

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

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 1995
OR

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

For the transition period from _____ to _____

Commission file number 1-7629

HOUSTON INDUSTRIES INCORPORATED
(Exact name of registrant as specified in its charter)

Texas 74-1885573

(State or other jurisdiction of
incorporation or organization) (I.R.S. Employer Identification No.)

5 Post Oak Park
4400 Post Oak Parkway
Houston, Texas 77027
(Address of principal executive offices) (Zip Code)

(713) 629-3000
(Registrant's telephone number, including area code)

Commission file number 1-3187

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.)

611 Walker Avenue
Houston, Texas 77002
(Address of principal executive offices) (Zip Code)

(713) 228-9211
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrants (1) have 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
registrants were required to file such reports), and (2) have been subject to
such filing requirements for the past 90 days. Yes No

As of October 31, 1995, Houston Industries Incorporated had 131,336,234 shares
of common stock outstanding, including 7,265,430 ESOP shares not deemed
outstanding for financial statement purposes. As of October 31, 1995, all of
Houston Lighting & Power Company's outstanding common stock was held, directly
or indirectly, by Houston Industries Incorporated.

HOUSTON INDUSTRIES INCORPORATED AND HOUSTON LIGHTING & POWER COMPANY
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED SEPTEMBER 30, 1995

This combined Form 10-Q is separately filed by Houston Industries Incorporated
and Houston Lighting & Power Company. Information contained herein relating to
Houston Lighting & Power Company is filed by Houston Industries Incorporated and
separately by Houston Lighting & Power Company on its own behalf. Houston
Lighting & Power Company makes no representation as to information relating to
Houston Industries Incorporated (except as it may relate to Houston Lighting &
Power Company) or to any other affiliate or subsidiary of Houston Industries
Incorporated.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1994 (Restated)	1995	1994 (Restated)
REVENUES.....	\$1,171,789	\$1,150,946	\$2,896,180	\$2,977,433
EXPENSES:				
Fuel.....	269,159	211,235	691,226	663,937
Purchased power.....	50,160	102,225	166,570	304,680
Operation and maintenance.....	228,913	212,507	645,092	610,447
Taxes other than income taxes.....	62,227	65,184	197,793	191,255
Depreciation and amortization.....	127,148	99,831	343,630	299,022
Total.....	737,607	690,982	2,044,311	2,069,341
OPERATING INCOME.....	434,182	459,964	851,869	908,092
OTHER INCOME (EXPENSE):				
Allowance for other funds used during construction.....	1,676	1,170	6,319	2,579
Dividend income.....	9,730		9,730	
Other - net.....	(8,103)	(7,509)	(35,756)	(20,938)
Total	3,303	(6,339)	(19,707)	(18,359)
INTEREST AND OTHER CHARGES:				
Interest on long-term debt.....	75,178	66,368	204,436	199,369
Other interest.....	2,777	5,475	21,454	18,510
Allowance for borrowed funds used during construction.....	(943)	(1,616)	(3,881)	(3,433)
Preferred dividends of subsidiary.....	6,772	8,305	23,207	24,981
Total	83,784	78,532	245,216	239,427
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING.....	353,701	375,093	586,946	650,306
INCOME TAXES.....	117,840	132,854	193,976	232,160
INCOME FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING.....	235,861	242,239	392,970	418,146
DISCONTINUED OPERATIONS (NET OF INCOME TAXES):				
Gain on sale of cable television subsidiary.....	618,088		708,695	
Loss from discontinued cable television operations.....		(6,271)		(21,355)
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING.....	853,949	235,968	1,101,665	396,791
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING FOR POSTEMPLOYMENT BENEFITS (NET OF INCOME TAXES OF \$4,415).....				(8,200)
NET INCOME.....	\$ 853,949	\$ 235,968	\$1,101,665	\$ 388,591

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HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME

EARNINGS PER COMMON SHARE:

CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING	\$ 1.90	\$ 1.97	\$ 3.17	\$ 3.41
DISCONTINUED OPERATIONS:				
Gain on sale of cable television subsidiary.....	4.99		5.73	
Loss from discontinued cable television operations.....		(0.05)		(0.17)
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING FOR POSTEMPLOYMENT BENEFITS.....				(0.07)
EARNINGS PER COMMON SHARE.....	\$ 6.89	\$ 1.92	\$ 8.90	\$ 3.17

DIVIDENDS DECLARED PER COMMON SHARE.....	\$ 0.75	\$ 0.75	\$ 2.25	\$ 2.25
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (000).....	123,947	123,060	123,773	122,665
Pro forma per share and weighted average share information reflecting the stock split effective November 16, 1995.				
CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING	\$ 0.95	\$ 0.98	\$ 1.59	\$ 1.70
DISCONTINUED OPERATIONS:				
Gain on sale of cable television subsidiary.....	2.49		2.86	
Loss from discontinued cable television operations.....		(0.02)		(0.09)
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING FOR POSTEMPLOYMENT BENEFITS.....				(0.03)
EARNINGS PER COMMON SHARE.....	\$ 3.44	\$ 0.96	\$ 4.45	\$ 1.58
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING (000).....	247,894	246,120	247,546	245,331

See Notes to Consolidated Financial Statements.

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

ASSETS

	SEPTEMBER 30, 1995	DECEMBER 31, 1994
	-----	-----
PROPERTY, PLANT AND EQUIPMENT - AT COST:		
Electric plant:		
Plant in service.....	\$ 11,976,652	\$ 11,743,070
Construction work in progress.....	340,423	333,180
Nuclear fuel.....	216,494	212,795
Plant held for future use.....	48,631	201,741
Electric plant acquisition adjustments.....	3,166	3,166
Other property.....	91,975	85,529
Total.....	----- 12,677,341	----- 12,579,481
Less accumulated depreciation and amortization.....	3,807,327	3,527,598
Property, plant and equipment - net.....	----- 8,870,014	----- 9,051,883
CURRENT ASSETS:		
Cash and cash equivalents.....	64,527	10,443
Special deposits.....	3,932	10
Accounts receivable - net.....	81,684	22,149
Accrued unbilled revenues.....	74,928	38,372
Time Warner dividends receivable.....	9,640	
Fuel stock, at lifo cost.....	49,430	56,711
Materials and supplies, at average cost.....	144,040	148,007
Prepayments.....	18,183	14,398
Total current assets.....	----- 446,364	----- 290,090
OTHER ASSETS:		
Net assets of discontinued cable television operations.....		618,982
Deferred plant costs - net.....	619,580	638,917
Deferred debits.....	343,909	281,204
Regulatory asset - net.....	230,813	235,463
Unamortized debt expense and premium on reacquired debt.....	161,456	161,885
Recoverable project costs - net.....	237,562	98,954
Investment in Time Warner equity securities.....	1,033,250	
Equity investment in foreign electric utility.....	28,280	25,699
Total other assets.....	----- 2,654,850	----- 2,061,104
Total.....	----- \$ 11,971,228	----- \$ 11,403,077
	=====	=====

See Notes to Consolidated Financial Statements.

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

CAPITALIZATION AND LIABILITIES

	SEPTEMBER 30, 1995	DECEMBER 31, 1994
	-----	-----
CAPITALIZATION:		
Common Stock Equity:		
Common stock, no par value	\$ 2,439,461	\$ 2,437,638
Unearned ESOP shares	(272,414)	(289,611)
Retained earnings	2,044,245	1,221,221
	-----	-----
Total common stock equity	4,211,292	3,369,248
	-----	-----
Preference Stock, no par value, authorized 10,000,000 shares; none outstanding		
Cumulative Preferred Stock of Subsidiary, no par value:		
Not subject to mandatory redemption	351,345	351,345
Subject to mandatory redemption	51,055	121,910
	-----	-----
Total cumulative preferred stock	402,400	473,255
	-----	-----
Long-Term Debt:		
Debentures	548,867	548,729
Long-term debt of subsidiaries:		
First mortgage bonds	2,997,668	3,020,400
Pollution control revenue bonds	4,419	155,247
Other	6,908	9,757
	-----	-----
Total long-term debt	3,557,862	3,734,133
	-----	-----
Total capitalization	8,171,554	7,576,636
	-----	-----
CURRENT LIABILITIES:		
Notes payable		423,291
Accounts payable	115,451	159,225
Taxes accrued	231,193	169,690
Interest accrued	87,669	73,527
Dividends accrued	98,502	98,469
Accrued liabilities to municipalities	27,531	21,307
Customer deposits	62,897	64,905
Current portion of long-term debt and preferred stock	179,449	49,475
Other	70,376	64,026
	-----	-----
Total current liabilities	873,068	1,123,915
	-----	-----
DEFERRED CREDITS:		
Accumulated deferred federal income taxes	2,036,986	1,763,230
Unamortized investment tax credit	397,007	411,580
Fuel-related credits	119,087	242,912
Other	373,526	284,804
	-----	-----
Total deferred credits	2,926,606	2,702,526
	-----	-----
COMMITMENTS AND CONTINGENCIES		
Total	\$ 11,971,228	\$ 11,403,077
	=====	=====

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)

	NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1994
		(Restated)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Income from continuing operations	\$ 392,970	\$ 418,146
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	343,630	299,022
Amortization of nuclear fuel	21,892	13,352
Deferred income taxes	53,855	69,898
Investment tax credit	(14,573)	(14,560)
Allowance for other funds used during construction	(6,319)	(2,579)
Fuel refund	(189,389)	
Fuel cost over recovery	55,905	152,130
Net cash provided by discontinued cable television operations	16,391	12,180
Changes in other assets and liabilities:		
Accounts receivable and accrued unbilled revenues	(96,091)	(21,422)
Inventory	11,248	6,896
Other current assets	(17,347)	15,464
Accounts payable	(43,774)	(72,471)
Interest and taxes accrued	75,645	7,978
Other current liabilities	10,569	13,475
Other - net	31,058	55,114
Net cash provided by operating activities	645,670	952,623
CASH FLOWS FROM INVESTING ACTIVITIES:		
Electric capital and nuclear fuel expenditures (including allowance for borrowed funds used during construction)	(206,474)	(297,861)
Non-regulated electric power project expenditures	(12,388)	(431)
Corporate headquarters expenditures (including capitalized interest)	(78,828)	(22,558)
Settlement of subsidiary debt in connection with sale of cable television subsidiary	621,954	
Net cash used in discontinued cable television operations	(47,601)	(32,601)
Other - net	(9,807)	(10,419)
Net cash provided by (used in) investing activities	266,856	(363,870)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sale of first mortgage bonds	142,988	
Payment of matured bonds		(19,500)
Redemption of preferred stock	(91,400)	(20,000)
Payment of common stock dividends	(278,611)	(276,202)
Decrease in notes payable - net	(423,291)	(212,785)
Extinguishment of long-term debt	(174,140)	
Net cash used in discontinued cable television operations	(40,798)	(72,298)
Other - net	6,810	5,026
Net cash used in financing activities	(858,442)	(595,759)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	54,084	(7,006)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	10,443	14,884
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 64,527	\$ 7,878

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SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash Payments:		
Interest (net of amounts capitalized)	\$ 261,292	\$ 262,570
Income taxes	61,691	136,933

See Notes to Consolidated Financial Statements.

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

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1994	1995	1994
Balance at Beginning of Period	\$ 1,283,326	\$ 1,160,081	\$ 1,221,221	\$ 1,191,230
Net Income for the Period	853,949	235,968	1,101,665	388,591
Total	2,137,275	1,396,049	2,322,886	1,579,821
Common Stock Dividends	(93,030)	(92,910)	(278,641)	(276,682)
Balance at End of Period	\$ 2,044,245	\$ 1,303,139	\$ 2,044,245	\$ 1,303,139

See Notes to Consolidated Financial Statements.

HOUSTON LIGHTING & POWER COMPANY
STATEMENTS OF INCOME
(THOUSANDS OF DOLLARS)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1994	1995	1994
OPERATING REVENUES	\$ 1,171,789	\$ 1,150,946	\$ 2,896,180	\$ 2,977,433
OPERATING EXPENSES:				
Fuel	269,159	211,235	691,226	663,937
Purchased power	50,160	102,225	166,570	304,680
Operation	169,248	156,809	464,174	431,611
Maintenance	59,665	55,698	180,918	178,836
Depreciation and amortization	126,849	99,571	342,723	298,175
Income taxes	126,223	139,365	222,533	248,359
Other taxes	62,227	65,184	197,793	191,255
Total	863,531	830,087	2,265,937	2,316,853
OPERATING INCOME	308,258	320,859	630,243	660,580
OTHER INCOME (EXPENSE):				
Allowance for other funds used during construction	1,676	1,170	6,319	2,579
Other - net	1,807	(1,494)	(8,701)	(7,253)
Total	3,483	(324)	(2,382)	(4,674)
INCOME BEFORE INTEREST CHARGES	311,741	320,535	627,861	655,906
INTEREST CHARGES:				
Interest on long-term debt	62,038	61,565	184,955	184,964
Other interest	2,715	1,189	6,639	5,938
Allowance for borrowed funds used during construction	(943)	(1,616)	(3,881)	(3,433)
Total	63,810	61,138	187,713	187,469
INCOME BEFORE CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING	247,931	259,397	440,148	468,437
CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING FOR POSTEMPLOYMENT BENEFITS (NET OF INCOME TAXES OF \$4,415)				(8,200)
NET INCOME	247,931	259,397	440,148	460,237
DIVIDENDS ON PREFERRED STOCK	6,772	8,305	23,207	24,981
INCOME AFTER PREFERRED DIVIDENDS	\$ 241,159	\$ 251,092	\$ 416,941	\$ 435,256

See Notes to Financial Statements.

HOUSTON LIGHTING & POWER COMPANY
BALANCE SHEETS
(THOUSANDS OF DOLLARS)

ASSETS

	SEPTEMBER 30, 1995	DECEMBER 31, 1994
	-----	-----
PROPERTY, PLANT AND EQUIPMENT - AT COST:		
Electric plant in service.....	\$ 11,976,652	\$ 11,743,070
Construction work in progress.....	340,423	333,180
Nuclear fuel.....	216,494	212,795
Plant held for future use.....	48,631	201,741
Electric plant acquisition adjustments.....	3,166	3,166
	-----	-----
Total.....	12,585,366	12,493,952
Less accumulated depreciation and amortization.....	3,797,095	3,517,923
	-----	-----
Property, plant and equipment - net.....	8,788,271	8,976,029
	-----	-----
CURRENT ASSETS:		
Cash and cash equivalents.....	268,992	235,867
Special deposits.....	432	10
Accounts receivable:		
Affiliated companies.....	3,724	4,213
Others.....	47,481	8,896
Accrued unbilled revenues.....	74,928	38,372
Inventory:		
Fuel stock, at lifo cost.....	49,430	56,711
Materials and supplies, at average cost.....	143,624	147,922
Prepayments.....	13,924	9,665
	-----	-----
Total current assets.....	602,535	501,656
	-----	-----
OTHER ASSETS:		
Deferred plant costs - net.....	619,580	638,917
Deferred debits.....	290,195	241,611
Unamortized debt expense and premium on reacquired debt.....	159,493	158,351
Regulatory asset - net.....	230,813	235,463
Recoverable project costs - net.....	237,562	98,954
	-----	-----
Total other assets.....	1,537,643	1,373,296
	-----	-----
Total.....	\$ 10,928,449	\$ 10,850,981
	=====	=====

See Notes to Financial Statements.

HOUSTON LIGHTING & POWER COMPANY
BALANCE SHEETS
(THOUSANDS OF DOLLARS)

CAPITALIZATION AND LIABILITIES

	SEPTEMBER 30, 1995	DECEMBER 31, 1994
	-----	-----
CAPITALIZATION:		
Common Stock Equity:		
Common stock, class A; no par value	\$ 1,524,949	\$ 1,524,949
Common stock, class B; no par value	150,978	150,978
Retained earnings	2,323,300	2,153,109
	-----	-----
Total common stock equity	3,999,227	3,829,036
	-----	-----
Cumulative Preferred Stock:		
Not subject to mandatory redemption	351,345	351,345
Subject to mandatory redemption	51,055	121,910
	-----	-----
Total cumulative preferred stock	402,400	473,255
	-----	-----
Long-Term Debt:		
First mortgage bonds	2,997,668	3,020,400
Pollution control revenue bonds	4,419	155,247
Other	6,908	9,757
	-----	-----
Total long-term debt	3,008,995	3,185,404
	-----	-----
Total capitalization	7,410,622	7,487,695
	-----	-----
CURRENT LIABILITIES:		
Accounts payable	100,892	148,042
Accounts payable to affiliated companies	4,845	10,936
Taxes accrued	258,113	181,043
Interest accrued	73,358	64,732
Accrued liabilities to municipalities	27,531	21,307
Customer deposits	62,897	64,905
Current portion of long-term debt and preferred stock	179,449	49,475
Other	66,576	59,912
	-----	-----
Total current liabilities	773,661	600,352
	-----	-----
DEFERRED CREDITS:		
Accumulated deferred federal income taxes	1,926,487	1,876,300
Unamortized investment tax credit	397,007	411,580
Fuel-related credits	119,087	242,912
Other	301,585	232,142
	-----	-----
Total deferred credits	2,744,166	2,762,934
	-----	-----
COMMITMENTS AND CONTINGENCIES		
Total	\$10,928,449	\$10,850,981
	=====	=====

See Notes to Financial Statements.

HOUSTON LIGHTING & POWER COMPANY
STATEMENTS OF CASH FLOWS

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

	NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 440,148	\$ 460,237
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	342,723	298,175
Amortization of nuclear fuel	21,892	13,352
Deferred income taxes	50,187	83,088
Investment tax credits	(14,573)	(14,560)
Allowance for other funds used during construction	(6,319)	(2,579)
Fuel refund	(189,389)	
Fuel cost over recovery	55,905	152,130
Cumulative effect of change in accounting for postemployment benefits		8,200
Changes in other assets and liabilities:		
Accounts receivable - net	(74,652)	(12,950)
Materials and supplies	4,298	5,320
Fuel stock	7,281	1,612
Accounts payable	(53,241)	(58,821)
Interest and taxes accrued	85,696	12,441
Other current liabilities	12,869	14,537
Other - net	36,884	43,109
Net cash provided by operating activities	719,709	1,003,291
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital and nuclear fuel expenditures (including allowance for borrowed funds used during construction)	(291,474)	(297,861)
Other - net	(6,906)	(9,808)
Net cash used in investing activities	(298,380)	(307,669)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from first mortgage bonds	142,988	
Payment of matured bonds		(19,500)
Payment of dividends	(271,979)	(272,259)
Decrease in notes payable		(171,100)
Redemption of preferred stock	(91,400)	(20,000)
Extinguishment of long-term debt	(174,140)	
Other - net	6,327	3,911
Net cash used in financing activities	(388,204)	(478,948)
NET INCREASE IN CASH AND CASH EQUIVALENTS	33,125	216,674
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	235,867	12,413
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 268,992	\$ 229,087
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Payments:		
Interest (net of amounts capitalized)	\$ 184,485	\$ 186,778
Income taxes	67,743	136,889

See Notes to Financial Statements.

HOUSTON LIGHTING & POWER COMPANY
 STATEMENTS OF RETAINED EARNINGS
 (THOUSANDS OF DOLLARS)

	THREE MONTHS ENDED SEPTEMBER 30,		NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1994	1995	1994
Balance at Beginning of Period	\$2,164,391	\$2,048,593	\$2,153,109	\$2,028,924
Net Income for the Period	247,931	259,397	440,148	460,237
Total	2,412,322	2,307,990	2,593,257	2,489,161
Deductions - Cash Dividends:				
Preferred	6,772	8,305	23,207	24,981
Common	82,250	82,251	246,750	246,746
Total	89,022	90,556	269,957	271,727
Balance at End of Period	\$2,323,300	\$2,217,434	\$2,323,300	\$2,217,434

See Notes to Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AND

HOUSTON LIGHTING & POWER COMPANY

NOTES TO FINANCIAL STATEMENTS

(1) GENERAL

The interim consolidated financial statements and notes contained in this Form 10-Q should be read in conjunction with the financial statements and notes contained in the Combined Form 8-K (File Nos. 1-7629 and 1-3187) dated May 12, 1995 of Houston Industries Incorporated (Company) and Houston Lighting & Power Company (HL&P) (Combined Form 8-K).

The results of interim periods are not necessarily indicative of results expected for the year due to, among other things, the seasonal nature of HL&P's business and the timing of scheduled and unscheduled maintenance. In the opinion of management, the interim financial information reflects all adjustments, including accruals of estimated expenses, necessary for a fair presentation of the results for the interim periods. Certain amounts from the previous year have been reclassified to conform to the 1995 presentation of financial statements. Such reclassifications do not affect earnings.

(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 Electric Generating Station (South Texas Project), which consists of two 1,250 megawatt (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 September 30, 1995, HL&P's investments (net of \$422.9 million plant accumulated depreciation and \$135.8 million nuclear fuel amortization) in the South Texas Project and in nuclear fuel, including allowance for funds used during construction, were \$2.0 billion and \$80.7 million, respectively.

(b) UNITED STATES NUCLEAR REGULATORY COMMISSION (NRC) INSPECTIONS AND OPERATIONS. Between June 1993 and February 1995, the South Texas Project was listed on the NRC's "watch list" of plants with weaknesses that warrant increased NRC regulatory attention. For information on these proceedings, see Note 2(b) of the notes to the financial statements included in the Combined Form 8-K, which note is incorporated herein by reference.

In October 1995, the NRC issued a Notice of Violation and Proposed Imposition of Civil Penalties of \$160,000 against HL&P based on conclusions that HL&P had discriminated against two former members of the South Texas Project's nuclear security department in retaliation for their having identified and reported safety concerns to the NRC. Certain current and former employees of

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HL&P or contractors of HL&P have asserted claims that their employment was terminated or disrupted in retaliation for their having made safety-related complaints to the NRC. Although no prediction can be made as to the ultimate outcome of these claims, the Company and HL&P do not believe they will have a material adverse effect on the Company's or HL&P's financial condition or results of operations. For information regarding these claims, see Note 2(b) of the notes to the financial statements included in the Company's and HL&P's Combined Quarterly Report on Form 10-Q for the quarter ended March 31, 1995 (Combined First Quarter Form 10-Q), which note is incorporated herein by reference.

(c) LITIGATION WITH CO-OWNERS OF THE SOUTH TEXAS PROJECT. In February 1994, the City of Austin (Austin), one of the four co-owners of the South Texas Project, filed suit (Austin II Litigation) against HL&P. The suit, which is pending in the 11th District Court of Harris County, Texas, is not anticipated to be tried before March 1996. Austin alleges that the outages at the South Texas Project from early 1993 to early 1994 were due to HL&P's failure to perform obligations it owed to Austin under the Participation Agreement among the four co-owners of the South Texas Project (Participation Agreement). Austin also asserts that HL&P breached certain undertakings voluntarily assumed by HL&P on behalf of the co-owners under the terms of the NRC Operating Licenses and Technical Specifications relating to the South Texas Project.

Under amended pleadings in the Austin II Litigation, Austin claims HL&P's failure to perform obligations it owed to Austin under the Participation Agreement have caused Austin damages of at least \$150 million due to the incurrence of increased operating and maintenance costs, the cost of replacement power and lost profits on wholesale transactions that did not occur. In May 1994, the City of San Antonio (San Antonio), another co-owner of the South Texas Project, intervened in the litigation filed by Austin against HL&P and asserted claims similar to those asserted by Austin. Although San Antonio has not specified the damages sought in its complaint, expert reports filed in the litigation have indicated that San Antonio's claims may be in excess of \$275 million. HL&P's motion to strike San Antonio's intervention and compel arbitration of San Antonio's claims under the Participation Agreement has been denied.

Although HL&P and the Company do not believe there is merit to either Austin's or San Antonio's claims and have opposed San Antonio's intervention in the Austin II Litigation, there can be no assurance as to the ultimate outcome of these matters.

- (d) NUCLEAR INSURANCE. For a discussion of the nuclear property and nuclear liability insurance maintained in connection with the South Texas Project and potential assessments associated therewith, see Note 2(d) of the notes to the financial statements included in the Combined Form 8-K.
- (e) NUCLEAR DECOMMISSIONING. For a discussion of nuclear decommissioning costs, the Company's decommissioning funding level and the accounting for debt and equity securities held by the decommissioning trust, see Note 2(e) of the notes to the financial statements included in the Combined Form 8-K.
- (f) DEFERRED PLANT COSTS. The amortization of deferred plant costs associated with the South Texas Project totaled \$6.4 million and \$19.3 million for the three and nine months ended September 30,

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1995, respectively, and is included on the Company's Statements of Consolidated Income and HL&P's Statements of Income in depreciation and amortization expense.

(3) SETTLEMENT OF RATE PROCEEDING AND OTHER MATTERS

In August 1995, the Public Utility Commission of Texas (Utility Commission) unanimously approved a settlement agreement (Settlement), entered into in February 1995, resolving HL&P's pending 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 Settlement precludes HL&P from seeking rate increases until after December 31, 1997. HL&P began recording the estimated effects of the Settlement in the first quarter of 1995.

In the third quarter and first nine months of 1995, HL&P's earnings were reduced by approximately \$42 million and \$79 million, respectively, as a result of the Settlement. The after-tax effects are as follows:

	THREE MONTHS ENDED SEPTEMBER 30, 1995	NINE MONTHS ENDED SEPTEMBER 30, 1995
	----- (Millions of Dollars)	
Reduction in Base Revenues.....	\$25	\$47
South Texas Project Write Down.....	14	19
One-Time Write-Off of Mine-Related Costs.....		6
Other Expenses.....	3	7
	---	---
Total Settlement Effect on Net Income.....	\$42	\$79
	===	===

The Settlement gives HL&P the option to write down up to \$50 million per year of its investment in the South Texas Project for a five year period commencing January 1, 1995. The parties to the Settlement agreed that any such write down will be treated as a reasonable and necessary expense during routine reviews of HL&P's earnings and any rate review proceeding initiated against HL&P. HL&P recorded in the third quarter a \$21 million pre-tax write down (in addition to a \$7 million pre-tax write down recorded during the second quarter) of this investment, which amounts are included in the Company's Statements of Consolidated Income and HL&P's Statements of Income in depreciation and amortization expense. HL&P began accruing decommissioning expense for its interest in the South Texas Project at an annual rate of \$14.8 million, a \$9 million annual increase over its 1994 expense.

In addition, the Settlement requires that HL&P commence amortizing, no later than January 1996, its investment in certain lignite reserves associated with the cancelled Malakoff Electric Generating Station (Malakoff) project (\$153 million as of September 30, 1995) over a period not to exceed seven years. This additional amortization will equal approximately \$22 million per year. HL&P does not currently anticipate beginning amortization of this investment until January 1996. As a result of this additional amortization, all of HL&P's remaining investment in Malakoff will be fully amortized no later than December 31, 2002.

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During the second quarter of 1995, HL&P recorded a one-time pre-tax charge of \$9 million incurred in connection with certain Malakoff mine-related costs which were not previously recorded and are not recoverable under the terms of the Settlement.

Also, the parties to the Settlement agreed to dismiss their respective appeals of certain Utility Commission orders as discussed below.

(4) APPEALS OF PRIOR UTILITY COMMISSION ORDERS

The following is a summary of the status of judicial review of the following Utility Commission orders:

- (a) 1991 RATE CASE. In accordance with the terms of the Settlement, the Office of Public Utility Counsel has dismissed with prejudice its appeal of the Utility Commission's order in Docket No. 9850 (1991 Rate Case). As a result of this action, the Utility Commission's decision in Docket No. 9850 has become final.
- (b) PRUDENCE REVIEW OF THE CONSTRUCTION OF THE SOUTH TEXAS PROJECT (DOCKET NO. 6668). Parties to the Settlement have either dismissed their respective appeals from the Utility Commission's 1986 order concerning the prudence of the construction of the South Texas Project or are committed to do so in the near future. However, an appeal by a party who did not join in the Settlement remains pending. For a discussion of Docket No. 6668, see Note 4(d) of the notes to the financial statements included in the Combined Form 8-K.
- (c) DEFERRED ACCOUNTING. In June 1994, the Texas Supreme Court held that the Utility Commission had statutory authority to grant deferred accounting treatment for both carrying costs and maintenance expenses. All remaining challenges to the Utility Commission's approval of deferred accounting for HL&P were rejected in August 1995 by the Court of Appeals, following remand to that court by the Texas Supreme Court. As a result, the Utility Commission's decisions in Docket Nos. 8230 and 9010 have become final.
- (d) 1988 RATE CASE. Two issues concerning HL&P's 1988 rate case (Docket No. 8425) are currently pending decision by the Texas Supreme Court: (i) the treatment by HL&P of certain costs associated with the Malakoff generating station as "plant held for future use" and (ii) the treatment by HL&P of certain tax savings associated with federal income tax deductions for expenses not included in cost of service for ratemaking purposes. For additional information regarding these issues, see Note 4(b) of the notes to the financial statements included in the Company's and HL&P's Combined Quarterly Form 10-Q for the quarter ended June 30, 1995, which note is incorporated herein by reference, and Note 4(b) of the notes to the financial statements included in the Combined Form 8-K.

(5) CAPITAL STOCK

- (a) COMPANY COMMON STOCK. At September 30, 1995 and December 31, 1994 the Company had authorized 400,000,000 shares of common stock, of which 124,040,835 and 123,526,350 shares, respectively, were outstanding. Outstanding shares exclude the unallocated Employee Stock

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Ownership Plan shares which as of September 30, 1995 and December 31, 1994 were 7,295,399 and 7,770,313, respectively. For information about the common stock split recently declared by the Company, see Note 9.

- (b) HL&P COMMON STOCK. All issued and outstanding Class A voting common stock of HL&P is held by the Company and all issued and outstanding Class B non-voting common stock of HL&P is held by Houston Industries (Delaware) Incorporated, a wholly-owned subsidiary of the Company.
- (c) HL&P PREFERRED STOCK. At September 30, 1995 and December 31, 1994, HL&P had 10,000,000 shares of preferred stock authorized, of which 4,318,397 and 5,232,397 shares, respectively, were outstanding.

In April 1995, HL&P redeemed, at \$100 per share, 514,000 shares of its \$9.375 cumulative preferred stock. The redemption included 257,000 shares in satisfaction of mandatory sinking fund requirements, and an additional 257,000 shares as an optional redemption.

In June 1995, HL&P redeemed, at \$100 per share, all 400,000 shares of its \$8.50 cumulative preferred stock. The redemption included 200,000 shares in satisfaction of mandatory sinking fund requirements, and the remaining 200,000 shares as an optional redemption.

(6) HL&P LONG-TERM DEBT

In June 1995, HL&P purchased from a third party \$19.0 million aggregate principal amount of its 8 3/4% first mortgage bonds due 2022 for a total purchase price of \$20.7 million.

In July 1995, \$150.9 million aggregate principal amount of revenue refunding bonds collateralized by HL&P's first mortgage bonds were issued on behalf of HL&P. The new bonds bear an initial interest rate of 5.8%, variable at HL&P's option after a five-year no-call period, and mature in 2015. Proceeds from these issuances were used in 1995 to redeem, at 102% of their aggregate principal amount, pollution control revenue bonds aggregating \$150.9 million (bearing a weighted average interest rate of 9.9%).

(7) DISCONTINUED CABLE TELEVISION OPERATIONS

In July 1995, the Company completed the sale of KBLCOM Incorporated (KBLCOM), its cable television subsidiary, to Time Warner Inc. (Time Warner). The Company's 1995 earnings include a gain on the sale of \$709 million, subject to post closing adjustments, \$91 million of which was recorded during the first quarter and the balance during the third quarter. Effective January 1, 1995, the operations of KBLCOM were accounted for as discontinued and prior periods were restated for consistency in reflecting KBLCOM as a discontinued operation. For a presentation of the Company's consolidated financial statements for the years 1992 through 1994 which reflects KBLCOM on a discontinued operations basis, see the Combined Form 8-K.

In exchange for KBLCOM's common stock, the Company received 1 million shares of Time Warner common stock and 11 million shares of non-publicly

traded convertible preferred stock. Time Warner also purchased from the Company for cash approximately \$622 million of

KBLCOM's intercompany indebtedness and assumed approximately \$650 million of KBLCOM's external debt and other liabilities. The convertible preferred stock has an aggregate liquidation preference (redeemable after July 6, 2000) of \$100 per share (plus accrued and unpaid dividends), is entitled to cumulative annual dividends of \$3.75 per share until July 6, 1999, is currently convertible by the Company and after four years is exchangeable by Time Warner into approximately 22.9 million shares of Time Warner common stock. Under the terms of the sale, the Company may make up to four demands for registration of its shares of Time Warner common stock. Subject to certain exceptions, the terms of the sale prohibit the Company from acquiring additional shares of Time Warner securities or selling shares of Time Warner securities to any holder of more than 5 percent of any class of Time Warner voting securities.

The Time Warner securities were recorded at a combined fair value of approximately \$1 billion on the closing date of the sale (previously estimated to be approximately \$1.1 billion) and are reflected on the Company's Consolidated Balance Sheets as investment in Time Warner equity securities. Investment in the Time Warner common stock is considered an "available for sale" equity security under Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and, therefore, unrealized net changes in the fair value of the securities (exclusive of dividends and write downs) will be excluded from earnings and reported as a net amount in a separate component of shareholders' equity until realized. Investment in the Time Warner convertible preferred stock is not subject to the requirements of SFAS No. 115 since it is a non-publicly traded equity security and, therefore, is accounted for under the cost method. Dividends on the securities will be recognized as income as earned. Based on current rates, after-tax dividends of approximately \$37 million are expected to be received annually through July 1999. The Company recorded pre-tax dividend income of \$9.7 million in the third quarter of 1995.

Operating results from discontinued operations for the nine months ended September 30, 1995 and 1994 were as follows:

	NINE MONTHS ENDED SEPTEMBER 30,	
	1995	1994
	(Thousands of Dollars)	
Revenues	\$ 143,925	\$187,308
Operating expenses (1).....	86,938	118,092
Gross operating margin (1).....	56,987	69,216
Depreciation, amortization, interest and other.....	81,570	96,245
Income tax benefit.....	(4,997)	(5,674)
Deferred loss (2).....	(19,586)	
Loss from discontinued operations (3).....	\$ 0	(\$21,355)

(1) Exclusive of depreciation and amortization.

(2) The net loss from discontinued operations of KBLCOM through the date of sale (July 6, 1995) was deferred by the Company. Upon closing of the sale the deferred loss was

included as an adjustment to the gain on sale of cable television subsidiary on the Company's Statements of Consolidated Income.

(3) Loss from discontinued operations of KBLCOM excludes the effects of corporate overhead charges and includes interest expense relating to the amount of intercompany debt that Time Warner purchased from the Company.

In March 1995, KBL Cable, Inc. (KBL Cable), a subsidiary of KBLCOM, made a scheduled repayment of \$15.8 million principal amount of its senior notes and senior subordinated notes. In the first quarter of 1995, KBL Cable repaid borrowings under its senior bank credit facility in the amount of \$25.0 million.

(8) EARLY RETIREMENT PLAN

The Company offered eligible employees (excluding officers) of the Company, HL&P and Houston Industries Energy, Inc. (HI Energy), who were 55 years of age or older and had at least 10 years of service as of July 31, 1995 an incentive program to retire early. For employees electing early retirement, the program would add five years of service credit and five years in age up to 35 years of service and age 65, respectively, in determining an employee's pension. Each participating employee (under age 62) would also receive a supplemental benefit to age 62. During July 1995, the early retirement incentive was accepted by approximately 300 employees.

Pension benefits and supplemental benefits (if applicable) are being paid out from the Houston Industries Incorporated Retirement Trust. Based on

the projected costs associated with the program, HL&P increased its retirement plan and supplemental benefits by approximately \$28 million and \$5 million, respectively. Pursuant to SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation", HL&P deferred the costs associated with the increases in these benefit obligations and is amortizing the costs over the period ending December 31, 1997.

(9) SUBSEQUENT EVENT

In November 1995, the Board of Directors of the Company approved a two-for-one common stock split in the form of a 100 percent stock dividend. This stock dividend will be effective for shareholders of record at the close of business on November 16, 1995 and distributed on December 9, 1995.

The pro forma effect of the stock split on shareholders' equity would have been to double the number of common stock shares issued and outstanding to 248,081,670 and 247,052,700 at September 30, 1995 and December 31, 1994, respectively.

The quarterly common stock dividend of \$0.75 per share declared on September 6, 1995 and payable on December 9, 1995 will be paid on the basis of pre-stock split shares of common stock. The Board of Directors has no current plans to change the Company's total dividend payout following the stock split.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

CURRENT ISSUES

HL&P

In August 1995, the Utility Commission unanimously approved a settlement agreement relating to HL&P's most recent rate case (including separate proceedings regarding the prudence of operation of the South Texas Project). Subject to certain changes in existing regulation or legislation, the Settlement precludes HL&P from seeking rate increases through December 31, 1997. HL&P began recording the estimated effects of the Settlement in the first quarter of 1995.

Effective retroactive to January 1, 1995, the Settlement reduced HL&P's base revenues \$73 million for the first nine months of 1995. The Settlement also provides HL&P the option to write down up to \$50 million per year of its investment in the South Texas Project, which amount will be treated as a reasonable and necessary expense during routine reviews of HL&P's earnings and any rate review proceeding initiated against HL&P. HL&P is also accruing decommissioning expenses for its interest in the South Texas Project at an annual rate of \$14.8 million, a \$9 million annual increase over its 1994 expense. The Settlement requires that HL&P commence amortizing, no later than January 1996, its investment in certain lignite reserves associated with the cancelled Malakoff project (\$153 million as of September 30, 1995) over a period not to exceed seven years. This additional amortization will equal approximately \$22 million per year. HL&P does not currently anticipate beginning amortization of this investment until January 1996. As a result of this additional amortization, all of HL&P's remaining investment in Malakoff will be fully amortized no later than December 31, 2002.

As a result of the Settlement, in the third quarter and first nine months of 1995, HL&P's earnings were reduced by approximately \$42 million and \$79 million, respectively. These reductions include HL&P's decision to write down \$21 million (\$14 million after-tax) and \$28 million (\$19 million after-tax) of its investment in the South Texas Project in the third quarter and first nine months of 1995, respectively. For additional information, see Note 3 to the Company's Consolidated and HL&P's Financial Statements (Financial Statements) in Item 1 of this Report.

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RESULTS OF OPERATIONS

COMPANY

Summary of selected financial data for the Company and its subsidiaries is set forth below:

	THREE MONTHS ENDED SEPTEMBER 30,		PERCENT CHANGE
	1995	1994	
	(Restated)		
	(Thousands of Dollars)		
Revenues.....	\$1,171,789	\$1,150,946	2
Operating Expenses.....	737,607	690,982	7
Operating Income.....	434,182	459,964	(6)
Interest and Other Charges.....	83,784	78,532	7
Income Taxes.....	117,840	132,854	(11)
Income from Continuing Operations.....	235,861	242,239	(3)
Net Income.....	853,949	235,968	262
	(Thousands of Dollars)		
	NINE MONTHS ENDED SEPTEMBER 30,		PERCENT CHANGE
	1995	1994	
	(Restated)		
	(Thousands of Dollars)		
Revenues.....	\$2,896,180	\$2,977,433	(3)
Operating Expenses.....	2,044,311	2,069,341	(1)
Operating Income.....	851,869	908,092	(6)
Interest and Other Charges.....	245,216	239,427	2
Income Taxes.....	193,976	232,160	(16)
Income from Continuing Operations.....	392,970	409,946	(4)
Net Income.....	1,101,665	388,591	184

The references to per share amounts below contemplate the effects of the two-for-one stock split which will be effective November 16, 1995. See Note 9 of the notes to the Financial Statements in Item 1 of this Report.

The Company had consolidated earnings per share of \$3.44 (\$6.89 pre-split) for the third quarter of 1995, including a one-time gain of \$618 million on the sale of KBLCOM. Excluding the gain from the KBLCOM sale, consolidated earnings per share from continuing operations for the third quarter of 1995 were \$0.95 (\$1.90 pre-split) compared to \$0.98 (\$1.97 pre-split) for the third quarter of 1994. Consolidated earnings per share for the nine months ended September 30, 1995 were \$4.45 (\$8.90 pre-split) per share, including the gain on the KBLCOM sale of \$709 million. Excluding the gain from the KBLCOM sale, consolidated earnings per share from continuing operations for the nine months ended September 30, 1995 were \$1.59 (\$3.17 pre-split) compared to \$1.67 (\$3.34 pre-split) per share for the same period in 1994. The decline in earnings from continuing operations is primarily

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attributable to (i) a decrease in HL&P's earnings as discussed below and (ii) increased expenses associated with HI Energy's project development activities, partially offset by dividends from Time Warner securities.

HL&P

Summary of selected financial data for HL&P is set forth below:

	THREE MONTHS ENDED SEPTEMBER 30,		PERCENT CHANGE
	1995	1994	
	(Thousands of Dollars)		
Base Revenues (1).....	\$ 869,950	\$ 888,015	(2)
Reconcilable Fuel Revenues.....	301,839	262,931	15
Operating Expenses (2).....	863,531	830,087	4
Operating Income (2).....	308,258	320,859	(4)
Interest Charges.....	63,810	61,138	4
Income After Preferred Dividends.....	241,159	251,092	(4)
	(Thousands of Dollars)		
	NINE MONTHS ENDED SEPTEMBER 30,		PERCENT CHANGE
	1995	1994	
	(Thousands of Dollars)		
Base Revenues (1).....	\$2,099,964	\$2,155,702	(3)
Reconcilable Fuel Revenues.....	796,216	821,731	(3)
Operating Expenses (2).....	2,265,937	2,316,853	(2)

Operating Income (2).....	630,243	660,580	(5)
Interest Charges.....	187,713	187,469	-
Income After Preferred Dividends.....	416,941	435,256	(4)

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- (1) Includes miscellaneous revenues, certain non-reconcilable fuel revenues and certain purchased power related revenues.
 - (2) Inclusive of income taxes.

The decrease in HL&P's earnings for the third quarter and first nine months of 1995 compared to the same periods in 1994 resulted primarily from the impact of the Settlement. For information regarding the terms of the Settlement and its effect on HL&P's financial position and results of operation, see Note 3 to the Financial Statements in Item 1 of this Report. The negative effects of the Settlement were partially offset by an increase in residential and commercial kilowatt-hour (KWH) sales for the third quarter and first nine months of 1995, as discussed below.

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OPERATING REVENUES AND SALES

The decreases in base revenues of \$18.1 million and \$55.7 million for the third quarter and first nine months of 1995, respectively, compared to the same periods in 1994, were due to the impact of the Settlement and a reduction in revenues associated with recovery of certain purchased power costs, partially offset by increases in residential and commercial KWH sales. The base revenues associated with certain purchased power costs were substantially reduced in 1995 upon expiration of a purchased power contract. The related expenses are equally reduced, resulting in no impact on earnings.

For the third quarter and first nine months of 1995, residential KWH sales increased 7% and 5%, respectively, and commercial KWH sales were up 4% and 5%, respectively, from the same periods in 1994. The increases in residential and commercial sales reflect hotter weather in 1995 and modest growth in both the number of customers and usage per customer. Firm industrial KWH sales decreased 5% and 4% for the third quarter and first nine months of 1995, respectively, compared to the same periods in 1994. Contributing to these decreases were a decline in sales to the chemicals and refining industries, primarily due to the loss of a large industrial customer to self generation, and the expiration of an economic development rate which caused some customers to make greater use of interruptible service or switch to alternative rates. Firm industrial sales exclude electricity sold at a reduced rate under agreements which allow HL&P to interrupt service under some circumstances.

Reconcilable fuel revenues are revenues that are collected through an energy component of electric rates. These revenues, which have no effect on earnings, are required to be periodically reconciled to fuel expenses. For information regarding the recovery of HL&P's fuel costs, see the Recovery of Fuel Costs section in Part 1 of the Company's and HL&P's Annual Report on Form 10-K for the year ended December 31, 1994 (1994 Combined Form 10-K).

FUEL AND PURCHASED POWER EXPENSES

Fuel expenses increased \$57.9 million for the third quarter of 1995 and \$27.3 million for the first nine months of 1995 compared to the same periods of 1994. These increases were primarily due to a \$66.1 million reduction to reconcilable fuel expense recorded in July 1994 resulting from payments HL&P received upon the transfer of its rights to receive certain railroad settlement payments. The increase was partially offset by a decline in the unit cost of gas and increased nuclear generation which has a per unit fuel cost that is substantially lower than HL&P's other fuel sources. For information regarding the railroad settlement payments, see Note 18 of the notes to the financial statements included in the Combined Form 8-K. The average cost of fuel for the third quarter and first nine months of 1995 was \$1.52 per million British Thermal Units (MMBtu) and \$1.59 per MMBtu, respectively. This compares to \$1.23 per MMBtu and \$1.52 per MMBtu for the same periods in 1994, inclusive of the effects of the railroad settlement payments discussed above. Purchased power expense decreased \$52.1 million and \$138.1 million for the third quarter and first nine months of 1995, respectively, when compared to the same periods in 1994 primarily due to the expiration of firm purchased power contracts.

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OPERATION AND MAINTENANCE, DEPRECIATION AND AMORTIZATION, AND OTHER

Operation and maintenance expense for the third quarter and first nine months of 1995 increased \$16.4 million and \$34.6 million, respectively, compared to the same periods in 1994. Substantially all of the increase in operation and maintenance expense resulted from (i) increased litigation and rate case expenses, (ii) lump sum wage payments primarily associated with the renewal of labor union contracts, and (iii) employee severance expenses. HL&P continues to review its staffing levels in light of the changing operating environment and may incur additional severance costs in the future. However, specific additional expenses cannot be determined at this time. Depreciation and amortization expense for the third quarter and first nine months of 1995 increased \$27.3 million and \$44.5 million, respectively, compared to 1994, primarily due to amortizations recorded as a result of the Settlement (see Note 3 to the Financial Statements in Item 1 of this Report). Other taxes increased \$6.5 million in the first nine months of 1995 compared to the same period in 1994, primarily due to increased state franchise tax obligations.

LIQUIDITY AND CAPITAL RESOURCES

COMPANY

GENERAL

The Company's cash requirements stem primarily from operating expenses, capital expenditures, payment of common stock dividends, payment of interest and principal payments on debt. Net cash provided by operating activities totaled \$645.7 million for the nine months ended September 30, 1995.

Net cash provided by investing activities for the nine months ended September 30, 1995 totaled \$266.9 million reflecting \$622 million received in connection with the Company's sale of KBLCOM less electric capital expenditures of \$206.5 million (including allowance for borrowed funds used during construction), corporate headquarters expenditures (including capitalized interest) of \$78.8 million, discontinued cable television operations expenditures of \$47.6 million and other expenditures.

Financing activities for the first nine months of 1995 resulted in a net cash outflow of \$858.4 million. The Company's primary financing activities were the decrease in short-term borrowings, the payment of dividends, the redemption of subsidiary preferred stock and the extinguishment and repayment of long-term debt, partially offset by the issuance of HL&P long-term debt. For information with respect to these matters, reference is made to Notes 5 and 6 to the Financial Statements in Item 1 of this Report.

SOURCES OF CAPITAL RESOURCES AND LIQUIDITY

The Company has registered with the Securities and Exchange Commission (SEC) \$250 million of debt securities which remain unissued. Proceeds from any sales of these securities are expected to be used for general corporate purposes including investments in and loans to subsidiaries.

The Company also has registered with the SEC five million shares of its common stock (10 million shares of common stock after giving effect to the stock split). Proceeds from the sale of these

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securities will be used for general corporate purposes, including, but not limited to, the redemption, repayment or retirement of outstanding indebtedness of the Company or the advance or contribution of funds to one or more of the Company's subsidiaries to be used for their general corporate purposes, including, without limitation, the redemption, repayment or retirement of indebtedness or preferred stock.

At September 30, 1995, the Company had approximately \$54 million in cash and cash equivalents invested in short-term investments. In addition, the Company has a commercial paper program supported by three bank credit facilities, the borrowing capacity under which was increased in the third quarter from \$800 million to \$1.1 billion. The Company had no commercial paper outstanding at September 30, 1995, reflecting the application of \$622 million of cash proceeds received in connection with the KBLCOM sale.

During the nine months ended September 30, 1995, HI Energy expended approximately \$12.4 million (compared to \$431,000 during the comparable period in 1994) on non-regulated electric power projects.

In June 1995, a subsidiary of HI Energy, the Company's non-regulated electric power subsidiary, entered into an agreement to construct, own and operate a 160 MW cogeneration facility to be built adjacent to a steel plant in San Nicolas, Argentina. In September 1995, various governmental approvals were obtained which allowed work to proceed. The project is expected to be completed in the fourth quarter of 1997. The plant is to be constructed by a consortium composed of GE Power Systems, Inc. and an Argentine construction company. The construction contract provides, subject to certain adjustments, for a contract price of approximately \$65 million to be paid in installments during the construction of the project. Upon completion, the project will sell steam to the steel plant and sell electricity on the wholesale Argentina electricity market.

On October 3, 1995, Texas Energy Partners plc (Texas Energy Partners), an English public limited company, jointly owned in equal shares by the Company and Central and South West Corporation, made an offer for all of the issued share capital of NORWEB plc (NORWEB), an English regional electricity company serving the northwest of England, including Manchester, for a total price equivalent to approximately \$2.7 billion. Texas Energy Partners withdrew the offer on October 12, 1995 after North West Water plc made a higher competing offer for all NORWEB shares. The Company expects that it may from time to time consider and evaluate other investment opportunities in foreign electric utility businesses.

RATIOS OF EARNINGS TO FIXED CHARGES

The Company's ratios of earnings to fixed charges for the nine and twelve months ended September 30, 1995 were 3.23 and 2.69, respectively. The Company believes that the ratio for the nine-month period is not necessarily indicative of the ratio for a twelve-month period due to the seasonal nature of HL&P's business.

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HL&P

GENERAL

HL&P's cash requirements stem primarily from operating expenses, capital expenditures, payment of dividends and interest and principal payments on debt. HL&P's net cash provided by operating activities for the first nine months of 1995 totaled \$719.7 million.

Net cash used in HL&P's investing activities for the first nine months of 1995 totaled \$298.4 million. HL&P's capital and nuclear fuel expenditures (excluding allowance for funds used during construction) for the first nine months of 1995 totaled \$287.6 million out of the \$449 million revised annual budget. HL&P expects to finance substantially all of its 1995 capital expenditures through funds generated internally from operations.

HL&P's financing activities for the first nine months of 1995 resulted in a net cash outflow of approximately \$388.2 million. Included in these activities were the payment of dividends, the redemption of preferred stock, and the extinguishment of long-term debt, partially offset by the issuance of long-term debt. For information with respect to these matters, reference is made to Notes 5 and 6 to the Financial Statements in Item 1 of this Report.

SOURCES OF CAPITAL RESOURCES AND LIQUIDITY

HL&P has registered with the SEC \$230 million aggregate liquidation value of preferred stock and \$580 million aggregate principal amount of debt securities that may be issued as first mortgage bonds and/or as debt securities collateralized by first mortgage bonds. Proceeds from any sale of these securities are expected to be used for general corporate purposes including the purchase, redemption (to the extent permitted by the terms of the outstanding securities), repayment or retirement of outstanding indebtedness or preferred stock of HL&P.

At September 30, 1995, HL&P had approximately \$269 million in cash and cash equivalents invested in short-term investments. In addition, HL&P has a commercial paper program supported by a bank credit facility of \$400 million. HL&P had no commercial paper outstanding at September 30, 1995.

RATIOS OF EARNINGS TO FIXED CHARGES

HL&P's ratios of earnings to fixed charges for the nine and twelve months ended September 30, 1995, were 4.30 and 3.59, respectively. HL&P's ratios of earnings to fixed charges and preferred dividends requirements for the nine and twelve months ended September 30, 1995, were 3.66 and 3.05, respectively. HL&P believes that the ratios for the nine-month period are not necessarily indicative of the ratios for a twelve-month period due to the seasonal nature of HL&P's business.

NEW ACCOUNTING PRONOUNCEMENTS

In March 1995, the Financial Accounting Standards Board issued SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." This accounting standard, effective for fiscal years beginning after December 15, 1995, requires companies to review certain assets for impairment whenever events or changes in circumstances indicate that the carrying

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amount of an asset may not be recoverable (such determination generally being made on the basis of whether net cash flows expected to result from such assets will recover the carrying amount of the assets). If an impairment is found to exist, the impairment loss to be recognized is the amount by which the carrying amount exceeds the fair value. The Company and HL&P are currently reviewing the provisions of SFAS No. 121, but, based on current estimates, the Company and HL&P do not expect the adoption of SFAS No. 121 to have a material impact on the Company's or HL&P's financial condition or results of operations.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting the Company and its subsidiaries, including HL&P, reference is made to the information set forth in Item 3 of the 1994 Combined Form 10-K, Item 1 of Part II of the Combined Forms 10-Q for each of the quarters ended March 31, 1995 and June 30, 1995, Notes 2, 3 and 4 to the Company's Consolidated and HL&P's Financial Statements in the Combined Form 8-K and Notes 2(b) and 3 to the Company's Consolidated and HL&P's Financial Statements in the Combined Forms 10-Q for each of the quarters ended March 31, 1995 and June 30, 1995, which information, as qualified and updated by the description of developments in regulatory and litigation matters contained in Notes 2, 3 and 4 of the Notes to the Financial Statements included in Part I of this Report, is incorporated herein by reference.

BICKI, ET AL V. HOUSTON INDUSTRIES INCORPORATED, formerly pending in the 129th District Court of Harris County, Texas, was dismissed without prejudice by the plaintiffs in September 1995. This lawsuit, previously reported in Part I of the Combined Form 10-K under BUSINESS OF HL&P - Environmental Quality, involved allegations concerning injuries suffered as a result of exposure to electric and magnetic fields.

ITEM 5. OTHER INFORMATION

ADDITIONAL SHARES REGISTERED AS A RESULT OF STOCK SPLIT

Pursuant to Rule 416(b) under the Securities Act of 1933 (Securities Act), the number of shares of the Company's common stock registered for sale under the Securities Act by the following Registration Statements on Forms S-3 and S-8 will be deemed to be increased by the Company's two for one stock split (effected in the form of a 100% stock dividend) on December 9, 1995 to cover the additional shares resulting from the application of the stock split to the registered shares of the Company's common stock remaining unsold under the following Registration Statements as of the November 16, 1995 record date for the stock split:

REGISTRATION STATEMENT NUMBER	TYPE OF REGISTRATION	PRE-SPLIT SHARES REGISTERED
-----	-----	-----
33-60756	Shelf Registration, Form S-3	5,000,000
33-55445	Shelf Registration, Form S-3	587,646
33-52207	Houston Industries Incorporated Investor's Choice Plan, Form S-3	4,000,000
33-55391	Houston Industries Incorporated Savings Plan, Form S-8	5,000,000
33-50629	Houston Industries Incorporated Stock Benefit Plan, Form S-8	100,000
33-37493	Houston Industries Incorporated Long-Term Incentive Compensation Plan (1989), Form S-8	500,000
33-52279	Houston Industries Incorporated Long-Term Incentive Compensation Plan (1994), Form S-8	2,000,000
33-56855	Houston Industries Energy, Inc. Long-Term Project Incentive Compensation Plan, Form S-8	250,000

The foregoing Registration Statements, which incorporate by reference this Report on Form 10-Q, are hereby amended pursuant to Rule 416(b) under the Securities Act to increase the amount of shares of the Company's common stock registered thereunder to reflect the 100% stock dividend.

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

(a) Exhibits.

HOUSTON INDUSTRIES INCORPORATED:

- Exhibit 10(a) - Termination of Houston Industries Incorporated Savings Plan and Trust Agreement as to KBLCOM Incorporated Effective as of June 30, 1995.
- Exhibit 11 - Computation of Earnings per Common Share and Common Equivalent Share.
- Exhibit 12 - Computation of Ratios of Earnings to Fixed Charges.
- Exhibit 27 - Financial Data Schedule.
- Exhibit 99(a) - Notes 2, 3, 4 and 18 to the Company's Consolidated Financial Statements included on pages 41 through 48 and 64 of the Combined Form 8-K.
- Exhibit 99(b) - Notes 2(b) and 3 to the Company's Consolidated and HL&P's Financial Statements included on pages 14 through 18 of the Combined Form 10-Q for the quarter ended March 31, 1995.
- Exhibit 99(c) - Notes 2(b), 3 and 4(b) to the Company's Consolidated and HL&P's Financial Statements included on pages 14 through 19 of the Combined Form 10-Q for the quarter ended June 30, 1995.
- Exhibit 99(d) - Part I, Item 3 - Legal Proceedings included on pages 31 through 32 of the 1994 Combined Form 10-K.
- Exhibit 99(e) - Part II, Item 1 - Legal Proceedings included on page 32 of the Combined Form 10-Q for the quarter ended March 31, 1995.
- Exhibit 99(f) - Part II, Item 1 - Legal Proceedings included on page 33 of the Combined Form 10-Q for the quarter ended June 30, 1995.
- Exhibit 99(g) - Part I, Item 1 - BUSINESS OF HL&P - Recovery of Fuel Costs and Environmental Quality included on pages 11 through 13 of the 1994 Combined Form 10-K.

HOUSTON LIGHTING & POWER COMPANY:

- Exhibit 12 - Computation of Ratios of Earnings to Fixed Charges and Ratios of Earnings to Fixed Charges and Preferred Dividends.
- Exhibit 27 - Financial Data Schedule.
- Exhibit 99(a) - Notes 2, 3, 4 and 18 to the Company's Consolidated Financial Statements included on pages 41 through 48 and 64 of the Combined Form 8-K.

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- Exhibit 99(b) - Notes 2(b) and 3 to the Company's Consolidated and HL&P's Financial Statements included on pages 14 through 18 of the Combined Form 10-Q for the quarter ended March 31, 1995.
- Exhibit 99(c) - Notes 2(b), 3 and 4 to the Company's Consolidated and HL&P's Financial Statements included on pages 14 through 19 of the Combined Form 10-Q for the quarter ended June 30, 1995.
- Exhibit 99(d) - Part I, Item 3 - Legal Proceedings included on pages 31 through 32 of the 1994 Combined Form 10-K.
- Exhibit 99(e) - Part II, Item 1 - Legal Proceedings included on page 32 of the Combined Form 10-Q for the quarter ended March 31, 1995.
- Exhibit 99(f) - Part II, Item 1 - Legal Proceedings included on page 33 of the Combined Form 10-Q for the quarter ended June 30, 1995.
- Exhibit 99(g) - Part I, Item 1 - BUSINESS OF HL&P - Recovery of Fuel Costs and Environmental Quality included on pages 11 through 13 of the 1994 Combined Form 10-K.

(b) Reports on Form 8-K.

HOUSTON INDUSTRIES INCORPORATED:

Current Report on Form 8-K dated July 6, 1995 (Item 2. Acquisition or Disposition of Assets).

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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
Comptroller and
Principal Accounting Officer

Date: November 14, 1995

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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 LIGHTING & POWER COMPANY
(Registrant)

/s/ KEN W. NABORS

Ken W. Nabors
Vice President and Comptroller
and Principal Accounting Officer

Date: November 14, 1995

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TERMINATION OF HOUSTON INDUSTRIES INCORPORATED
SAVINGS PLAN AND TRUST AGREEMENT
AS TO KBLCOM INCORPORATED

RECITALS

WHEREAS, effective January 1, 1994, the KBLCOM Incorporated Savings Plan, as established effective July 1, 1989 (the "KBLCOM Plan"), was amended, restated, consolidated with, merged into and continued in the form of and by the adoption of the Houston Industries Incorporated Savings Plan, as amended and restated effective January 1, 1994 (the "Plan"), so as to provide for a continuation of substantially identical benefits for the former participants of the KBLCOM Plan and the Plan, and to provide for the merger of all the assets held under the Houston Industries Incorporated Master Savings Trust, as established effective July 1, 1989, and thereafter amended (the "Trust") for the benefit of the participants in the KBLCOM Plan with all the assets held under the Trust for the benefit of the participants in the Plan so that from and after January 1, 1994, such Plans constituted a "single plan" within the meaning and purview of Section 414(l) of the Internal Revenue Code of 1986, as amended; and

WHEREAS, by Agreement and Plan of Merger, dated as of January 26, 1995, by and among HOUSTON INDUSTRIES INCORPORATED, a Texas corporation ("HII"), KBLCOM INCORPORATED, a Delaware corporation ("the Company"), TIME WARNER, INC., a Delaware corporation, ("TW"), and TW KBLCOM ACQUISITION CORP., a Delaware corporation and wholly owned subsidiary of TW, TW will acquire by merger all of the issued and outstanding common stock of the Company on or about July 6, 1995 (the "Merger").

TERMINATION OF PLAN AND TRUST

NOW, THEREFORE, in connection with said Merger and as authorized by the resolutions of the Board of Directors of the Company dated January 24, 1995, the Company hereby (i) terminates the Plan and Trust, effective as of the close of business on June 30, 1995, with respect to its current and former employees and the current and former employees of all of its subsidiaries, (ii) fully vests each KBLCOM Participant who was an active Employee at any time between January 1, 1995 and June 30, 1995, inclusive, and each other KBLCOM Participant with an Account balance under the Plan as of January 1, 1995 which was subject to forfeiture as of such date in their Account balances under the Plan (as such terms are defined in the Plan), (iii) gives notice of such termination to The Northern Trust Company, Trustee (the "Trustee") and (iv) directs the Trustee to make distributions from the Trust Fund as directed by the HII Benefits Committee (the "Committee") after receipt of appropriate directions from the Committee in accordance with the terms of the Plan.

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IN WITNESS WHEREOF, the Company has caused these presents to be executed by its duly authorized officers in a number of copies, all of which shall constitute one and the same instrument, which may be sufficiently evidenced by any executed copy hereof, this 30th day of June, 1995, but effective as of the close of business June 30, 1995.

KBLCOM INCORPORATED

By JONATHAN F. MYERS
Jonathan F. Myers
Senior Vice President

ATTEST:

HUGH RICE KELLY
Secretary

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,	
	1995	1994	1995	1994
Primary Earnings Per Share:				
(1) Weighted average shares of common stock outstanding.....	123,947,087	123,060,083	123,772,849	122,665,312
(2) Effect of issuance of shares from assumed exercise of stock options (treasury stock method).....	5,571	(51,776)	(5,200)	(43,374)
(3) Weighted average shares.....	123,952,658	123,008,307	123,767,649	122,621,938
(4) Net income.....	\$ 853,949	\$ 235,968	\$ 1,101,665	\$ 388,591
(5) Primary earnings per share (line 4/line 3).....	\$ 6.89	\$ 1.92	\$ 8.90	\$ 3.17
Fully Diluted Earnings Per Share:				
(6) Weighted average shares per computation on line 3 above.....	123,952,658	123,008,307	123,767,649	122,621,938
(7) Shares applicable to options included on line 2 above.....	(5,571)	51,776	5,200	43,374
(8) Dilutive effect of stock options based on the average price for the period or period-end price, whichever is higher, of \$44.13 and \$35.25 for the third quarter of 1995 and 1994, respectively, and \$44.13 and \$36.39 for the first nine months of 1995 and 1994, respectively (treasury stock method).....	8,610	(50,426)	8,610	(43,374)
(9) Weighted average shares.....	123,955,697	123,009,657	123,781,459	122,621,938
(10) Net income.....	\$ 853,949	\$ 235,968	\$ 1,101,665	\$ 388,591
(11) Fully diluted earnings per share (line 10/line 9).....	\$ 6.89	\$ 1.92	\$ 8.90	\$ 3.17

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.

The calculations for the nine months ended September 30, 1995 and the three and nine months ended September 30, 1994 are submitted in accordance with Regulation S-K item 601(b) (11) although they are contrary to paragraphs 30 and 40 of APB Opinion No. 15 because they produce anti-dilutive results.

For information about the common stock split recently declared by the Company, see Note 9 of the notes to the Company's Consolidated Financial Statements in Item 1 of this Report.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
 COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES
 (THOUSANDS OF DOLLARS)

	NINE MONTHS ENDED SEPTEMBER 30, 1995	TWELVE MONTHS ENDED SEPTEMBER 30, 1995
	-----	-----
Fixed Charges as Defined:		
(1) Interest on Long-Term Debt.....	\$ 204,436	\$ 270,561
(2) Other Interest.....	21,454	28,020
(3) Preferred Dividends Factor of Subsidiary.....	34,578	47,077
(4) Interest Component of Rentals Charged to Operating Expense.....	2,686	3,688
(5) Total Fixed Charges.....	\$ 263,154	\$ 349,346
	=====	=====
Earnings as Defined:		
(6) Income from Continuing Operations Before Cumulative Effect of Change in Accounting.....	\$ 392,970	\$ 398,809
(7) Income Taxes for Continuing Operations Before Cumulative Effect of Change in Accounting.....	193,976	192,240
(8) Total Fixed Charges (line 5).....	263,154	349,346
	-----	-----
(9) Income from Continuing Operations Before Cumulative Effect of Change in Accounting, Income Taxes and Fixed Charges.....	\$ 850,100	\$ 940,395
	=====	=====
Preferred Dividends Factor of Subsidiary:		
(10) Preferred Stock Dividends of Subsidiary.....	\$ 23,207	\$ 31,809
(11) Ratio of Pre-Tax Income from Continuing Operations to Income from Continuing Operations (line 6 plus line 7 divided by line 6).....	1.49	1.48
	-----	-----
(12) Preferred Dividends Factor of Subsidiary (line 10 times line 11).....	\$ 34,578	\$ 47,077
	=====	=====
Ratio of Earnings to Fixed Charges (line 9 divided by line 5).....	3.23	2.69

UT

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

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HOUSTON INDUSTRIES
1000

9-MOS	DEC-31-1995	SEP-30-1995	PER-BOOK
	8,788,271		
	1,143,273		
		446,364	
	1,593,320		
		0	
		11,971,228	
			2,167,047
	0		
	2,044,245		
4,211,292			
	51,055		
		351,345	
	3,551,797		
		0	
	0		
	150,130		
		25,700	
	6,065		
		3,619	
3,620,225			
11,971,228			
	2,896,180		
		193,976	
	2,044,311		
	2,044,311		
		851,869	
		(19,707)	
832,162			
	222,009		
		1,124,872	
	23,207		
1,101,665			
	278,641		
	184,899		
	645,670		
		\$8.90	
		\$8.90	

(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 megawatt 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, 1994, HL&P's investments (net of accumulated depreciation and amortization) in the South Texas Project and in nuclear fuel, including AFUDC, were \$2.1 billion and \$99 million, respectively.
- (b) UNITED STATES NUCLEAR REGULATORY COMMISSION (NRC) INSPECTIONS AND OPERATIONS. Both generating units at the South Texas Project were out of service from February 1993 to February 1994, when Unit No. 1 was returned to service. Unit No. 2 was returned to service in May 1994. HL&P removed the units from service in February 1993 when a problem was encountered with certain of the units' auxiliary feedwater pumps.

In February 1995, the NRC removed the South Texas Project from its "watch list" of plants with weaknesses that warranted increased NRC attention. The NRC placed the South Texas Project on the "watch list" in June 1993, following the issuance of a report by an NRC Diagnostic Evaluation Team (DET) which conducted a review of the South Texas Project operations.

Certain current and former employees of HL&P or contractors of HL&P have asserted claims that their employment was terminated or disrupted in retaliation for their having made safety-related complaints to the NRC. Civil proceedings by the complaining personnel and administrative proceedings by the Department of Labor remain pending against HL&P, and the NRC has jurisdiction to take enforcement action against HL&P and/or individual employees with respect to these matters. Based on its own internal investigation, in October 1994 the NRC issued a notice of violation and proposed a \$100,000 civil penalty against HL&P in one such case in which HL&P had terminated the site access of a former contractor employee. In that action, the NRC also requested information relating to possible further enforcement action in this matter against two HL&P managers involved in such termination. HL&P strongly disagrees with the NRC's conclusions, and has requested the NRC to give further consideration of its notice. In February 1995, the NRC conducted an enforcement conference with respect to that matter, but no result has been received.

HL&P has provided documents and other assistance to a subcommittee of the U. S. House of Representatives (Subcommittee) that is conducting an inquiry related to the South Texas Project. Although the precise focus and timing of the inquiry has not been identified by the Subcommittee, it is anticipated that the Subcommittee will inquire into matters related to HL&P's handling of employee concerns and to issues related to the NRC's 1993 DET review of the South Texas Project. In connection with that inquiry, HL&P has been advised that the U. S. General Accounting Office (GAO) is conducting a review of the NRC's inspection process as it relates to the South Texas Project and other plants, and HL&P is cooperating with the GAO in its investigation and with the NRC in a similar review it has initiated. While no prediction can

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be made at this time as to the ultimate outcome of these matters, the Company and HL&P do not believe that they will have a material adverse effect on the Company's or HL&P's financial condition or results of operations.

- (c) LITIGATION WITH CO-OWNERS OF THE SOUTH TEXAS PROJECT. In February 1994, the City of Austin (Austin), one of the four co-owners of the South Texas Project, filed suit (Austin II Litigation) against HL&P. That suit is pending in the 152nd District Court for Harris County, Texas, which has set a trial date for October 1995. Austin alleges that the outages at the South Texas Project from early 1993 to early 1994 were due to HL&P's failure to perform obligations it owed to Austin under the Participation Agreement among the four co-owners of the South Texas Project (Participation Agreement). Austin also asserts that HL&P breached certain undertakings voluntarily assumed by HL&P under the terms and conditions of the Operating Licenses and Technical Specifications relating to the South Texas Project. Austin claims that such failures have caused Austin damages of at least \$125 million due to the incurrence of increased operating and maintenance costs, the cost of replacement power and lost profits on wholesale transactions that did not occur. In May 1994, the City of San Antonio (San Antonio), another co-owner of the South Texas Project, intervened in the litigation filed by Austin against HL&P and asserted claims similar to those asserted by Austin. San Antonio has not identified the amount of damages it intends to seek from HL&P. HL&P is contesting San Antonio's intervention and has called for arbitration of San Antonio's claim under the arbitration provisions of the Participation Agreement. The trial court has denied HL&P's requests, but review of these decisions is currently pending before the 1st Court of Appeals in Houston.

In a previous lawsuit (Austin I Litigation) filed in 1983 against the Company and HL&P, Austin alleged that it had been fraudulently induced to participate in the South Texas Project and that HL&P had failed to perform properly its duties as project manager. In May 1993, the courts entered a judgement in favor of the Company and HL&P, concluding, among other things, that the Participation Agreement did not impose on HL&P a duty to exercise reasonable skill and care as project manager. During the course of the Austin I Litigation, San

Antonio and Central Power and Light Company (CPL), a subsidiary of Central and South West Corporation, two of the co-owners in the South Texas Project, also asserted claims for unspecified damages against HL&P as project manager of the South Texas Project, alleging HL&P breached its duties and obligations. San Antonio and CPL requested arbitration of their claims under the Participation Agreement. In 1992, the Company and HL&P entered into a settlement agreement with CPL (CPL Settlement) providing for CPL's withdrawal of its demand for arbitration. San Antonio's claims for arbitration remain pending. Under the Participation Agreement, San Antonio's arbitration claims will be heard by a panel of five arbitrators consisting of four arbitrators named by each co-owner and a fifth arbitrator selected by the four appointed arbitrators.

Although the CPL Settlement did not directly affect San Antonio's pending demand for arbitration, HL&P and CPL reached certain understandings in such agreement which contemplated that: (i) CPL's previously appointed arbitrator would be replaced by CPL; (ii) arbitrators approved by CPL or HL&P in any future arbitrations would be mutually acceptable to HL&P and CPL; and (iii) HL&P and CPL would resolve any future disputes between them concerning the South Texas Project without resorting to the arbitration provision of the

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Participation Agreement. Austin and San Antonio have asserted in the pending Austin II Litigation that such understandings have rendered the arbitration provisions of the Participation Agreement void and that neither Austin nor San Antonio should be required to participate in or be bound by such proceedings.

Although HL&P and the Company do not believe there is merit to either Austin's or San Antonio's claims and have opposed San Antonio's intervention in the Austin II Litigation, there can be no assurance as to the ultimate outcome of these matters.

- (d) 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 the maximum amount of property damage insurance currently available through the insurance industry, consisting 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 on March 1, 1995 and under portions of the excess property insurance coverage in effect prior to March 1, 1995, HL&P and the other owners of the South Texas Project are subject to assessments, the maximum aggregate assessment under current policies being \$26.9 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 for owners of nuclear power plants, such as the South Texas Project, was decreased from \$9.0 billion to \$8.92 billion effective in November 1994. 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.

- (e) NUCLEAR DECOMMISSIONING. HL&P and the other co-owners of the South Texas Project are required by the NRC to meet minimum decommissioning funding requirements to pay the costs of decommissioning the South Texas Project. Pursuant to the terms of the order of the Utility Commission in Docket No. 9850, HL&P is currently funding decommissioning costs for the South Texas Project with an independent trustee at an annual amount of \$6 million, which is recorded in depreciation and amortization expense. HL&P's funding level is estimated to provide approximately \$146 million, in 1989 dollars, an amount which exceeds the current NRC minimum.

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The Company adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," effective January 1, 1994. At December 31, 1994, the securities held in the Company's nuclear decommissioning trust totaling \$25.1 million (reflected on the Company's Consolidated and HL&P's Balance Sheets in deferred debits and deferred credits) are classified as available for sale. Such securities are reported on the balance sheets at fair value, which at December 31, 1994 approximates cost, and any unrealized gains or losses will be reported as a separate component of common stock equity. Earnings, net of taxes and administrative costs, are reinvested in the funds.

In May 1994, an outside consultant estimated HL&P's portion of decommissioning costs to be approximately \$318 million, in 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. Under the terms of the Proposed Settlement, HL&P would increase funding of decommissioning costs to an annual amount of approximately \$14.8 million consistent with such study. While the current and projected funding levels presently 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 or the assumptions used in estimating decommissioning costs will ultimately prove to be correct.

(3) RATE REVIEW, FUEL RECONCILIATION AND OTHER PROCEEDINGS

In February 1994, the Utility Commission initiated a proceeding (Docket No. 12065) to determine whether HL&P's existing rates are just and reasonable. Subsequently, the scope of the docket was expanded to include reconciliation of HL&P's fuel costs from April 1, 1990 to July 31, 1994. The Utility Commission also initiated a separate proceeding (Docket No. 13126) to review issues regarding the prudence of operation of the South Texas Project from the date of commercial operation through the present. That review would encompass the outage at the South Texas Project during 1993 through 1994.

Hearings began in Docket No. 12065 in January 1995, and the Utility Commission has retained a consultant to review the South Texas Project for the purpose of providing testimony in Docket No. 13126 regarding the prudence of HL&P's management of operation of the South Texas Project. In February 1995, all major parties to these proceedings signed the Proposed Settlement resolving the issues with respect to HL&P, including the prudence issues related to operation of the South Texas Project. Approval of the Proposed Settlement by the Utility Commission will be required. To that end, the parties have established procedural dates for a hearing on issues raised by the parties who are opposed to the Proposed Settlement. A decision by the Utility Commission on the Proposed Settlement is not anticipated before early summer.

Under the Proposed Settlement, HL&P's base rates would be reduced by approximately \$62 million per year, effective retroactively to January 1, 1995, and rates would be frozen for three years, subject to certain conditions. Under the Proposed Settlement, HL&P would amortize its remaining investment of \$218 million in the cancelled Malakoff plant over a period not to exceed

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seven years. HL&P also would increase its decommissioning expense for the South Texas Project by \$9 million per year.

Under the Proposed Settlement, approximately \$70 million of fuel expenditures and related interest incurred by HL&P during the fuel reconciliation period would not be recoverable from ratepayers. This \$70 million was recorded as a one-time, pre-tax charge to reconcilable fuel revenues to reflect the anticipation of approval of the Proposed Settlement. HL&P also would establish a new fuel factor approximately 17 percent below that currently in effect and would refund to customers the balance in its fuel over-recovery account, estimated to be approximately \$180 million after giving effect to the amounts not recoverable from ratepayers.

HL&P recovers fuel costs incurred in electric generation through a fixed fuel factor that is set by the Utility Commission. The difference between fuel revenues billed pursuant to such factor and fuel expense incurred is recorded as an addition to or a reduction of revenue, with a corresponding entry to under- or over-recovered fuel, as appropriate. Amounts collected pursuant to the fixed fuel factor must be reconciled periodically against actual, reasonable costs as determined by the Utility Commission. Currently, HL&P has an over-recovery fuel account balance that will be refunded pursuant to the Proposed Settlement.

In the event that the Proposed Settlement is not approved by the Utility Commission, including issues related to the South Texas Project, Docket No. 12065 will be remanded to an Administrative Law Judge (ALJ) to resume detailed hearings in this docket. Prior to reaching agreement on the terms of the Proposed Settlement, HL&P argued that its existing rates were just and reasonable and should not be reduced. Other parties argued that rate decreases in annual amounts ranging from \$26 million to \$173 million were required and that additional decreases might be justified following an examination of the prudence of the management of the South Texas Project and the costs incurred in connection with the outages at the South Texas Project. Testimony filed by the Utility Commission staff included a recommendation to remove from rate base \$515 million of HL&P's investment in the South Texas Project to reflect the staff's view that such investment was not fully "used and useful" in providing service, a position HL&P vigorously disputes.

In the event the Proposed Settlement is not approved by the Utility Commission, the fuel reconciliation issues in Docket Nos. 12065 and 13126 would be remanded to an ALJ for additional proceedings. A major issue in Docket No. 13126 will be whether the incremental fuel costs incurred as a result of outages at the South Texas Project represent reasonable costs. HL&P filed testimony in Docket No. 13126, which

testimony concluded that the outages at the South Texas Project did not result from imprudent management. HL&P also filed testimony analyzing the extent to which regulatory issues extended the outages. In that testimony an outside consultant retained by HL&P concluded that the duration of the outages was controlled by both the resolution of NRC regulatory issues as well as necessary equipment repairs unrelated to NRC regulatory issues and that the incremental effect of NRC regulatory issues on the duration of the outages was only 39 days per unit. Estimates as to the cost of replacement power may vary significantly based on a number of factors, including the capacity factor at which the South Texas Project might be assumed to have operated had it not been out of service due to the outages. However, HL&P believes that applying a reasonable range

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of assumptions would result in replacement fuel costs of less than \$10 million for the 39 day periods identified by HL&P's consultant and less than \$100 million for the entire length of the outages. Any fuel costs determined to have been unreasonably incurred would not be recoverable from customers and would be charged against the Company's earnings.

Although the Company and HL&P believe that the Proposed Settlement is in the best interest of HL&P, its ratepayers, and the Company and its shareholders, no assurance can be given that (i) the Utility Commission ultimately will approve the terms of the Proposed Settlement or (ii) in the event the Proposed Settlement is not approved and proceedings against HL&P resumed, that the outcome of such proceedings would be favorable to HL&P.

(4) APPEALS OF PRIOR UTILITY COMMISSION RATE ORDERS

Pursuant to a series of applications filed by HL&P in recent years, the Utility Commission has granted HL&P rate increases to reflect in electric rates HL&P's substantial investment in new plant construction, including the South Texas Project. Although Utility Commission action on those applications has been completed, judicial review of a number of the Utility Commission orders is pending. 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. The pending appeals from the Utility Commission orders are in various stages. In the event the courts ultimately reverse actions of the Utility Commission in any of these proceedings, such matters would be remanded to the Utility Commission for action in light of the courts' orders. Because of the number of variables which can affect the ultimate resolution of such matters on remand, the Company and HL&P generally are not in a position at this time to predict the outcome of the matters on appeal or the ultimate effect that adverse action by the courts could have on the Company and HL&P. On remand, the Utility Commission's action could range from granting rate relief substantially equal to the rates previously approved to a reduction in the revenues to which HL&P was entitled during the time the applicable rates were in effect, which could require a refund to customers of amounts collected pursuant to such rates. Judicial review has been concluded or currently is pending on the final orders of the Utility Commission described below.

- (a) 1991 RATE CASE. In HL&P's 1991 rate case (Docket No. 9850), the Utility Commission approved a non-unanimous settlement agreement providing for a \$313 million increase in HL&P's base rates, termination of deferrals granted with respect to Unit No. 2 of the South Texas Project and of the qualified phase-in plan deferrals granted with respect to Unit No. 1 of the South Texas Project, and recovery of deferred plant costs. The settlement authorized a 12.55 percent return on common equity for HL&P. Rates contemplated by the settlement agreement were implemented in May 1991 and remain in effect (subject to the outcome of the current rate proceeding described in Note 3).

The Utility Commission's order in Docket No. 9850 was affirmed on review by a District Court, and the Austin Court of Appeals affirmed that decision on procedural grounds due to the failure of the appellant to file the record with the court in a timely manner. On review, the Texas

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Supreme Court has remanded the case to the Austin Court of Appeals for consideration of the appellant's challenges to the Utility Commission's order, which include issues regarding deferred accounting, the treatment of federal income tax expense and certain other matters. As to federal tax issues, a recent decision of the Austin Court of Appeals, in an appeal involving GTE-SW (and to which HL&P was not a party), held that when a utility pays federal income taxes as part of a consolidated group, the utility's ratepayers are entitled to a fair share of the tax savings actually realized, which can include savings resulting from unregulated activities. The Texas Supreme Court has agreed to hear an appeal of that decision, but on points not involving the federal income tax issues, though tax issues could be decided in such opinion.

Because the Utility Commission's order in Docket No. 9850 found that HL&P would have been entitled to rate relief greater than the \$313 million agreed to in the settlement, HL&P believes that any disallowance that might be required if the court's ruling in the GTE

decision were applied in Docket No. 9850 would be offset by that greater amount. However, that amount may not be sufficient if the Austin Court of Appeals also concludes that the Utility Commission's inclusion of deferred accounting costs in the settlement was improper. For a discussion of the Texas Supreme Court's decision on deferred accounting treatment, see Note 4(c). Although HL&P believes that it could demonstrate entitlement to rate relief equal to that agreed to in the stipulation in Docket No. 9850, HL&P cannot rule out the possibility that a remand and reopening of that settlement would be required if decisions unfavorable to HL&P are rendered on both the deferred accounting treatment and the calculation of tax expense for rate making purposes.

The parties to the Proposed Settlement have agreed to withdraw their appeals of the Utility Commission's orders in such docket, subject to HL&P's dismissing its appeal in Docket No. 6668.

- (b) 1988 RATE CASE. In HL&P's 1988 rate case (Docket No. 8425), the Utility Commission granted HL&P a \$227 million increase in base revenues, allowed a 12.92 percent return on common equity, authorized a qualified phase-in plan for Unit No. 1 of the South Texas Project (including approximately 72 percent of HL&P's investment in Unit No. 1 of the South Texas Project in rate base) and authorized HL&P to use deferred accounting for Unit No. 2 of the South Texas Project. Rates substantially corresponding to the increase granted were implemented by HL&P in June 1989 and remained in effect until May 1991.

In August 1994, the Austin Court of Appeals affirmed the Utility Commission's order in Docket No. 8425 on all matters other than the Utility Commission's treatment of tax savings associated with deductions taken for expenses disallowed in cost of service. The court held that the Utility Commission had failed to require that such tax savings be passed on to ratepayers, and ordered that the case be remanded to the Utility Commission with instructions to adjust HL&P's cost of service accordingly. Discretionary review is being sought from the Texas Supreme Court by all parties to the proceeding.

The parties to the Proposed Settlement have agreed to dismiss their respective appeals of Docket No. 8425, subject to HL&P's dismissing its appeal in Docket No. 6668. A separate party to this appeal, however, has not agreed to dismiss its appeal.

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- (c) DEFERRED ACCOUNTING. Deferred accounting treatment for certain costs associated with Unit No. 1 of the South Texas Project was authorized by the Utility Commission in Docket No. 8230 and was extended in Docket No. 9010. Similar deferred accounting treatment with respect to Unit No. 2 of the South Texas Project was authorized in Docket No. 8425. For a discussion of the deferred accounting treatment granted, see Note 1(f).

In June 1994, the Texas Supreme Court decided the appeal of Docket Nos. 8230 and 9010, as well as all other pending deferred accounting cases involving other utilities, upholding deferred accounting treatment for both carrying costs and operation and maintenance expenses as within the Utility Commission's statutory authority and reversed the Austin Court of Appeals decision to the extent that the Austin Court of Appeals had rejected deferred accounting treatment for carrying charges. Because the lower appellate court had upheld deferred accounting only as to operation and maintenance expenses, the Texas Supreme Court remanded Docket Nos. 8230 and 9010 to the Austin Court of Appeals to consider the points of error challenging the granting of deferred accounting for carrying costs which it had not reached in its earlier consideration of the case. The Texas Supreme Court opinion did state, however, that when deferred costs are considered for addition to the utility's rate base in an ensuing rate case, the Utility Commission must then determine to what extent inclusion of the deferred costs is necessary to preserve the utility's financial integrity. Under the terms of the Proposed Settlement, South Texas Project deferrals will continue to be amortized under the schedule previously established.

The Office of the Public Utility Counsel (OPUC) has agreed, pursuant to the Proposed Settlement, to withdraw and dismiss its appeal if the Proposed Settlement becomes effective and on the condition that HL&P dismisses its appeal in Docket No. 6668. However, the appeal of the State of Texas remains pending.

- (d) PRUDENCE REVIEW OF THE CONSTRUCTION OF THE SOUTH TEXAS PROJECT. In June 1990, the Utility Commission ruled in a separate docket (Docket No. 6668) that had been created to review the prudence of HL&P's planning and construction of the South Texas Project that \$375.5 million out of HL&P's \$2.8 billion investment in the two units of the South Texas Project had been imprudently incurred. That ruling was incorporated into HL&P's 1988 and 1991 rate cases and resulted in HL&P's recording an after-tax charge of \$15 million in 1990. Several parties appealed the Utility Commission's decision, but a District Court dismissed these appeals on procedural grounds. The Austin Court of Appeals reversed and directed consideration of the appeals, and the Texas Supreme Court denied discretionary review in 1994. At this time, no action has been taken by the appellants to proceed with the appeals. Unless the order in Docket No. 6668 is modified or reversed on appeal, the amount found imprudent by the Utility Commission will be sustained.

Under the Proposed Settlement, OPUC, HL&P and the City of Houston each has agreed to dismiss its respective appeals of Docket No. 6668. A

separate party to this appeal, however, has not agreed to dismiss its appeal. If this party does not elect to dismiss its appeal, HL&P may elect to maintain its appeal, whereupon OPUC and City of Houston shall also be entitled to maintain their appeals.

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(18) RAILROAD SETTLEMENT PAYMENTS

In July 1994, HL&P contributed as equity its rights to receive certain railroad settlement payments to HL&P Receivables, Inc. (HLPR), a wholly-owned subsidiary of HL&P. HLPR transferred the receivables to a trust. A bank purchased certificates evidencing a senior interest in the trust and HLPR holds a certificate evidencing a subordinate interest in the trust. HL&P received as a dividend from HLPR approximately \$66.1 million, an amount equal to HLPR's proceeds from the sale. Consistent with the manner in which HL&P recorded receipts of the settlement payments, HL&P recorded the transaction as a \$66.1 million reduction to reconcilable fuel expense in July 1994. The reduction to reconcilable fuel expense had no effect on earnings.

- (b) UNITED STATES NUCLEAR REGULATORY COMMISSION (NRC) INSPECTIONS AND OPERATIONS. HL&P removed both generating units at the South Texas Project from service in February 1993 when a problem was encountered with certain of the units' auxiliary feedwater pumps. The units were out of service from February 1993 to February 1994, when Unit No. 1 was returned to service.

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Unit No. 2 was returned to service in May 1994. In June 1993, the NRC placed the South Texas Project on its "watch list" of plants with weaknesses that warrant increased attention after a review of the South Texas Project operations. In February 1995, the NRC removed the South Texas Project from its "watch list".

Certain current and former employees or contractors of HL&P have asserted claims that their employment was terminated or disrupted in retaliation for their having made safety-related complaints to the NRC. Civil proceedings by the complaining personnel and administrative proceedings by the Department of Labor remain pending against HL&P, and the NRC has jurisdiction to take enforcement action against HL&P and/or individual employees with respect to these matters. On May 8, 1995, the NRC announced that it was withdrawing a previously proposed Notice of Violation and \$100,000 civil penalty, as well as possible individual enforcement action against two HL&P managers in connection with one such case, involving a contractor employee whose site access was terminated. Allegations of retaliation by that individual remain pending before an Administrative Law Judge (ALJ) of the Department of Labor. In another such case, involving two former HL&P employees who were terminated during a reduction in force, another Department of Labor ALJ in April 1995 issued his recommended decision in favor of the former employees, ordering reinstatement of one with back-pay and back-pay without exemplary damages to the individuals, but indicated his intention to hold a further hearing to consider whether additional compensatory damages should be awarded. HL&P considers the ALJ's conclusions to be erroneous and is asking the Secretary of Labor not to adopt the ALJ's recommendation. If the recommendation is adopted by the Secretary of Labor, HL&P could appeal that decision to the United States Court of Appeals. Civil actions by these employees remain pending. For additional information, see Note 2(b) of the notes to the financial statements included in the Combined Form 8-K.

While no prediction can be made at this time as to the ultimate outcome of these matters, the Company and HL&P do not believe that they will have a material adverse effect on the Company's or HL&P's financial condition or results of operations.

- (3) RATE REVIEW, FUEL RECONCILIATION AND OTHER PROCEEDINGS

In February 1994, the Public Utility Commission of Texas (Utility Commission) initiated a proceeding (Docket No. 12065) to determine whether HL&P's existing rates are just and reasonable. Subsequently, the scope of the docket was expanded to include reconciliation of HL&P's fuel costs from April 1, 1990 to July 31, 1994. The Utility Commission also initiated a

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separate proceeding (Docket No. 13126) to review issues regarding the prudence of operation of the South Texas Project from the date of commercial operation through the present. That review would encompass the outage at the South Texas Project during 1993 and 1994.

Hearings began in Docket No. 12065 in January 1995. In February 1995, all major parties to these proceedings signed an agreement resolving the issues with respect to HL&P, including the prudence issues related to operation of the South Texas Project (Proposed Settlement). Approval of the Proposed Settlement by the Utility Commission will be required. Hearings on the Proposed Settlement are currently scheduled to begin in early June 1995. A decision by the Utility Commission on the Proposed Settlement is not anticipated before late summer.

Under the Proposed Settlement, HL&P's base rates would be reduced by approximately \$62 million per year, effective retroactively to January 1, 1995, and HL&P would be precluded from seeking rate increases for three years, subject to certain conditions. Under the Proposed Settlement, HL&P would amortize its remaining investment of \$218 million in the cancelled Malakoff Electric Generating Station (Malakoff) plant over a period not to exceed seven years. HL&P also would increase its decommissioning expense for the South Texas Project by \$9 million per year.

The Proposed Settlement also provides HL&P the option to write down up to \$50 million per year of its investment in the South Texas Project during the five-year period commencing January 1, 1995. The parties to the Proposed Settlement agreed that any write down would be treated as a reasonable and necessary expense during routine reviews of HL&P's earnings and any rate review proceeding initiated against HL&P.

Until the approval of the Proposed Settlement by the Utility Commission, HL&P's existing rates will continue in effect; however, HL&P's financial statements for the first quarter of 1995 reflect the estimated effects of the Proposed Settlement. In the first quarter of 1995, HL&P's pre-tax earnings were reduced by approximately \$17 million in the aggregate as a result of reflecting the estimated effects of the Proposed Settlement on revenues and expenses for the quarter. Deferred revenues are included on the Company's Consolidated and HL&P's Balance Sheets in other deferred

credits subject to refund when the Proposed Settlement is approved.

Under the Proposed Settlement, approximately \$70 million of fuel expenditures and related interest incurred by HL&P during the fuel reconciliation period would not be recoverable from ratepayers. This \$70 million was recorded in the fourth quarter of 1994 as a one-time, pre-tax charge to reconcilable fuel revenues to reflect the anticipation of approval of the Proposed Settlement. Under the Proposed Settlement, HL&P would also establish a new fuel factor approximately 17 percent below that currently in effect and would refund to customers the balance in its fuel over-recovery account, estimated to be approximately \$180 million after giving effect to the amounts not recoverable from ratepayers. As contemplated by the Proposed Settlement and approved by an ALJ, HL&P implemented a new fuel factor 17 percent lower than its previous factor and refunded to customers approximately \$110 million of the approximately \$180 million in fuel cost overrecoveries in April 1995. The remaining \$70 million will be refunded if the Proposed Settlement is approved by the Utility Commission.

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In the event the Proposed Settlement is not approved by the Utility Commission, Docket No. 12065 would be remanded to an ALJ to resume detailed hearings in this docket and with respect to issues related to the South Texas Project. Prior to reaching agreement on the terms of the Proposed Settlement, HL&P argued that its existing rates were just and reasonable and should not be reduced. Other parties argued that rate decreases in annual amounts ranging from \$26 million to \$173 million were required and that additional decreases might be justified following an examination of the prudence of the management of the South Texas Project and the costs incurred in connection with the outages at the South Texas Project. Testimony filed by the Utility Commission staff included a recommendation to remove from rate base \$515 million of HL&P's investment in the South Texas Project to reflect the staff's view that such investment was not fully "used and useful" in providing service, a position HL&P vigorously disputes.

In the event the Proposed Settlement is not approved by the Utility Commission, the fuel reconciliation issues in Docket Nos. 12065 and 13126 would be remanded to an ALJ for additional proceedings. A major issue in Docket No. 13126 would be whether the incremental fuel costs incurred as a result of outages at the South Texas Project represent reasonable costs. The Utility Commission has retained a consultant to review the South Texas Project for the purpose of providing testimony in Docket No. 13126 regarding the prudence of HL&P's management of operation of the South Texas Project. HL&P filed testimony in Docket No. 13126, which testimony concluded that the outages at the South Texas Project did not result from imprudent management. HL&P also filed testimony analyzing the extent to which regulatory issues extended the outages. In that testimony an outside consultant retained by HL&P concluded that the duration of the outages was controlled by both the resolution of NRC regulatory issues as well as necessary equipment repairs unrelated to NRC regulatory issues and that the incremental effect of NRC regulatory issues on the duration of the outages was only 39 days per unit. Estimates as to the cost of replacement power may vary significantly based on a number of factors, including the capacity factor at which the South Texas Project might be assumed to have operated had it not been out of service due to the outages. However, HL&P believes that applying a reasonable range of assumptions would result in replacement fuel costs of less than \$10 million for the 39 day periods identified by HL&P's consultant and less than \$100 million for the entire length of the outages. Any fuel costs determined to have been unreasonably incurred would not be recoverable from customers and would be charged against the Company's earnings.

Although the Company and HL&P believe that the Proposed Settlement is in the best interest of HL&P, its ratepayers, the Company and its shareholders, no assurance can be given that (i) the Utility Commission ultimately will approve the terms of the Proposed Settlement or (ii) in the event the Proposed Settlement is not approved and proceedings against HL&P are resumed, that the outcome of such proceedings would be favorable to HL&P.

(2) JOINTLY-OWNED NUCLEAR PLANT

- (b) UNITED STATES NUCLEAR REGULATORY COMMISSION (NRC) INSPECTIONS AND OPERATIONS. HL&P removed both generating units at the South Texas Project from service in February 1993 when a problem was encountered with certain of the units' auxiliary feedwater pumps. The units were

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out of service from February 1993 to February 1994, when Unit No. 1 was returned to service. Unit No. 2 was returned to service in May 1994. In June 1993, the NRC placed the South Texas Project on its "watch list" of plants with weaknesses that warrant increased attention after a review of the South Texas Project operations. In February 1995, the NRC removed the South Texas Project from its "watch list".

For a discussion concerning litigation by certain current and former employees or contractors of HL&P asserting that their employment was terminated or disrupted in retaliation for their having made safety-related complaints to the NRC, see Note 2(b) of the notes to the financial statements included in the Combined Form 8-K and Note 2(b) to the financial statements included in the Company's and HL&P's Combined Quarterly Report on Form 10-Q for the quarter ended March 31, 1995 (Combined Form 10-Q).

While no prediction can be made at this time as to the ultimate outcome of these matters, the Company and HL&P do not believe that they will have a material adverse effect on the Company's or HL&P's financial condition or results of operations.

(3) RATE REVIEW, FUEL RECONCILIATION AND OTHER PROCEEDINGS

In February 1994, the Public Utility Commission of Texas (Utility Commission) initiated a proceeding (Docket No. 12065) to determine whether HL&P's existing rates are just and reasonable and to reconcile HL&P's fuel costs from April 1, 1990 to July 31, 1994. The Utility Commission also initiated a separate proceeding (Docket No. 13126) to review issues regarding the prudence of operation of the South Texas Project from the date of commercial operation through the present (a period including the outage at the South Texas Project during 1993 and 1994).

In February 1995, all major parties to these proceedings signed an agreement resolving the issues with respect to HL&P, including the prudence issues related to operation of the South Texas Project (Proposed Settlement). In July 1995, an Administrative Law Judge (ALJ) recommended that the Utility Commission issue a final order consistent with the Proposed Settlement. A decision is expected by the Utility Commission at a Final Order Meeting scheduled for August 30, 1995.

Under the Proposed Settlement, HL&P's base rates would be reduced by approximately \$62 million per year, effective retroactively to January 1, 1995, and HL&P would be precluded from seeking rate increases for three years, subject to certain conditions. Under the Proposed Settlement, HL&P would amortize its remaining investment (\$211 million as of June 30, 1995) in the cancelled Malakoff Electric Generating Station (Malakoff) plant over a period not to exceed

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seven years. HL&P also would increase its decommissioning expense for the South Texas Project by \$9 million per year.

The Proposed Settlement also provides HL&P the option to write down a portion of its investment in the South Texas Project during the five-year period commencing January 1, 1995. The parties to the Proposed Settlement agreed that up to \$50 million per year of any write down would be treated as a reasonable and necessary expense during routine reviews of HL&P's earnings and any rate review proceeding initiated against HL&P. In the second quarter of 1995, HL&P recorded a \$7 million write down of its investment in the South Texas Project pursuant to this provision of the Proposed Settlement, which amount is included on the Company's Consolidated and HL&P's Statements of Income in depreciation and amortization expense.

Until the approval of the Proposed Settlement by the Utility Commission, HL&P's existing rates will continue in effect; however, HL&P's financial statements for 1995 reflect the estimated effects of the Proposed Settlement. In the second quarter and first six months of 1995, HL&P's pre-tax earnings were reduced by approximately \$39 million and \$56 million, respectively, which represent the estimated effects of the Proposed Settlement on revenues and expenses. Included in these reductions are charges of \$7 million related to the South Texas Project investment as discussed above and a one-time, pre-tax charge of \$9 million incurred in connection with certain mine-related costs which were not previously recorded and are not recoverable under the terms of the Proposed Settlement. (See Note 5 to these financial statements.) Deferred revenues are included on the Company's Consolidated and HL&P's Balance Sheets in other deferred credits subject to refund in the event the Proposed Settlement is approved.

Under the terms of the Proposed Settlement, HL&P previously agreed that approximately \$70 million of fuel expenditures and related interest incurred during the fuel reconciliation period would not be recoverable from ratepayers. This \$70 million was recorded in December 1994 as a one-time, pre-tax charge to reconcilable fuel revenues and will be refunded to ratepayers in the event that the Proposed Settlement is approved by the Utility Commission.

For additional information regarding Docket Nos. 12065 and 13126, see Note 3 to the financial statements included in the Combined Form 10-Q, which note

is incorporated herein by reference.

(4) APPEALS OF PRIOR UTILITY COMMISSION RATE ORDERS

Pursuant to a series of applications filed by HL&P in recent years, the Utility Commission has granted HL&P rate increases to reflect in electric rates HL&P's substantial investment in new plant construction, including the South Texas Project. Although Utility Commission action on those applications has been completed, judicial review of a number of the Utility Commission orders is pending. In the event the courts ultimately reverse actions of the Utility Commission in any of these proceedings, such matters would be remanded to the Utility Commission for action in light of the courts' orders. Because of the number of variables which can affect the ultimate resolution of such matters on remand, the Company and HL&P generally are not in a position at this time to predict the outcome of the matters on appeal or the ultimate effect that adverse action by the courts could have on the Company and HL&P.

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(b) 1988 RATE CASE. In HL&P's 1988 rate case (Docket No. 8425), the Utility Commission granted HL&P a \$227 million increase in base revenues, allowed a 12.92 percent return on common equity, authorized a qualified phase-in for Unit No. 1 of the South Texas Project (including

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approximately 72 percent of HL&P's investment in Unit No. 1 of the South Texas Project in rate base) and authorized HL&P to use deferred accounting for Unit No. 2 of the South Texas Project. Rates substantially corresponding to the increase granted were implemented by HL&P in June 1989 and remained in effect until May 1991.

In August 1994, the Austin Court of Appeals affirmed the Utility Commission's order in Docket No. 8425 on all matters other than the Utility Commission's treatment of tax savings associated with deductions taken for expenses disallowed from cost of service. The court held that the Utility Commission had failed to require that such tax savings be passed on to ratepayers. Both HL&P and other parties sought review by the Texas Supreme Court, which granted discretionary review as to the issue of certain Malakoff plant expenditures treated as "Plant Held for Future Use", and brought the entire case before it for consideration, including the tax issue raised by HL&P. The case has been scheduled for oral argument in September 1995 by the Texas Supreme Court.

Although no assurance can be given in this matter, the Company believes that if the principles and rationale of the GTE-SW decision discussed in Note 4(a) above were applied, the Utility Commission's treatment of the tax issue in Docket No. 8425 should be upheld.

ITEM 3. LEGAL PROCEEDINGS.

For a description of certain legal and regulatory proceedings affecting the Company and its subsidiaries (including (i) HL&P's rate cases, (ii) certain environmental matters and (iii) litigation related to the South Texas Project), see "Business - Regulatory Matters - Environmental Quality" in Item 1 of this Report, "LIQUIDITY AND CAPITAL RESOURCES - HL&P - Environmental Expenditures" in Item 7 of this Report and Notes 1(f) and 2 through 5 to the Financial Statements in Item 8 of this Report, which sections and notes are incorporated herein by reference.

HL&P is a defendant in litigation arising out of the environmental remediation of a site in Corpus Christi, Texas. The site in question was operated as a metals reclaiming operation for a number of years, and, though HL&P neither operated nor had any ownership interest in the site, some transformers and other equipment that HL&P sold as surplus allegedly were delivered to that site, where the site operators subsequently disposed of the materials in ways that caused environmental damage. In one case, DUMES, ET AL. V. HL&P, ET AL., pending in the U.S. District Court for the Southern District of Texas, Corpus Christi Division, a group of approximately 70 landowners near the site are seeking damages primarily for lead contamination to their property. They have pled damages of approximately \$1 million each and also seek punitive damages totaling \$51 million. The Plaintiffs seek to impose responsibility on HL&P and the other utility that undertook to clean up the property, neither of which contributed more than an insignificant amount of lead to the site, on the theory that lead was deposited on their properties during the site remediation itself. In addition, Gulf States Utilities Company (Gulf States) filed suit (GULF STATES UTILITIES CO. V. HOUSTON LIGHTING & POWER CO., ET AL.) in the United States District Court for the Southern District of Texas, Houston Division, against HL&P and two other utilities concerning a site in Houston, Texas, which allegedly has been contaminated by polychlorinated biphenyls and which Gulf States has undertaken to remediate pursuant to an EPA order. HL&P does not believe, based on its records, that it contributed material to that site and in October 1994, Gulf States dismissed its claims against HL&P. HL&P remains in the case on cross-claims asserted by two co-defendants. The ultimate outcome of these pending cases cannot be predicted at this time. Based on information currently available, the Company and HL&P believe that none of these cases will result in a material adverse effect on the Company's or HL&P's financial condition or results of operations.

HL&P and the other owners of the South Texas Project filed suit in 1990 against Westinghouse Electric Corporation (Westinghouse) in the 23rd District Court for Matagorda County, Texas (Cause No. 90-S-0684-C), alleging breach of warranty and misrepresentation in connection with the steam generators supplied by Westinghouse for the South Texas Project. In recent years, other utilities have encountered stress corrosion cracking in steam generator tubes in Westinghouse units similar to those supplied for the South Texas Project. Failure of such tubes can result in a reduction of plant efficiency, and, in some cases, utilities have replaced their steam generators. During an inspection concluded in the fall of 1993, evidence was found of stress corrosion cracking consistent with that encountered with Westinghouse steam generators at other facilities, and a small number of tubes were found to require plugging. To date, stress corrosion cracking has not had a significant impact on operation of either unit; however, the owners of the South Texas Project have approved remedial operating

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plans and have undertaken expenditures to minimize and delay further corrosion. The litigation, which is in discovery, seeks appropriate damages and other relief from Westinghouse and is currently scheduled for trial in July 1995. No prediction can be made as to the ultimate outcome of this litigation.

In April 1994, two former employees of HL&P filed a class action and shareholder derivative suit on behalf of all shareholders of the Company. This lawsuit (PACE AND FUENTEZ V. HOUSTON INDUSTRIES INCORPORATED) alleges various acts of mismanagement against certain officers and directors of the Company and HL&P and, seeks unspecified actual and punitive damages for the benefit of shareholders of the Company. The Company and HL&P believe that the suit is without merit. The lawsuit is pending in the 122nd Judicial District of Galveston County, Texas.

In June 1994, a former employee of HL&P filed a lawsuit (PACE, INDIVIDUALLY AND AS A REPRESENTATIVE OF ALL OTHERS SIMILARLY SITUATED V. HOUSTON LIGHTING & POWER COMPANY) in the 56th Judicial District Court of Galveston County, Texas alleging that HL&P has been overcharging ratepayers and owes a refund of more than \$500 million. The claim was based on the argument that the Utility Commission failed to allocate to ratepayers alleged tax benefits accruing to the Company and HL&P because HL&P's federal income taxes are paid as part of a consolidated group. The court has granted HL&P's motion for summary judgment, which has now become final.

In July 1990, the Company paid approximately \$104.5 million to the Internal Revenue Service (IRS) in connection with an IRS audit of the Company's 1983 and 1984 federal income tax returns. In November 1991, the Company filed a refund suit in the U.S. Court of Federal Claims seeking the return of \$52.1 million of tax, \$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's 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 October 1994, the Court granted the Company's Motion for Partial Summary Judgment on the fuel cost over-recovery issue. On February 21, 1995, the Court entered partial judgment in favor of the Company for this issue. The U.S. Government (Government) must file its notice of appeal on or before April 24, 1995. If the Government does not appeal or if the Government appeals but does not prevail, the Company would be entitled to a refund of overpaid tax, interest

paid on the overpaid tax in July 1990 and interest on both of those amounts from July 1990. Although, the Company would not be entitled to a refund until all appeals are decided in its favor, the amount owed to the Company will continue to accrue interest. If the Government appeals and prevails, the Company's ultimate financial exposure should be immaterial because of offsetting tax deductions to which the Company is entitled in the year the over-recovery was refunded to ratepayers (and which the IRS has conceded).

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting the Company and its subsidiaries, including HL&P, reference is made to the information set forth in Item 3 of the Company's and HL&P's Annual Report on Form 10-K for the year ended December 31, 1994 (1994 Combined Form 10-K) and Notes 2, 3 and 4 to the Company's Consolidated and HL&P's Financial Statements in the Combined Form 8-K, which information, as qualified and updated by the description of developments in regulatory and litigation matters contained in Notes 2, 3 and 4 of the Notes to the Company's Consolidated and HL&P's Financial Statements included in Part I of this Report, is incorporated herein by reference.

In April 1995, the government filed a notice of appeal with respect to the judgment entered in favor of the Company in its refund suit pending in the U.S. Court of Federal Claims. For additional information regarding the Company's tax case, see Item 3 to the 1994 Combined Form 10-K.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting the Company and its subsidiaries, including HL&P, reference is made to the information set forth in Item 3 of the 1994 Combined Form 10-K, Item 1 of Part II of the Combined Form 10-Q, Notes 2, 3 and 4 to the Company's Consolidated and HL&P's Financial Statements in the Combined Form 8-K and Notes 2(b) and 3 to the Company's Consolidated and HL&P's Financial Statements in the Combined Form 10-Q, which information, as qualified and updated by the description of developments in regulatory and litigation matters contained in Notes 2, 3 and 4 of the Notes to the Financial Statements included in Part I of this Report, is incorporated herein by reference.

GULF STATES UTILITIES CO. V. HOUSTON LIGHTING & POWER CO., ET AL., formerly pending in the United States District Court for the Southern District of Texas, Houston Division, was dismissed upon joint stipulation of all the parties in June 1995. Under the terms of the Agreement of Compromise and Settlement, HL&P bears its own fees, costs and expenses, but is not required to pay any other amounts.

RECOVERY OF FUEL COSTS. For information relating to the cost of fuel over the last three years, see "Operating Statistics of HL&P" below and "Results of Operations - HL&P - Fuel and Purchased Power Expense" in Item 7 of this Report. Utility Commission rules provide for the recovery of certain fuel and purchased power costs through an energy component of electric rates (fixed fuel factor). The fixed fuel factor is established during either a utility's general rate proceeding or an interim fuel proceeding and is to be generally effective for a minimum of six months, unless a substantial change in a utility's cost of fuel occurs. In that event, a utility may be authorized to revise the fixed fuel factor in its rates appropriately. In any event, a fuel reconciliation is required every three years.

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In October 1991, the Utility Commission approved HL&P's fixed fuel factor as contemplated in the settlement agreement reached in February 1991 by HL&P and most other parties to Docket No. 9850. See Note 10(c) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report. In November 1993, the Utility Commission authorized HL&P to implement a higher fuel factor under Docket No. 12370. The Company can request a revision to its fuel factor in April and October each year.

Reconciliation of fuel costs after March 1990 is required in 1994, and under Utility Commission rules, HL&P has anticipated that a filing would be required in May 1994. However, the Utility Commission staff has requested that such filing be delayed to the fourth quarter of 1994. If that request is granted by the Utility Commission, HL&P anticipates that fuel costs through some time in 1994 will be submitted for reconciliation at that time. No hearing would be anticipated in that reconciliation proceeding before 1995, and the schedule for reconciliation of those costs could be affected by the institution of a rate proceeding by the Utility Commission and/or a prudence inquiry concerning the outage at the South Texas Project. For a discussion of that outage and the possibility that a rate proceeding may be instituted, see Notes 9(f), 10(f) and 10(g), respectively, to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference.

REGULATORY MATTERS

ENERGY ACT. In October 1992, the Energy Act became law. For a description of the Energy Act, see "Competition" above and Note 8(a) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report.

RATES AND SERVICES. Pursuant to the PURA, the Utility Commission has original jurisdiction over electric rates and services in unincorporated areas of the State of Texas and in the incorporated municipalities that have relinquished original jurisdiction. Original jurisdiction over electric rates and services in the remaining incorporated municipalities served by HL&P is exercised by such municipalities, including Houston, but the Utility Commission has appellate jurisdiction over electric rates and services within those incorporated municipalities.

In 1993, the Texas Legislature considered changes to PURA as part of a required review under the Sunset Act. None of the proposed changes to the Utility Commission or Texas utility regulation were enacted. However, the legislature passed legislation continuing the current PURA until September 1, 1995. The legislature also established a joint interim committee to study certain regulatory issues prior to the next legislative session which begins in January 1995. These issues include, among other items, tax issues relating to public utilities, the organization and authority of the Utility Commission and IRP. Recommendations from this study period will be considered during the next legislative session.

UTILITY COMMISSION PROCEEDINGS. For information concerning the Utility Commission's orders with respect to HL&P's applications for general rate increases with the Utility Commission (Docket No. 8425 for the 1988 rate case and Docket No. 9850 for the 1990 rate case) and the municipalities within HL&P's service area and the appeals of such orders, see Notes 10(b) and 10(c) to the Company's Consolidated and HL&P's

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Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference. HL&P's 1986 general rate case (Docket Nos. 6765 and 6766) and 1984 rate case (Docket No. 5779) have been affirmed and are no longer subject to appellate review. For a discussion of the possibility that a rate proceeding may be instituted, see Notes 10(f) and 10(g) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference.

PRUDENCE REVIEW OF CONSTRUCTION OF THE SOUTH TEXAS PROJECT. For information concerning the Utility Commission's orders with respect to a prudence review of the planning, management and construction of the South Texas Project (Docket No. 6668) and the appeals of such orders, see Note 10(d) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which note is incorporated herein by reference.

DEFERRED ACCOUNTING DOCKETS. For information concerning the Utility Commission's orders allowing deferred accounting treatment for certain costs associated with the South Texas Project (Docket Nos. 8230, 9010 and 8425), the appeals of such orders and related proceedings, see Notes 10(b), 10(e) and 11 to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference.

ENVIRONMENTAL QUALITY. General. HL&P is subject to regulation with

respect to air and water quality, solid waste management and other environmental matters by various federal, state and local authorities. Environmental regulations continue to be affected by legislation, administrative actions and judicial review and interpretation. As a result, the precise effect of potential regulations upon existing and proposed facilities and operations cannot presently be determined. However, developments in these and other areas of regulation have required HL&P to make substantial expenditures to modify, supplement or replace equipment and facilities and may, in the future, delay or impede construction and operation of new facilities or require expenditures to modify existing facilities. For information regarding environmental expenditures, see "Capital Program" above.

Air. The TNRCC has jurisdiction and enforcement power to determine the permissible level of air contaminants emitted in the State of Texas. The standards established by the Texas Clean Air Act and the rules of the TNRCC are subject to modification by standards promulgated by the EPA. Compliance with such standards has resulted, and is expected to continue to result, in substantial expenditures by HL&P. In addition, expanded permit and fee systems and enforcement penalties may discourage industrial growth within HL&P's service area.

In November 1990, significant amendments to the Clean Air Act became law. The law is designed to control emissions of air pollutants which contribute to acid rain, to reduce urban air pollution and to reduce emissions of toxic air pollutants. Parts of the Clean Air Act are directed at reducing emissions of sulfur dioxide from electric utility generating units. This reduction program includes an "allowance" system which sets forth formulas and criteria to establish a cap on sulfur dioxide emissions from utility generating units. HL&P has been allocated allowances sufficient to permit continued operation of its existing facilities and some expansion of its solid-fuel generating facilities without substantial additional expense relating to modification of its facilities.

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HL&P has already made substantial investments in pollution control facilities, and all of its generating facilities currently comply in all material respects with sulfur dioxide emission standards established by the Clean Air Act. As a result of this previous investment, HL&P does not anticipate that significant expenditures for sulfur dioxide removal equipment will be required. Provisions of the Clean Air Act dealing with urban air pollution require establishing new emission limitations for nitrogen oxides from existing sources. Although initial limitations were finalized in 1993, further reductions may be required in the future. The cost of modifications necessary to reduce nitrogen oxide emissions from existing sources has been estimated at \$29 million in 1994 and \$10.5 million in 1995. The Clean Air Act also calls for additional stack gas continuous emissions monitoring equipment to be installed on various HL&P generating facilities. Capital expenditures of \$12 million in 1994 and \$2 million in 1995 are anticipated for installation of this new monitoring equipment. See "Capital Program" above.

The Clean Air Act established a new permitting program to be administered in Texas by the TNRCC. The precise requirements of the program cannot be determined until the permit program is approved by the EPA. However, based on regulations promulgated by the TNRCC, HL&P anticipates that additional expenditures may be required for administering the permitting process. The legislation could also substantially increase the cost of constructing new generating units.

Water. The TNRCC has jurisdiction over water discharges in the State of Texas and is empowered to set water quality standards and issue permits regulating water quality. The TNRCC jurisdiction is currently shared with the EPA, which also issues water discharge permits and reviews the Texas water quality standards program.

HL&P has obtained permits from both the TNRCC and the EPA for all facilities currently in operation which require such permits. Applications for renewal of permits for existing facilities have been submitted as required. The reissued permits reflect changes in federal and state regulations which may increase the cost of maintaining compliance. Although compliance with the new regulations has resulted and will continue to result in additional costs to HL&P, the costs are not expected to have a material impact on HL&P's financial condition or results of operations.

For a description of certain Administrative Orders issued by the EPA to HL&P under the Clean Water Act and for a description of certain other environmental litigation, see Item 3 of this Report.

HOUSTON LIGHTING & POWER COMPANY
 COMPUTATION OF RATIOS OF EARNINGS TO FIXED CHARGES AND
 RATIOS OF EARNINGS TO FIXED CHARGES AND PREFERRED DIVIDENDS
 (THOUSANDS OF DOLLARS)

	NINE MONTHS ENDED SEPTEMBER 30, 1995	TWELVE MONTHS ENDED SEPTEMBER 30, 1995
	-----	-----
Fixed Charges as Defined:		
(1) Interest on Long-Term Debt.....	\$ 184,955	\$ 246,524
(2) Other Interest.....	6,639	9,194
(3) Amortization of (Premium) Discount.....	6,474	8,595
(4) Interest Component of Rentals Charged to Operating Expense.....	2,686	3,688
(5) Total Fixed Charges.....	\$ 200,754 =====	\$ 268,001 =====
Earnings as Defined:		
(6) Net Income	\$ 440,148 -----	\$ 466,675 -----
Federal Income Taxes:		
(7) Current.....	181,323	190,780
(8) Deferred (Net).....	40,573	37,536
(9) Total Federal Income Taxes.....	221,896	228,316
(10) Total Fixed Charges (line 5).....	200,754	268,001
(11) Earnings Before Income Taxes and Fixed Charges (line 6 plus line 9 plus line 10).....	\$ 862,798 =====	\$ 962,992 =====
Ratio of Earnings to Fixed Charges (line 11 divided by line 5).....	4.30	3.59
Preferred Dividends Requirements:		
(12) Preferred Dividends	\$ 23,207	\$ 31,809
(13) Less Tax Deduction for Preferred Dividends.....	41	54
(14) Total.....	23,166	31,755
(15) Ratio of Pre-Tax Income to Net Income (line 6 plus line 9 divided by line 6).....	1.50	1.49
(16) Line 14 times line 15.....	34,749	47,315
(17) Add Back Tax Deduction (line 13).....	41	54
(18) Preferred Dividends Factor.....	\$ 34,790 =====	\$ 47,369 =====
(19) Total Fixed Charges (line 5).....	\$ 200,754	\$ 268,001
(20) Preferred Dividends Factor (line 18).....	34,790	47,369
(21) Total.....	\$ 235,544 =====	\$ 315,370 =====
Ratio of Earnings to Fixed Charges and Preferred Dividends Requirements (line 11 divided by line 21).....	3.66	3.05

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

0000048732
HOUSTON LIGHTING & POWER
1000

9-MOS		
	DEC-31-1995	
	SEP-30-1995	
	PER-BOOK	
8,788,271		
0		
602,535		
1,537,643		
	0	
	10,928,449	
	1,675,927	
	0	
3,999,227	2,323,300	
	51,055	
	351,345	
	3,002,930	
	0	
	0	
150,130		
25,700		
6,065		
	3,619	
3,338,378		
10,928,449		
2,896,180		
	222,533	
2,043,404		
2,265,937		
	630,243	
	(2,382)	
627,861		
	187,713	
	440,148	
	23,207	
416,941		
	246,750	
	184,899	
	719,709	
	0	
	0	

(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 megawatt 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, 1994, HL&P's investments (net of accumulated depreciation and amortization) in the South Texas Project and in nuclear fuel, including AFUDC, were \$2.1 billion and \$99 million, respectively.
- (b) UNITED STATES NUCLEAR REGULATORY COMMISSION (NRC) INSPECTIONS AND OPERATIONS. Both generating units at the South Texas Project were out of service from February 1993 to February 1994, when Unit No. 1 was returned to service. Unit No. 2 was returned to service in May 1994. HL&P removed the units from service in February 1993 when a problem was encountered with certain of the units' auxiliary feedwater pumps.

In February 1995, the NRC removed the South Texas Project from its "watch list" of plants with weaknesses that warranted increased NRC attention. The NRC placed the South Texas Project on the "watch list" in June 1993, following the issuance of a report by an NRC Diagnostic Evaluation Team (DET) which conducted a review of the South Texas Project operations.

Certain current and former employees of HL&P or contractors of HL&P have asserted claims that their employment was terminated or disrupted in retaliation for their having made safety-related complaints to the NRC. Civil proceedings by the complaining personnel and administrative proceedings by the Department of Labor remain pending against HL&P, and the NRC has jurisdiction to take enforcement action against HL&P and/or individual employees with respect to these matters. Based on its own internal investigation, in October 1994 the NRC issued a notice of violation and proposed a \$100,000 civil penalty against HL&P in one such case in which HL&P had terminated the site access of a former contractor employee. In that action, the NRC also requested information relating to possible further enforcement action in this matter against two HL&P managers involved in such termination. HL&P strongly disagrees with the NRC's conclusions, and has requested the NRC to give further consideration of its notice. In February 1995, the NRC conducted an enforcement conference with respect to that matter, but no result has been received.

HL&P has provided documents and other assistance to a subcommittee of the U. S. House of Representatives (Subcommittee) that is conducting an inquiry related to the South Texas Project. Although the precise focus and timing of the inquiry has not been identified by the Subcommittee, it is anticipated that the Subcommittee will inquire into matters related to HL&P's handling of employee concerns and to issues related to the NRC's 1993 DET review of the South Texas Project. In connection with that inquiry, HL&P has been advised that the U. S. General Accounting Office (GAO) is conducting a review of the NRC's inspection process as it relates to the South Texas Project and other plants, and HL&P is cooperating with the GAO in its investigation and with the NRC in a similar review it has initiated. While no prediction can

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be made at this time as to the ultimate outcome of these matters, the Company and HL&P do not believe that they will have a material adverse effect on the Company's or HL&P's financial condition or results of operations.

- (c) LITIGATION WITH CO-OWNERS OF THE SOUTH TEXAS PROJECT. In February 1994, the City of Austin (Austin), one of the four co-owners of the South Texas Project, filed suit (Austin II Litigation) against HL&P. That suit is pending in the 152nd District Court for Harris County, Texas, which has set a trial date for October 1995. Austin alleges that the outages at the South Texas Project from early 1993 to early 1994 were due to HL&P's failure to perform obligations it owed to Austin under the Participation Agreement among the four co-owners of the South Texas Project (Participation Agreement). Austin also asserts that HL&P breached certain undertakings voluntarily assumed by HL&P under the terms and conditions of the Operating Licenses and Technical Specifications relating to the South Texas Project. Austin claims that such failures have caused Austin damages of at least \$125 million due to the incurrence of increased operating and maintenance costs, the cost of replacement power and lost profits on wholesale transactions that did not occur. In May 1994, the City of San Antonio (San Antonio), another co-owner of the South Texas Project, intervened in the litigation filed by Austin against HL&P and asserted claims similar to those asserted by Austin. San Antonio has not identified the amount of damages it intends to seek from HL&P. HL&P is contesting San Antonio's intervention and has called for arbitration of San Antonio's claim under the arbitration provisions of the Participation Agreement. The trial court has denied HL&P's requests, but review of these decisions is currently pending before the 1st Court of Appeals in Houston.

In a previous lawsuit (Austin I Litigation) filed in 1983 against the Company and HL&P, Austin alleged that it had been fraudulently induced to participate in the South Texas Project and that HL&P had failed to perform properly its duties as project manager. In May 1993, the courts entered a judgement in favor of the Company and HL&P, concluding, among other things, that the Participation Agreement did not impose on HL&P a duty to exercise reasonable skill and care as project manager. During the course of the Austin I Litigation, San

Antonio and Central Power and Light Company (CPL), a subsidiary of Central and South West Corporation, two of the co-owners in the South Texas Project, also asserted claims for unspecified damages against HL&P as project manager of the South Texas Project, alleging HL&P breached its duties and obligations. San Antonio and CPL requested arbitration of their claims under the Participation Agreement. In 1992, the Company and HL&P entered into a settlement agreement with CPL (CPL Settlement) providing for CPL's withdrawal of its demand for arbitration. San Antonio's claims for arbitration remain pending. Under the Participation Agreement, San Antonio's arbitration claims will be heard by a panel of five arbitrators consisting of four arbitrators named by each co-owner and a fifth arbitrator selected by the four appointed arbitrators.

Although the CPL Settlement did not directly affect San Antonio's pending demand for arbitration, HL&P and CPL reached certain understandings in such agreement which contemplated that: (i) CPL's previously appointed arbitrator would be replaced by CPL; (ii) arbitrators approved by CPL or HL&P in any future arbitrations would be mutually acceptable to HL&P and CPL; and (iii) HL&P and CPL would resolve any future disputes between them concerning the South Texas Project without resorting to the arbitration provision of the

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Participation Agreement. Austin and San Antonio have asserted in the pending Austin II Litigation that such understandings have rendered the arbitration provisions of the Participation Agreement void and that neither Austin nor San Antonio should be required to participate in or be bound by such proceedings.

Although HL&P and the Company do not believe there is merit to either Austin's or San Antonio's claims and have opposed San Antonio's intervention in the Austin II Litigation, there can be no assurance as to the ultimate outcome of these matters.

- (d) 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 the maximum amount of property damage insurance currently available through the insurance industry, consisting 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 on March 1, 1995 and under portions of the excess property insurance coverage in effect prior to March 1, 1995, HL&P and the other owners of the South Texas Project are subject to assessments, the maximum aggregate assessment under current policies being \$26.9 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 for owners of nuclear power plants, such as the South Texas Project, was decreased from \$9.0 billion to \$8.92 billion effective in November 1994. 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.

- (e) NUCLEAR DECOMMISSIONING. HL&P and the other co-owners of the South Texas Project are required by the NRC to meet minimum decommissioning funding requirements to pay the costs of decommissioning the South Texas Project. Pursuant to the terms of the order of the Utility Commission in Docket No. 9850, HL&P is currently funding decommissioning costs for the South Texas Project with an independent trustee at an annual amount of \$6 million, which is recorded in depreciation and amortization expense. HL&P's funding level is estimated to provide approximately \$146 million, in 1989 dollars, an amount which exceeds the current NRC minimum.

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The Company adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," effective January 1, 1994. At December 31, 1994, the securities held in the Company's nuclear decommissioning trust totaling \$25.1 million (reflected on the Company's Consolidated and HL&P's Balance Sheets in deferred debits and deferred credits) are classified as available for sale. Such securities are reported on the balance sheets at fair value, which at December 31, 1994 approximates cost, and any unrealized gains or losses will be reported as a separate component of common stock equity. Earnings, net of taxes and administrative costs, are reinvested in the funds.

In May 1994, an outside consultant estimated HL&P's portion of decommissioning costs to be approximately \$318 million, in 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. Under the terms of the Proposed Settlement, HL&P would increase funding of decommissioning costs to an annual amount of approximately \$14.8 million consistent with such study. While the current and projected funding levels presently 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 or the assumptions used in estimating decommissioning costs will ultimately prove to be correct.

(3) RATE REVIEW, FUEL RECONCILIATION AND OTHER PROCEEDINGS

In February 1994, the Utility Commission initiated a proceeding (Docket No. 12065) to determine whether HL&P's existing rates are just and reasonable. Subsequently, the scope of the docket was expanded to include reconciliation of HL&P's fuel costs from April 1, 1990 to July 31, 1994. The Utility Commission also initiated a separate proceeding (Docket No. 13126) to review issues regarding the prudence of operation of the South Texas Project from the date of commercial operation through the present. That review would encompass the outage at the South Texas Project during 1993 through 1994.

Hearings began in Docket No. 12065 in January 1995, and the Utility Commission has retained a consultant to review the South Texas Project for the purpose of providing testimony in Docket No. 13126 regarding the prudence of HL&P's management of operation of the South Texas Project. In February 1995, all major parties to these proceedings signed the Proposed Settlement resolving the issues with respect to HL&P, including the prudence issues related to operation of the South Texas Project. Approval of the Proposed Settlement by the Utility Commission will be required. To that end, the parties have established procedural dates for a hearing on issues raised by the parties who are opposed to the Proposed Settlement. A decision by the Utility Commission on the Proposed Settlement is not anticipated before early summer.

Under the Proposed Settlement, HL&P's base rates would be reduced by approximately \$62 million per year, effective retroactively to January 1, 1995, and rates would be frozen for three years, subject to certain conditions. Under the Proposed Settlement, HL&P would amortize its remaining investment of \$218 million in the cancelled Malakoff plant over a period not to exceed

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seven years. HL&P also would increase its decommissioning expense for the South Texas Project by \$9 million per year.

Under the Proposed Settlement, approximately \$70 million of fuel expenditures and related interest incurred by HL&P during the fuel reconciliation period would not be recoverable from ratepayers. This \$70 million was recorded as a one-time, pre-tax charge to reconcilable fuel revenues to reflect the anticipation of approval of the Proposed Settlement. HL&P also would establish a new fuel factor approximately 17 percent below that currently in effect and would refund to customers the balance in its fuel over-recovery account, estimated to be approximately \$180 million after giving effect to the amounts not recoverable from ratepayers.

HL&P recovers fuel costs incurred in electric generation through a fixed fuel factor that is set by the Utility Commission. The difference between fuel revenues billed pursuant to such factor and fuel expense incurred is recorded as an addition to or a reduction of revenue, with a corresponding entry to under- or over-recovered fuel, as appropriate. Amounts collected pursuant to the fixed fuel factor must be reconciled periodically against actual, reasonable costs as determined by the Utility Commission. Currently, HL&P has an over-recovery fuel account balance that will be refunded pursuant to the Proposed Settlement.

In the event that the Proposed Settlement is not approved by the Utility Commission, including issues related to the South Texas Project, Docket No. 12065 will be remanded to an Administrative Law Judge (ALJ) to resume detailed hearings in this docket. Prior to reaching agreement on the terms of the Proposed Settlement, HL&P argued that its existing rates were just and reasonable and should not be reduced. Other parties argued that rate decreases in annual amounts ranging from \$26 million to \$173 million were required and that additional decreases might be justified following an examination of the prudence of the management of the South Texas Project and the costs incurred in connection with the outages at the South Texas Project. Testimony filed by the Utility Commission staff included a recommendation to remove from rate base \$515 million of HL&P's investment in the South Texas Project to reflect the staff's view that such investment was not fully "used and useful" in providing service, a position HL&P vigorously disputes.

In the event the Proposed Settlement is not approved by the Utility Commission, the fuel reconciliation issues in Docket Nos. 12065 and 13126 would be remanded to an ALJ for additional proceedings. A major issue in Docket No. 13126 will be whether the incremental fuel costs incurred as a result of outages at the South Texas Project represent reasonable costs. HL&P filed testimony in Docket No. 13126, which

testimony concluded that the outages at the South Texas Project did not result from imprudent management. HL&P also filed testimony analyzing the extent to which regulatory issues extended the outages. In that testimony an outside consultant retained by HL&P concluded that the duration of the outages was controlled by both the resolution of NRC regulatory issues as well as necessary equipment repairs unrelated to NRC regulatory issues and that the incremental effect of NRC regulatory issues on the duration of the outages was only 39 days per unit. Estimates as to the cost of replacement power may vary significantly based on a number of factors, including the capacity factor at which the South Texas Project might be assumed to have operated had it not been out of service due to the outages. However, HL&P believes that applying a reasonable range

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of assumptions would result in replacement fuel costs of less than \$10 million for the 39 day periods identified by HL&P's consultant and less than \$100 million for the entire length of the outages. Any fuel costs determined to have been unreasonably incurred would not be recoverable from customers and would be charged against the Company's earnings.

Although the Company and HL&P believe that the Proposed Settlement is in the best interest of HL&P, its ratepayers, and the Company and its shareholders, no assurance can be given that (i) the Utility Commission ultimately will approve the terms of the Proposed Settlement or (ii) in the event the Proposed Settlement is not approved and proceedings against HL&P resumed, that the outcome of such proceedings would be favorable to HL&P.

(4) APPEALS OF PRIOR UTILITY COMMISSION RATE ORDERS

Pursuant to a series of applications filed by HL&P in recent years, the Utility Commission has granted HL&P rate increases to reflect in electric rates HL&P's substantial investment in new plant construction, including the South Texas Project. Although Utility Commission action on those applications has been completed, judicial review of a number of the Utility Commission orders is pending. 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. The pending appeals from the Utility Commission orders are in various stages. In the event the courts ultimately reverse actions of the Utility Commission in any of these proceedings, such matters would be remanded to the Utility Commission for action in light of the courts' orders. Because of the number of variables which can affect the ultimate resolution of such matters on remand, the Company and HL&P generally are not in a position at this time to predict the outcome of the matters on appeal or the ultimate effect that adverse action by the courts could have on the Company and HL&P. On remand, the Utility Commission's action could range from granting rate relief substantially equal to the rates previously approved to a reduction in the revenues to which HL&P was entitled during the time the applicable rates were in effect, which could require a refund to customers of amounts collected pursuant to such rates. Judicial review has been concluded or currently is pending on the final orders of the Utility Commission described below.

- (a) 1991 RATE CASE. In HL&P's 1991 rate case (Docket No. 9850), the Utility Commission approved a non-unanimous settlement agreement providing for a \$313 million increase in HL&P's base rates, termination of deferrals granted with respect to Unit No. 2 of the South Texas Project and of the qualified phase-in plan deferrals granted with respect to Unit No. 1 of the South Texas Project, and recovery of deferred plant costs. The settlement authorized a 12.55 percent return on common equity for HL&P. Rates contemplated by the settlement agreement were implemented in May 1991 and remain in effect (subject to the outcome of the current rate proceeding described in Note 3).

The Utility Commission's order in Docket No. 9850 was affirmed on review by a District Court, and the Austin Court of Appeals affirmed that decision on procedural grounds due to the failure of the appellant to file the record with the court in a timely manner. On review, the Texas

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Supreme Court has remanded the case to the Austin Court of Appeals for consideration of the appellant's challenges to the Utility Commission's order, which include issues regarding deferred accounting, the treatment of federal income tax expense and certain other matters. As to federal tax issues, a recent decision of the Austin Court of Appeals, in an appeal involving GTE-SW (and to which HL&P was not a party), held that when a utility pays federal income taxes as part of a consolidated group, the utility's ratepayers are entitled to a fair share of the tax savings actually realized, which can include savings resulting from unregulated activities. The Texas Supreme Court has agreed to hear an appeal of that decision, but on points not involving the federal income tax issues, though tax issues could be decided in such opinion.

Because the Utility Commission's order in Docket No. 9850 found that HL&P would have been entitled to rate relief greater than the \$313 million agreed to in the settlement, HL&P believes that any disallowance that might be required if the court's ruling in the GTE

decision were applied in Docket No. 9850 would be offset by that greater amount. However, that amount may not be sufficient if the Austin Court of Appeals also concludes that the Utility Commission's inclusion of deferred accounting costs in the settlement was improper. For a discussion of the Texas Supreme Court's decision on deferred accounting treatment, see Note 4(c). Although HL&P believes that it could demonstrate entitlement to rate relief equal to that agreed to in the stipulation in Docket No. 9850, HL&P cannot rule out the possibility that a remand and reopening of that settlement would be required if decisions unfavorable to HL&P are rendered on both the deferred accounting treatment and the calculation of tax expense for rate making purposes.

The parties to the Proposed Settlement have agreed to withdraw their appeals of the Utility Commission's orders in such docket, subject to HL&P's dismissing its appeal in Docket No. 6668.

- (b) 1988 RATE CASE. In HL&P's 1988 rate case (Docket No. 8425), the Utility Commission granted HL&P a \$227 million increase in base revenues, allowed a 12.92 percent return on common equity, authorized a qualified phase-in plan for Unit No. 1 of the South Texas Project (including approximately 72 percent of HL&P's investment in Unit No. 1 of the South Texas Project in rate base) and authorized HL&P to use deferred accounting for Unit No. 2 of the South Texas Project. Rates substantially corresponding to the increase granted were implemented by HL&P in June 1989 and remained in effect until May 1991.

In August 1994, the Austin Court of Appeals affirmed the Utility Commission's order in Docket No. 8425 on all matters other than the Utility Commission's treatment of tax savings associated with deductions taken for expenses disallowed in cost of service. The court held that the Utility Commission had failed to require that such tax savings be passed on to ratepayers, and ordered that the case be remanded to the Utility Commission with instructions to adjust HL&P's cost of service accordingly. Discretionary review is being sought from the Texas Supreme Court by all parties to the proceeding.

The parties to the Proposed Settlement have agreed to dismiss their respective appeals of Docket No. 8425, subject to HL&P's dismissing its appeal in Docket No. 6668. A separate party to this appeal, however, has not agreed to dismiss its appeal.

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- (c) DEFERRED ACCOUNTING. Deferred accounting treatment for certain costs associated with Unit No. 1 of the South Texas Project was authorized by the Utility Commission in Docket No. 8230 and was extended in Docket No. 9010. Similar deferred accounting treatment with respect to Unit No. 2 of the South Texas Project was authorized in Docket No. 8425. For a discussion of the deferred accounting treatment granted, see Note 1(f).

In June 1994, the Texas Supreme Court decided the appeal of Docket Nos. 8230 and 9010, as well as all other pending deferred accounting cases involving other utilities, upholding deferred accounting treatment for both carrying costs and operation and maintenance expenses as within the Utility Commission's statutory authority and reversed the Austin Court of Appeals decision to the extent that the Austin Court of Appeals had rejected deferred accounting treatment for carrying charges. Because the lower appellate court had upheld deferred accounting only as to operation and maintenance expenses, the Texas Supreme Court remanded Docket Nos. 8230 and 9010 to the Austin Court of Appeals to consider the points of error challenging the granting of deferred accounting for carrying costs which it had not reached in its earlier consideration of the case. The Texas Supreme Court opinion did state, however, that when deferred costs are considered for addition to the utility's rate base in an ensuing rate case, the Utility Commission must then determine to what extent inclusion of the deferred costs is necessary to preserve the utility's financial integrity. Under the terms of the Proposed Settlement, South Texas Project deferrals will continue to be amortized under the schedule previously established.

The Office of the Public Utility Counsel (OPUC) has agreed, pursuant to the Proposed Settlement, to withdraw and dismiss its appeal if the Proposed Settlement becomes effective and on the condition that HL&P dismisses its appeal in Docket No. 6668. However, the appeal of the State of Texas remains pending.

- (d) PRUDENCE REVIEW OF THE CONSTRUCTION OF THE SOUTH TEXAS PROJECT. In June 1990, the Utility Commission ruled in a separate docket (Docket No. 6668) that had been created to review the prudence of HL&P's planning and construction of the South Texas Project that \$375.5 million out of HL&P's \$2.8 billion investment in the two units of the South Texas Project had been imprudently incurred. That ruling was incorporated into HL&P's 1988 and 1991 rate cases and resulted in HL&P's recording an after-tax charge of \$15 million in 1990. Several parties appealed the Utility Commission's decision, but a District Court dismissed these appeals on procedural grounds. The Austin Court of Appeals reversed and directed consideration of the appeals, and the Texas Supreme Court denied discretionary review in 1994. At this time, no action has been taken by the appellants to proceed with the appeals. Unless the order in Docket No. 6668 is modified or reversed on appeal, the amount found imprudent by the Utility Commission will be sustained.

Under the Proposed Settlement, OPUC, HL&P and the City of Houston each has agreed to dismiss its respective appeals of Docket No. 6668. A

separate party to this appeal, however, has not agreed to dismiss its appeal. If this party does not elect to dismiss its appeal, HL&P may elect to maintain its appeal, whereupon OPUC and City of Houston shall also be entitled to maintain their appeals.

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(18) RAILROAD SETTLEMENT PAYMENTS

In July 1994, HL&P contributed as equity its rights to receive certain railroad settlement payments to HL&P Receivables, Inc. (HLPR), a wholly-owned subsidiary of HL&P. HLPR transferred the receivables to a trust. A bank purchased certificates evidencing a senior interest in the trust and HLPR holds a certificate evidencing a subordinate interest in the trust. HL&P received as a dividend from HLPR approximately \$66.1 million, an amount equal to HLPR's proceeds from the sale. Consistent with the manner in which HL&P recorded receipts of the settlement payments, HL&P recorded the transaction as a \$66.1 million reduction to reconcilable fuel expense in July 1994. The reduction to reconcilable fuel expense had no effect on earnings.

- (b) UNITED STATES NUCLEAR REGULATORY COMMISSION (NRC) INSPECTIONS AND OPERATIONS. HL&P removed both generating units at the South Texas Project from service in February 1993 when a problem was encountered with certain of the units' auxiliary feedwater pumps. The units were out of service from February 1993 to February 1994, when Unit No. 1 was returned to service.

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Unit No. 2 was returned to service in May 1994. In June 1993, the NRC placed the South Texas Project on its "watch list" of plants with weaknesses that warrant increased attention after a review of the South Texas Project operations. In February 1995, the NRC removed the South Texas Project from its "watch list".

Certain current and former employees or contractors of HL&P have asserted claims that their employment was terminated or disrupted in retaliation for their having made safety-related complaints to the NRC. Civil proceedings by the complaining personnel and administrative proceedings by the Department of Labor remain pending against HL&P, and the NRC has jurisdiction to take enforcement action against HL&P and/or individual employees with respect to these matters. On May 8, 1995, the NRC announced that it was withdrawing a previously proposed Notice of Violation and \$100,000 civil penalty, as well as possible individual enforcement action against two HL&P managers in connection with one such case, involving a contractor employee whose site access was terminated. Allegations of retaliation by that individual remain pending before an Administrative Law Judge (ALJ) of the Department of Labor. In another such case, involving two former HL&P employees who were terminated during a reduction in force, another Department of Labor ALJ in April 1995 issued his recommended decision in favor of the former employees, ordering reinstatement of one with back-pay and back-pay without exemplary damages to the individuals, but indicated his intention to hold a further hearing to consider whether additional compensatory damages should be awarded. HL&P considers the ALJ's conclusions to be erroneous and is asking the Secretary of Labor not to adopt the ALJ's recommendation. If the recommendation is adopted by the Secretary of Labor, HL&P could appeal that decision to the United States Court of Appeals. Civil actions by these employees remain pending. For additional information, see Note 2(b) of the notes to the financial statements included in the Combined Form 8-K.

While no prediction can be made at this time as to the ultimate outcome of these matters, the Company and HL&P do not believe that they will have a material adverse effect on the Company's or HL&P's financial condition or results of operations.

- (3) RATE REVIEW, FUEL RECONCILIATION AND OTHER PROCEEDINGS

In February 1994, the Public Utility Commission of Texas (Utility Commission) initiated a proceeding (Docket No. 12065) to determine whether HL&P's existing rates are just and reasonable. Subsequently, the scope of the docket was expanded to include reconciliation of HL&P's fuel costs from April 1, 1990 to July 31, 1994. The Utility Commission also initiated a

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separate proceeding (Docket No. 13126) to review issues regarding the prudence of operation of the South Texas Project from the date of commercial operation through the present. That review would encompass the outage at the South Texas Project during 1993 and 1994.

Hearings began in Docket No. 12065 in January 1995. In February 1995, all major parties to these proceedings signed an agreement resolving the issues with respect to HL&P, including the prudence issues related to operation of the South Texas Project (Proposed Settlement). Approval of the Proposed Settlement by the Utility Commission will be required. Hearings on the Proposed Settlement are currently scheduled to begin in early June 1995. A decision by the Utility Commission on the Proposed Settlement is not anticipated before late summer.

Under the Proposed Settlement, HL&P's base rates would be reduced by approximately \$62 million per year, effective retroactively to January 1, 1995, and HL&P would be precluded from seeking rate increases for three years, subject to certain conditions. Under the Proposed Settlement, HL&P would amortize its remaining investment of \$218 million in the cancelled Malakoff Electric Generating Station (Malakoff) plant over a period not to exceed seven years. HL&P also would increase its decommissioning expense for the South Texas Project by \$9 million per year.

The Proposed Settlement also provides HL&P the option to write down up to \$50 million per year of its investment in the South Texas Project during the five-year period commencing January 1, 1995. The parties to the Proposed Settlement agreed that any write down would be treated as a reasonable and necessary expense during routine reviews of HL&P's earnings and any rate review proceeding initiated against HL&P.

Until the approval of the Proposed Settlement by the Utility Commission, HL&P's existing rates will continue in effect; however, HL&P's financial statements for the first quarter of 1995 reflect the estimated effects of the Proposed Settlement. In the first quarter of 1995, HL&P's pre-tax earnings were reduced by approximately \$17 million in the aggregate as a result of reflecting the estimated effects of the Proposed Settlement on revenues and expenses for the quarter. Deferred revenues are included on the Company's Consolidated and HL&P's Balance Sheets in other deferred

credits subject to refund when the Proposed Settlement is approved.

Under the Proposed Settlement, approximately \$70 million of fuel expenditures and related interest incurred by HL&P during the fuel reconciliation period would not be recoverable from ratepayers. This \$70 million was recorded in the fourth quarter of 1994 as a one-time, pre-tax charge to reconcilable fuel revenues to reflect the anticipation of approval of the Proposed Settlement. Under the Proposed Settlement, HL&P would also establish a new fuel factor approximately 17 percent below that currently in effect and would refund to customers the balance in its fuel over-recovery account, estimated to be approximately \$180 million after giving effect to the amounts not recoverable from ratepayers. As contemplated by the Proposed Settlement and approved by an ALJ, HL&P implemented a new fuel factor 17 percent lower than its previous factor and refunded to customers approximately \$110 million of the approximately \$180 million in fuel cost overrecoveries in April 1995. The remaining \$70 million will be refunded if the Proposed Settlement is approved by the Utility Commission.

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In the event the Proposed Settlement is not approved by the Utility Commission, Docket No. 12065 would be remanded to an ALJ to resume detailed hearings in this docket and with respect to issues related to the South Texas Project. Prior to reaching agreement on the terms of the Proposed Settlement, HL&P argued that its existing rates were just and reasonable and should not be reduced. Other parties argued that rate decreases in annual amounts ranging from \$26 million to \$173 million were required and that additional decreases might be justified following an examination of the prudence of the management of the South Texas Project and the costs incurred in connection with the outages at the South Texas Project. Testimony filed by the Utility Commission staff included a recommendation to remove from rate base \$515 million of HL&P's investment in the South Texas Project to reflect the staff's view that such investment was not fully "used and useful" in providing service, a position HL&P vigorously disputes.

In the event the Proposed Settlement is not approved by the Utility Commission, the fuel reconciliation issues in Docket Nos. 12065 and 13126 would be remanded to an ALJ for additional proceedings. A major issue in Docket No. 13126 would be whether the incremental fuel costs incurred as a result of outages at the South Texas Project represent reasonable costs. The Utility Commission has retained a consultant to review the South Texas Project for the purpose of providing testimony in Docket No. 13126 regarding the prudence of HL&P's management of operation of the South Texas Project. HL&P filed testimony in Docket No. 13126, which testimony concluded that the outages at the South Texas Project did not result from imprudent management. HL&P also filed testimony analyzing the extent to which regulatory issues extended the outages. In that testimony an outside consultant retained by HL&P concluded that the duration of the outages was controlled by both the resolution of NRC regulatory issues as well as necessary equipment repairs unrelated to NRC regulatory issues and that the incremental effect of NRC regulatory issues on the duration of the outages was only 39 days per unit. Estimates as to the cost of replacement power may vary significantly based on a number of factors, including the capacity factor at which the South Texas Project might be assumed to have operated had it not been out of service due to the outages. However, HL&P believes that applying a reasonable range of assumptions would result in replacement fuel costs of less than \$10 million for the 39 day periods identified by HL&P's consultant and less than \$100 million for the entire length of the outages. Any fuel costs determined to have been unreasonably incurred would not be recoverable from customers and would be charged against the Company's earnings.

Although the Company and HL&P believe that the Proposed Settlement is in the best interest of HL&P, its ratepayers, the Company and its shareholders, no assurance can be given that (i) the Utility Commission ultimately will approve the terms of the Proposed Settlement or (ii) in the event the Proposed Settlement is not approved and proceedings against HL&P are resumed, that the outcome of such proceedings would be favorable to HL&P.

(2) JOINTLY-OWNED NUCLEAR PLANT

- (b) UNITED STATES NUCLEAR REGULATORY COMMISSION (NRC) INSPECTIONS AND OPERATIONS. HL&P removed both generating units at the South Texas Project from service in February 1993 when a problem was encountered with certain of the units' auxiliary feedwater pumps. The units were

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out of service from February 1993 to February 1994, when Unit No. 1 was returned to service. Unit No. 2 was returned to service in May 1994. In June 1993, the NRC placed the South Texas Project on its "watch list" of plants with weaknesses that warrant increased attention after a review of the South Texas Project operations. In February 1995, the NRC removed the South Texas Project from its "watch list".

For a discussion concerning litigation by certain current and former employees or contractors of HL&P asserting that their employment was terminated or disrupted in retaliation for their having made safety-related complaints to the NRC, see Note 2(b) of the notes to the financial statements included in the Combined Form 8-K and Note 2(b) to the financial statements included in the Company's and HL&P's Combined Quarterly Report on Form 10-Q for the quarter ended March 31, 1995 (Combined Form 10-Q).

While no prediction can be made at this time as to the ultimate outcome of these matters, the Company and HL&P do not believe that they will have a material adverse effect on the Company's or HL&P's financial condition or results of operations.

(3) RATE REVIEW, FUEL RECONCILIATION AND OTHER PROCEEDINGS

In February 1994, the Public Utility Commission of Texas (Utility Commission) initiated a proceeding (Docket No. 12065) to determine whether HL&P's existing rates are just and reasonable and to reconcile HL&P's fuel costs from April 1, 1990 to July 31, 1994. The Utility Commission also initiated a separate proceeding (Docket No. 13126) to review issues regarding the prudence of operation of the South Texas Project from the date of commercial operation through the present (a period including the outage at the South Texas Project during 1993 and 1994).

In February 1995, all major parties to these proceedings signed an agreement resolving the issues with respect to HL&P, including the prudence issues related to operation of the South Texas Project (Proposed Settlement). In July 1995, an Administrative Law Judge (ALJ) recommended that the Utility Commission issue a final order consistent with the Proposed Settlement. A decision is expected by the Utility Commission at a Final Order Meeting scheduled for August 30, 1995.

Under the Proposed Settlement, HL&P's base rates would be reduced by approximately \$62 million per year, effective retroactively to January 1, 1995, and HL&P would be precluded from seeking rate increases for three years, subject to certain conditions. Under the Proposed Settlement, HL&P would amortize its remaining investment (\$211 million as of June 30, 1995) in the cancelled Malakoff Electric Generating Station (Malakoff) plant over a period not to exceed

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seven years. HL&P also would increase its decommissioning expense for the South Texas Project by \$9 million per year.

The Proposed Settlement also provides HL&P the option to write down a portion of its investment in the South Texas Project during the five-year period commencing January 1, 1995. The parties to the Proposed Settlement agreed that up to \$50 million per year of any write down would be treated as a reasonable and necessary expense during routine reviews of HL&P's earnings and any rate review proceeding initiated against HL&P. In the second quarter of 1995, HL&P recorded a \$7 million write down of its investment in the South Texas Project pursuant to this provision of the Proposed Settlement, which amount is included on the Company's Consolidated and HL&P's Statements of Income in depreciation and amortization expense.

Until the approval of the Proposed Settlement by the Utility Commission, HL&P's existing rates will continue in effect; however, HL&P's financial statements for 1995 reflect the estimated effects of the Proposed Settlement. In the second quarter and first six months of 1995, HL&P's pre-tax earnings were reduced by approximately \$39 million and \$56 million, respectively, which represent the estimated effects of the Proposed Settlement on revenues and expenses. Included in these reductions are charges of \$7 million related to the South Texas Project investment as discussed above and a one-time, pre-tax charge of \$9 million incurred in connection with certain mine-related costs which were not previously recorded and are not recoverable under the terms of the Proposed Settlement. (See Note 5 to these financial statements.) Deferred revenues are included on the Company's Consolidated and HL&P's Balance Sheets in other deferred credits subject to refund in the event the Proposed Settlement is approved.

Under the terms of the Proposed Settlement, HL&P previously agreed that approximately \$70 million of fuel expenditures and related interest incurred during the fuel reconciliation period would not be recoverable from ratepayers. This \$70 million was recorded in December 1994 as a one-time, pre-tax charge to reconcilable fuel revenues and will be refunded to ratepayers in the event that the Proposed Settlement is approved by the Utility Commission.

For additional information regarding Docket Nos. 12065 and 13126, see Note 3 to the financial statements included in the Combined Form 10-Q, which note

is incorporated herein by reference.

(4) APPEALS OF PRIOR UTILITY COMMISSION RATE ORDERS

Pursuant to a series of applications filed by HL&P in recent years, the Utility Commission has granted HL&P rate increases to reflect in electric rates HL&P's substantial investment in new plant construction, including the South Texas Project. Although Utility Commission action on those applications has been completed, judicial review of a number of the Utility Commission orders is pending. In the event the courts ultimately reverse actions of the Utility Commission in any of these proceedings, such matters would be remanded to the Utility Commission for action in light of the courts' orders. Because of the number of variables which can affect the ultimate resolution of such matters on remand, the Company and HL&P generally are not in a position at this time to predict the outcome of the matters on appeal or the ultimate effect that adverse action by the courts could have on the Company and HL&P.

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(b) 1988 RATE CASE. In HL&P's 1988 rate case (Docket No. 8425), the Utility Commission granted HL&P a \$227 million increase in base revenues, allowed a 12.92 percent return on common equity, authorized a qualified phase-in for Unit No. 1 of the South Texas Project (including

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approximately 72 percent of HL&P's investment in Unit No. 1 of the South Texas Project in rate base) and authorized HL&P to use deferred accounting for Unit No. 2 of the South Texas Project. Rates substantially corresponding to the increase granted were implemented by HL&P in June 1989 and remained in effect until May 1991.

In August 1994, the Austin Court of Appeals affirmed the Utility Commission's order in Docket No. 8425 on all matters other than the Utility Commission's treatment of tax savings associated with deductions taken for expenses disallowed from cost of service. The court held that the Utility Commission had failed to require that such tax savings be passed on to ratepayers. Both HL&P and other parties sought review by the Texas Supreme Court, which granted discretionary review as to the issue of certain Malakoff plant expenditures treated as "Plant Held for Future Use", and brought the entire case before it for consideration, including the tax issue raised by HL&P. The case has been scheduled for oral argument in September 1995 by the Texas Supreme Court.

Although no assurance can be given in this matter, the Company believes that if the principles and rationale of the GTE-SW decision discussed in Note 4(a) above were applied, the Utility Commission's treatment of the tax issue in Docket No. 8425 should be upheld.

ITEM 3. LEGAL PROCEEDINGS.

For a description of certain legal and regulatory proceedings affecting the Company and its subsidiaries (including (i) HL&P's rate cases, (ii) certain environmental matters and (iii) litigation related to the South Texas Project), see "Business - Regulatory Matters - Environmental Quality" in Item 1 of this Report, "LIQUIDITY AND CAPITAL RESOURCES - HL&P - Environmental Expenditures" in Item 7 of this Report and Notes 1(f) and 2 through 5 to the Financial Statements in Item 8 of this Report, which sections and notes are incorporated herein by reference.

HL&P is a defendant in litigation arising out of the environmental remediation of a site in Corpus Christi, Texas. The site in question was operated as a metals reclaiming operation for a number of years, and, though HL&P neither operated nor had any ownership interest in the site, some transformers and other equipment that HL&P sold as surplus allegedly were delivered to that site, where the site operators subsequently disposed of the materials in ways that caused environmental damage. In one case, DUMES, ET AL. V. HL&P, ET AL., pending in the U.S. District Court for the Southern District of Texas, Corpus Christi Division, a group of approximately 70 landowners near the site are seeking damages primarily for lead contamination to their property. They have pled damages of approximately \$1 million each and also seek punitive damages totaling \$51 million. The Plaintiffs seek to impose responsibility on HL&P and the other utility that undertook to clean up the property, neither of which contributed more than an insignificant amount of lead to the site, on the theory that lead was deposited on their properties during the site remediation itself. In addition, Gulf States Utilities Company (Gulf States) filed suit (GULF STATES UTILITIES CO. V. HOUSTON LIGHTING & POWER CO., ET AL.) in the United States District Court for the Southern District of Texas, Houston Division, against HL&P and two other utilities concerning a site in Houston, Texas, which allegedly has been contaminated by polychlorinated biphenyls and which Gulf States has undertaken to remediate pursuant to an EPA order. HL&P does not believe, based on its records, that it contributed material to that site and in October 1994, Gulf States dismissed its claims against HL&P. HL&P remains in the case on cross-claims asserted by two co-defendants. The ultimate outcome of these pending cases cannot be predicted at this time. Based on information currently available, the Company and HL&P believe that none of these cases will result in a material adverse effect on the Company's or HL&P's financial condition or results of operations.

HL&P and the other owners of the South Texas Project filed suit in 1990 against Westinghouse Electric Corporation (Westinghouse) in the 23rd District Court for Matagorda County, Texas (Cause No. 90-S-0684-C), alleging breach of warranty and misrepresentation in connection with the steam generators supplied by Westinghouse for the South Texas Project. In recent years, other utilities have encountered stress corrosion cracking in steam generator tubes in Westinghouse units similar to those supplied for the South Texas Project. Failure of such tubes can result in a reduction of plant efficiency, and, in some cases, utilities have replaced their steam generators. During an inspection concluded in the fall of 1993, evidence was found of stress corrosion cracking consistent with that encountered with Westinghouse steam generators at other facilities, and a small number of tubes were found to require plugging. To date, stress corrosion cracking has not had a significant impact on operation of either unit; however, the owners of the South Texas Project have approved remedial operating

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plans and have undertaken expenditures to minimize and delay further corrosion. The litigation, which is in discovery, seeks appropriate damages and other relief from Westinghouse and is currently scheduled for trial in July 1995. No prediction can be made as to the ultimate outcome of this litigation.

In April 1994, two former employees of HL&P filed a class action and shareholder derivative suit on behalf of all shareholders of the Company. This lawsuit (PACE AND FUENTEZ V. HOUSTON INDUSTRIES INCORPORATED) alleges various acts of mismanagement against certain officers and directors of the Company and HL&P and, seeks unspecified actual and punitive damages for the benefit of shareholders of the Company. The Company and HL&P believe that the suit is without merit. The lawsuit is pending in the 122nd Judicial District of Galveston County, Texas.

In June 1994, a former employee of HL&P filed a lawsuit (PACE, INDIVIDUALLY AND AS A REPRESENTATIVE OF ALL OTHERS SIMILARLY SITUATED V. HOUSTON LIGHTING & POWER COMPANY) in the 56th Judicial District Court of Galveston County, Texas alleging that HL&P has been overcharging ratepayers and owes a refund of more than \$500 million. The claim was based on the argument that the Utility Commission failed to allocate to ratepayers alleged tax benefits accruing to the Company and HL&P because HL&P's federal income taxes are paid as part of a consolidated group. The court has granted HL&P's motion for summary judgment, which has now become final.

In July 1990, the Company paid approximately \$104.5 million to the Internal Revenue Service (IRS) in connection with an IRS audit of the Company's 1983 and 1984 federal income tax returns. In November 1991, the Company filed a refund suit in the U.S. Court of Federal Claims seeking the return of \$52.1 million of tax, \$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's 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 October 1994, the Court granted the Company's Motion for Partial Summary Judgment on the fuel cost over-recovery issue. On February 21, 1995, the Court entered partial judgment in favor of the Company for this issue. The U.S. Government (Government) must file its notice of appeal on or before April 24, 1995. If the Government does not appeal or if the Government appeals but does not prevail, the Company would be entitled to a refund of overpaid tax, interest

paid on the overpaid tax in July 1990 and interest on both of those amounts from July 1990. Although, the Company would not be entitled to a refund until all appeals are decided in its favor, the amount owed to the Company will continue to accrue interest. If the Government appeals and prevails, the Company's ultimate financial exposure should be immaterial because of offsetting tax deductions to which the Company is entitled in the year the over-recovery was refunded to ratepayers (and which the IRS has conceded).

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting the Company and its subsidiaries, including HL&P, reference is made to the information set forth in Item 3 of the Company's and HL&P's Annual Report on Form 10-K for the year ended December 31, 1994 (1994 Combined Form 10-K) and Notes 2, 3 and 4 to the Company's Consolidated and HL&P's Financial Statements in the Combined Form 8-K, which information, as qualified and updated by the description of developments in regulatory and litigation matters contained in Notes 2, 3 and 4 of the Notes to the Company's Consolidated and HL&P's Financial Statements included in Part I of this Report, is incorporated herein by reference.

In April 1995, the government filed a notice of appeal with respect to the judgment entered in favor of the Company in its refund suit pending in the U.S. Court of Federal Claims. For additional information regarding the Company's tax case, see Item 3 to the 1994 Combined Form 10-K.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting the Company and its subsidiaries, including HL&P, reference is made to the information set forth in Item 3 of the 1994 Combined Form 10-K, Item 1 of Part II of the Combined Form 10-Q, Notes 2, 3 and 4 to the Company's Consolidated and HL&P's Financial Statements in the Combined Form 8-K and Notes 2(b) and 3 to the Company's Consolidated and HL&P's Financial Statements in the Combined Form 10-Q, which information, as qualified and updated by the description of developments in regulatory and litigation matters contained in Notes 2, 3 and 4 of the Notes to the Financial Statements included in Part I of this Report, is incorporated herein by reference.

GULF STATES UTILITIES CO. V. HOUSTON LIGHTING & POWER CO., ET AL., formerly pending in the United States District Court for the Southern District of Texas, Houston Division, was dismissed upon joint stipulation of all the parties in June 1995. Under the terms of the Agreement of Compromise and Settlement, HL&P bears its own fees, costs and expenses, but is not required to pay any other amounts.

RECOVERY OF FUEL COSTS. For information relating to the cost of fuel over the last three years, see "Operating Statistics of HL&P" below and "Results of Operations - HL&P - Fuel and Purchased Power Expense" in Item 7 of this Report. Utility Commission rules provide for the recovery of certain fuel and purchased power costs through an energy component of electric rates (fixed fuel factor). The fixed fuel factor is established during either a utility's general rate proceeding or an interim fuel proceeding and is to be generally effective for a minimum of six months, unless a substantial change in a utility's cost of fuel occurs. In that event, a utility may be authorized to revise the fixed fuel factor in its rates appropriately. In any event, a fuel reconciliation is required every three years.

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In October 1991, the Utility Commission approved HL&P's fixed fuel factor as contemplated in the settlement agreement reached in February 1991 by HL&P and most other parties to Docket No. 9850. See Note 10(c) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report. In November 1993, the Utility Commission authorized HL&P to implement a higher fuel factor under Docket No. 12370. The Company can request a revision to its fuel factor in April and October each year.

Reconciliation of fuel costs after March 1990 is required in 1994, and under Utility Commission rules, HL&P has anticipated that a filing would be required in May 1994. However, the Utility Commission staff has requested that such filing be delayed to the fourth quarter of 1994. If that request is granted by the Utility Commission, HL&P anticipates that fuel costs through some time in 1994 will be submitted for reconciliation at that time. No hearing would be anticipated in that reconciliation proceeding before 1995, and the schedule for reconciliation of those costs could be affected by the institution of a rate proceeding by the Utility Commission and/or a prudence inquiry concerning the outage at the South Texas Project. For a discussion of that outage and the possibility that a rate proceeding may be instituted, see Notes 9(f), 10(f) and 10(g), respectively, to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference.

REGULATORY MATTERS

ENERGY ACT. In October 1992, the Energy Act became law. For a description of the Energy Act, see "Competition" above and Note 8(a) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report.

RATES AND SERVICES. Pursuant to the PURA, the Utility Commission has original jurisdiction over electric rates and services in unincorporated areas of the State of Texas and in the incorporated municipalities that have relinquished original jurisdiction. Original jurisdiction over electric rates and services in the remaining incorporated municipalities served by HL&P is exercised by such municipalities, including Houston, but the Utility Commission has appellate jurisdiction over electric rates and services within those incorporated municipalities.

In 1993, the Texas Legislature considered changes to PURA as part of a required review under the Sunset Act. None of the proposed changes to the Utility Commission or Texas utility regulation were enacted. However, the legislature passed legislation continuing the current PURA until September 1, 1995. The legislature also established a joint interim committee to study certain regulatory issues prior to the next legislative session which begins in January 1995. These issues include, among other items, tax issues relating to public utilities, the organization and authority of the Utility Commission and IRP. Recommendations from this study period will be considered during the next legislative session.

UTILITY COMMISSION PROCEEDINGS. For information concerning the Utility Commission's orders with respect to HL&P's applications for general rate increases with the Utility Commission (Docket No. 8425 for the 1988 rate case and Docket No. 9850 for the 1990 rate case) and the municipalities within HL&P's service area and the appeals of such orders, see Notes 10(b) and 10(c) to the Company's Consolidated and HL&P's

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Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference. HL&P's 1986 general rate case (Docket Nos. 6765 and 6766) and 1984 rate case (Docket No. 5779) have been affirmed and are no longer subject to appellate review. For a discussion of the possibility that a rate proceeding may be instituted, see Notes 10(f) and 10(g) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference.

PRUDENCE REVIEW OF CONSTRUCTION OF THE SOUTH TEXAS PROJECT. For information concerning the Utility Commission's orders with respect to a prudence review of the planning, management and construction of the South Texas Project (Docket No. 6668) and the appeals of such orders, see Note 10(d) to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which note is incorporated herein by reference.

DEFERRED ACCOUNTING DOCKETS. For information concerning the Utility Commission's orders allowing deferred accounting treatment for certain costs associated with the South Texas Project (Docket Nos. 8230, 9010 and 8425), the appeals of such orders and related proceedings, see Notes 10(b), 10(e) and 11 to the Company's Consolidated and HL&P's Financial Statements in Item 8 of this Report, which notes are incorporated herein by reference.

ENVIRONMENTAL QUALITY. General. HL&P is subject to regulation with

respect to air and water quality, solid waste management and other environmental matters by various federal, state and local authorities. Environmental regulations continue to be affected by legislation, administrative actions and judicial review and interpretation. As a result, the precise effect of potential regulations upon existing and proposed facilities and operations cannot presently be determined. However, developments in these and other areas of regulation have required HL&P to make substantial expenditures to modify, supplement or replace equipment and facilities and may, in the future, delay or impede construction and operation of new facilities or require expenditures to modify existing facilities. For information regarding environmental expenditures, see "Capital Program" above.

Air. The TNRCC has jurisdiction and enforcement power to determine the permissible level of air contaminants emitted in the State of Texas. The standards established by the Texas Clean Air Act and the rules of the TNRCC are subject to modification by standards promulgated by the EPA. Compliance with such standards has resulted, and is expected to continue to result, in substantial expenditures by HL&P. In addition, expanded permit and fee systems and enforcement penalties may discourage industrial growth within HL&P's service area.

In November 1990, significant amendments to the Clean Air Act became law. The law is designed to control emissions of air pollutants which contribute to acid rain, to reduce urban air pollution and to reduce emissions of toxic air pollutants. Parts of the Clean Air Act are directed at reducing emissions of sulfur dioxide from electric utility generating units. This reduction program includes an "allowance" system which sets forth formulas and criteria to establish a cap on sulfur dioxide emissions from utility generating units. HL&P has been allocated allowances sufficient to permit continued operation of its existing facilities and some expansion of its solid-fuel generating facilities without substantial additional expense relating to modification of its facilities.

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HL&P has already made substantial investments in pollution control facilities, and all of its generating facilities currently comply in all material respects with sulfur dioxide emission standards established by the Clean Air Act. As a result of this previous investment, HL&P does not anticipate that significant expenditures for sulfur dioxide removal equipment will be required. Provisions of the Clean Air Act dealing with urban air pollution require establishing new emission limitations for nitrogen oxides from existing sources. Although initial limitations were finalized in 1993, further reductions may be required in the future. The cost of modifications necessary to reduce nitrogen oxide emissions from existing sources has been estimated at \$29 million in 1994 and \$10.5 million in 1995. The Clean Air Act also calls for additional stack gas continuous emissions monitoring equipment to be installed on various HL&P generating facilities. Capital expenditures of \$12 million in 1994 and \$2 million in 1995 are anticipated for installation of this new monitoring equipment. See "Capital Program" above.

The Clean Air Act established a new permitting program to be administered in Texas by the TNRCC. The precise requirements of the program cannot be determined until the permit program is approved by the EPA. However, based on regulations promulgated by the TNRCC, HL&P anticipates that additional expenditures may be required for administering the permitting process. The legislation could also substantially increase the cost of constructing new generating units.

Water. The TNRCC has jurisdiction over water discharges in the State of Texas and is empowered to set water quality standards and issue permits regulating water quality. The TNRCC jurisdiction is currently shared with the EPA, which also issues water discharge permits and reviews the Texas water quality standards program.

HL&P has obtained permits from both the TNRCC and the EPA for all facilities currently in operation which require such permits. Applications for renewal of permits for existing facilities have been submitted as required. The reissued permits reflect changes in federal and state regulations which may increase the cost of maintaining compliance. Although compliance with the new regulations has resulted and will continue to result in additional costs to HL&P, the costs are not expected to have a material impact on HL&P's financial condition or results of operations.

For a description of certain Administrative Orders issued by the EPA to HL&P under the Clean Water Act and for a description of certain other environmental litigation, see Item 3 of this Report.