rate refund the additional amount that Minnegasco would have realized from its 1993 rate case by applying the Court's ruling to that case, which remained on appeal.

The MPUC decided in Minnegasco's 1993 rate case that (1) Minnegasco's unregulated appliance sales and service operations are required to pay the regulated utility operations a fee for the use of Minnegasco's name, image and reputation ("goodwill") and (2) a portion of the cost of responding to certain gas leak calls not be allowed in rates. Minnegasco appealed those decisions to the Court of Appeals. On June 13, 1996, in a case appealed prior to the 1993 rate case, the Court reversed the MPUC's decisions on these two issues, finding in Minnegasco's favor and, in July, the Court denied the MPUC's request for rehearing.

In its December 4, 1996 Order After Reconsideration, the MPUC determined that Minnegasco was entitled to an annual rate increase of $13.3 million as compared to the $12.9 million granted in June 1996. The MPUC decided that Minnegasco's unregulated appliance sales and service operations should not pay a fee for goodwill associated with the

Minnegasco name, but refused to allow Minnegasco to recover certain costs associated with gas leak check calls, and did not approve Minnegasco's request with respect to the 1993 rate case costs. An appeal related to the 1993 rate case is pending before the Court of Appeals. Minnegasco requested and, on February 20, 1997, the MPUC voted to grant a stay of the Commission's order pending Minnegasco's appeal of the gas leak issue in the 1995 rate case. Minnegasco is accruing for any necessary interim rate refunds should the Court deny Minnegasco's appeal.

CHANGE IN ESTIMATED SERVICE LIVES OF CERTAIN ASSETS

Pursuant to an updated study of the useful lives of certain assets, in July 1995, the Company changed the depreciation rates associated with certain of its natural gas pipeline and gathering assets, see "Interstate Pipelines" and "Natural Gas Gathering" elsewhere herein. This change had the effect of increasing the Company's 1995 income before extraordinary item by approximately $3.2 million ($0.03 per share) and represents an annualized increase of approximately $6.5 million.

ITEM 3. LEGAL PROCEEDINGS

On August 14, 1996, an action styled Shaw vs. NorAm Energy Corp., et al. was filed in the District Court of Harris County, Texas by a purported NorAm stockholder against the Company, certain of its officers and directors and Houston Industries to enjoin the Transaction or to rescind the Transaction and/or to recover damages in the event that the Transaction is consummated. The complaint alleges, among other things, that the merger consideration is inadequate, that the Company's Board of Directors breached its fiduciary duties and that Houston Industries aided and abetted such breaches of fiduciary duties. In addition, the plaintiff seeks certification as a class action. The Company believes that the claims are without merit and intends to vigorously defend against the lawsuit. The Company does not believe that the matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

On December 18, 1995, the Louisiana Department of Environmental Quality advised the Company, that the Company, through one of its subsidiaries, and together with several other unaffiliated entities, have been named under state law as potentially responsible parties with respect to a hazardous substance site in Shreveport, Louisiana and may be required to share in the remediation cost, if any are incurred. However, considering the information currently known about the site and the involvement of the Company and its subsidiaries with respect to the site, the Company does not believe that the matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

On October 24, 1994, the United States Environmental Protection Agency (the "EPA") advised the Company that MRT and a number of other companies have been named under federal law as potentially responsible parties for a landfill site in West Memphis, Arkansas and may be required to share in the cost of remediation of this site. The EPA is continuing to investigate the possibility that other companies may have sent waste material to this site. Considering the information currently known about the site and the involvement of MRT, the Company does not believe that this matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

The Company is a party to litigation (other than that specifically noted) which arises in the normal course of business. Management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. Management believes that the effect on the Company's results of operations, financial position or cash flows, if any, from the disposition of theses matters will not be material.

[Exhibit 99(e)]

[Excerpt from NorAm First Quarter 10-Q for 1997]

G. As more fully described in the Company's 1996 Report on Form 10-K, the Company is currently working with the Minnesota Pollution Control Agency regarding the remediation of several sites on which gas was manufactured from the late 1800's to approximately 1960. The Company has made an accrual for its estimate of the costs of remediation (undiscounted and without regard to potential third-party recoveries) and, based upon discussions to date and prior decisions by regulators in the relevant jurisdictions, the Company continues to believe that it will be allowed substantial recovery of these costs through its regulated rates.

In addition, the Company has identified sites with possible mercury contamination based on the type of facilities located on these sites. The Company has not confirmed the existence of contamination at these sites, nor has any federal, state or local governmental agency imposed on the Company an obligation to investigate or remediate existing or potential mercury contamination. To the extent that any compliance costs are ultimately identified and quantified, the Company will provide an appropriate accrual and, to the extent justified based on the circumstances within each of the Company's regulatory jurisdictions, set up regulatory assets in anticipation of recovery through the ratemaking process.

On October 24, 1994, the United States Environmental Protection Agency advised MRT that it had been named a potentially responsible party under federal law with respect to a landfill site in West Memphis, Arkansas, see Note H.

On December 18, 1995, the Louisiana Department of Environmental Quality advised the Company that it had been named a potentially responsible party under state law with respect to a hazardous substance site in Shreveport, Louisiana, see Note H.

While the nature of environmental contingencies makes complete evaluation impractical, the Company is currently aware of no other environmental matter which could reasonably be expected to have a material impact on its results of operations, financial position or cash flows.

H. On August 14, 1996, an action styled Shaw vs. NorAm Energy Corp., et al. was filed in the District Court of Harris County, Texas by a purported NorAm stockholder against the Company, certain of its officers and directors and Houston Industries to enjoin the merger between the Company and Houston Industries (see Note B) or to rescind such merger and/or to recover damages in the event that the Transaction is consummated. The complaint alleges, among other things, that the merger consideration is inadequate, the Company's Board of Directors breached its fiduciary duties and that Houston Industries aided and abetted such breaches of fiduciary duties. In addition, the plaintiff seeks certification as a class action.

The Company believes that the claims are without merit and intends to vigorously defend against the lawsuit. Management believes that the effect on the Company's results of operations, financial position or cash flows, if any, from the disposition of this matter will not be material.

On October 24, 1994, the United States Environmental Protection Agency advised MRT, a wholly-owned subsidiary of the Company, that MRT, together with a number of other companies, had been named under federal law as a potentially responsible party for a landfill site in West Memphis, Arkansas and may be required to share in the cost of remediation of this site.

However, considering the information currently known about the site and the involvement of MRT, the Company does not believe that this matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

On December 18, 1995, the Louisiana Department of Environmental Quality advised the Company that the Company, through one of its subsidiaries and together with several other unaffiliated entities, had been named under state law as a potentially responsible party with respect to a hazardous substance site in Shreveport, Louisiana and may be required to share in the remediation cost, if any, of the site. However, considering the information currently known about the site and the involvement of the Company and its subsidiaries with respect to the site, the Company does not believe that the matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

The Company is a party to litigation (other than that specifically noted) which arises in the normal course of business. Management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters.

Management believes that the effect on the Company's results of operations, financial position or cash flows, if any, from the disposition of these matters will not be material.

[Exhibit 99(f)]

[Excerpt from NorAm Second Quarter Form 10-Q for 1997]

K. As more fully described in the Company's 1996 Report on Form 10-K, the Company is currently working with the Minnesota Pollution Control Agency regarding the remediation of several sites on which gas was manufactured from the late 1800's to approximately 1960. The Company has made an accrual for its estimate of the costs of remediation (undiscounted and without regard to potential third-party recoveries) and, based upon discussions to date and prior decisions by regulators in the relevant jurisdictions, the Company continues to believe that it will be allowed substantial recovery of these costs through its regulated rates.

In addition, the Company has identified sites with possible mercury contamination based on the type of facilities located on these sites. The Company has not confirmed the existence of contamination at these sites, nor has any federal, state or local governmental agency imposed on the Company an obligation to investigate or remediate existing or potential mercury contamination. To the extent that any compliance costs are ultimately identified and quantified, the Company will provide an appropriate accrual and, to the extent justified based on the circumstances within each of the Company's regulatory jurisdictions, set up regulatory assets in anticipation of recovery through the ratemaking process.

On June 18, 1997, the Mississippi Department of Environmental Quality advised the Company that the Company, through its Entex Distribution Division, had been identified as a potentially responsible party at a former manufactured gas plant site in Biloxi, Mississippi, see Note L.

On October 24, 1994, the United States Environmental Protection Agency advised MRT that it had been named a potentially responsible party under federal law with respect to a landfill site in West Memphis, Arkansas, see Note L.

On December 18, 1995, the Louisiana Department of Environmental Quality advised the Company that it had been named a potentially responsible party under state law with respect to a hazardous substance site in Shreveport, Louisiana, see Note L.

While the nature of environmental contingencies makes complete evaluation impractical, the Company is currently aware of no other environmental matter which could reasonably be expected to have a material impact on its results of operations, financial position or cash flows.

L. On June 18, 1997, the Mississippi Department of Environmental Quality advised the Company that the Company, through its Entex Distribution Division, had been identified as a potentially responsible party at a former manufactured gas plant site in Biloxi, Mississippi. Considering the information currently known about the site, the Company does not believe that the matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

On August 14, 1996, an action styled Shaw vs. NorAm Energy Corp., et al. was filed in the District Court of Harris County, Texas by a purported NorAm stockholder against the Company, certain of its officers and directors and HI to enjoin the merger between the Company and HI (see Note B) or to rescind such merger and/or to recover damages in the event that the HI merger transaction is consummated. The complaint alleges, among other things, that the merger consideration is inadequate, the Company's Board of Directors breached its fiduciary duties that HI aided and abetted such breaches of fiduciary duties. In addition, the plaintiff seeks certification as a class action. The Company believes that the claims are without merit and intends to vigorously defend against the lawsuit. Management believes that the effect on the Company's results of operations, financial position or cash flows, if any, from the disposition of this matter will not be material.

On October 24, 1994, the United States Environmental Protection Agency advised MRT, a wholly-owned subsidiary of the Company, that MRT, together with a number of other companies, had been named under federal law as a potentially responsible party for a landfill site in West Memphis, Arkansas and may be required to share in the cost of remediation of this site. However, considering the information currently known about the site and the involvement of MRT, the Company does not believe that this matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

On December 18, 1995, the Louisiana Department of Environmental Quality advised the Company that the Company, through one of its subsidiaries and together with several other unaffiliated entities, had been named under state law as a potentially responsible party with respect to a hazardous substance site in Shreveport, Louisiana and may be required to share in the remediation cost, if any, of the site. However, considering the information currently known about the site and the involvement of the Company and its subsidiaries with respect to the site, the Company does not believe that the matter will have a material adverse effect on the financial position, results of operations or cash flows of the Company.

The Company is a party to litigation (other than that specifically noted) which arises in the normal course of business. Management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. Management believes that the effect on the Company's results of operations, financial position or cash flows, if any, from the disposition of these matters will not be material.