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

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1998

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 1-3187

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

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

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

Commission file number 1-13265

NORAM ENERGY CORP.
(Exact name of registrant as specified in its charter)

Delaware	76-0511406
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1111 Louisiana Houston, Texas	77002
(Address of principal executive offices)	(Zip Code)

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

NORAM ENERGY CORP. MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTION H(1)(a) AND (b) OF FORM 10-Q AND IS THEREFORE FILING THIS FORM 10-Q WITH THE REDUCED DISCLOSURE FORMAT.

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 [X] No [ ]

As of May 6, 1998, Houston Industries Incorporated had 296,039,637 shares of common stock outstanding, including 11,984,708 ESOP shares not deemed outstanding for financial statement purposes and excluding 98,866 shares held as treasury stock. As of May 6, 1998, all 1,000 shares of NorAm Energy Corp.'s common stock were held by Houston Industries Incorporated.

THIS COMBINED QUARTERLY REPORT ON FORM 10-Q IS SEPARATELY FILED BY HOUSTON INDUSTRIES INCORPORATED (COMPANY) AND NORAM ENERGY CORP. (NORAM). INFORMATION CONTAINED HEREIN RELATING TO NORAM IS FILED BY THE COMPANY AND SEPARATELY BY NORAM ON ITS OWN BEHALF. NORAM MAKES NO REPRESENTATION AS TO INFORMATION RELATING TO THE COMPANY (EXCEPT AS IT MAY RELATE TO NORAM AND ITS SUBSIDIARIES), HOUSTON INDUSTRIES ENERGY, INC., HOUSTON INDUSTRIES POWER GENERATION, INC. OR ANY OTHER AFFILIATE OR SUBSIDIARY OF THE COMPANY.

HOUSTON INDUSTRIES INCORPORATED
AND NORAM ENERGY CORP.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 1998

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

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

	Three Months Ended March 31, 1998	Three Months Ended March 31, 1997
REVENUES:		
Electric Operations	$ 846,562	$ 856,534
Natural Gas Distribution	716,896	
Interstate Pipeline	70,981	
Energy Marketing	1,045,619	
International	27,246	19,830
Other	24,106	1,737
Eliminations	(94,698)	
Total	2,636,712	878,101
EXPENSES:		
Fuel and cost of gas sold	1,286,092	223,965
Purchased power	412,652	100,992
Operation and maintenance	375,897	196,010
Taxes other than income taxes	88,777	62,454
Depreciation and amortization	175,599	130,990
Other operating expenses	16,726	7,474
Total	2,355,743	721,885
OPERATING INCOME	280,969	156,216
OTHER INCOME (EXPENSE):		
Unrealized loss on ACES	(189,320)	
Time Warner dividend income	10,313	10,403
Interest income - IRS refund	981	
Other - net	6,233	(1,762)
Total	(171,793)	8,641
INTEREST AND OTHER CHARGES:		
Interest on long-term debt	106,029	62,801
Other interest	24,359	16,410
Distributions on trust securities	7,410	4,519
Allowance for borrowed funds used during construction	(957)	(1,100)
Preferred dividends of subsidiary		2,125
Total	136,841	84,755
INCOME (LOSS) BEFORE INCOME TAXES AND PREFERRED DIVIDENDS	(27,665)	80,102
INCOME TAXES	3,575	20,482
PREFERRED DIVIDENDS	97	
NET INCOME (LOSS)	$ (31,337)	$ 59,620
BASIC EARNINGS (LOSS) PER COMMON SHARE	$ (.11)	$ .26
DILUTED EARNINGS (LOSS) PER COMMON SHARE	$ (.11)	$ .26

See Notes to Consolidated Financial Statements.

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

ASSETS

	March 31, 1998	December 31, 1997
PROPERTY, PLANT AND EQUIPMENT - AT COST:		
Electric plant:		
Plant in service	$12,725,730	$12,614,000
Construction work in progress	172,893	224,959
Nuclear fuel	256,423	255,567
Plant held for future use	48,631	48,631
Gas plant and pipelines:		
Natural gas distribution	1,351,870	1,326,442
Interstate pipelines	1,259,530	1,258,087
Energy marketing	167,573	162,519
Other property	164,580	149,019
Total	16,147,230	16,039,224
Less accumulated depreciation and amortization	4,907,060	4,770,179
Property, plant and equipment - net	11,240,170	11,269,045
CURRENT ASSETS:		
Cash and cash equivalents	139,066	51,712
Accounts receivable - net	698,323	962,974
Accrued unbilled revenues	136,381	205,860
Time Warner dividends receivable	10,313	10,313
Fuel stock and petroleum products	63,398	88,819
Materials and supplies, at average cost	151,407	156,160
Restricted deposit for bond redemption	290,000	
Prepayments and other current assets	25,485	42,169
Total current assets	1,514,373	1,518,007
OTHER ASSETS:		
Goodwill--net	2,013,907	2,026,395
Investment in Time Warner securities	990,000	990,000
Equity investments in and advances to foreign and non-rate regulated affiliates - net	712,888	704,102
Deferred plant costs - net	555,124	561,569
Deferred debits	503,904	510,686
Regulatory tax asset - net	355,065	356,509
Unamortized debt expense and premium on reacquired debt	213,617	202,453
Fuel-related debits	184,604	197,304
Recoverable project costs - net	68,230	78,485
Total other assets	5,597,339	5,627,503
Total	$18,351,882	$18,414,555

See Notes to Consolidated Financial Statements.

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

CAPITALIZATION AND LIABILITIES

	March 31, 1998	December 31, 1997
CAPITALIZATION:		
Common stock equity:		
Common stock, no par value	$ 3,122,071	$ 3,112,098
Treasury stock, at cost	(2,207)	(2,066)
Unearned ESOP shares	(226,175)	(229,827)
Retained earnings	1,875,213	2,013,055
Foreign currency loss	(702)	(821)
Unrealized loss on marketable equity securities	(4,255)	(5,634)
Total common stock equity	4,763,945	4,886,805
Preference stock, none outstanding		
Cumulative preferred stock, no par value, not subject to mandatory redemption	9,740	9,740
Company/NorAm obligated mandatorily redeemable trust preferred securities of subsidiary trusts holding solely subordinated debentures of Company/NorAm	355,952	362,172
Long-term debt:		
Automatic common exchange securities (ACES)	1,363,106	1,173,786
Debentures	969,002	669,291
First mortgage bonds	1,931,610	2,495,459
Notes payable	742,534	745,889
Pollution control revenue bonds	512,685	118,000
Other	15,364	15,590
Total long-term debt	5,534,301	5,218,015
Total capitalization	10,663,938	10,476,732
CURRENT LIABILITIES:		
Notes payable	1,738,004	2,124,956
Accounts payable	725,480	879,612
Taxes accrued	172,165	240,739
Interest accrued	102,781	109,901
Dividends declared	113,552	110,716
Customer deposits	82,064	82,437
Current portion of long-term debt	708,421	251,169
Other	158,328	193,384
Total current liabilities	3,800,795	3,992,914
DEFERRED CREDITS:		
Accumulated deferred income taxes	2,737,976	2,792,781
Benefit liabilities	405,600	397,586
Unamortized investment tax credit	344,041	349,072
Fuel-related credits	69,775	75,956
Other	329,757	329,514
Total deferred credits	3,887,149	3,944,909
COMMITMENTS AND CONTINGENCIES		
Total	$ 18,351,882	$ 18,414,555

See Notes to Consolidated Financial Statements.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED CASH FLOWS

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

	Three Months Ended March 31, 1998	Three Months Ended March 31, 1997
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (31,337)	$ 59,620
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	175,599	130,990
Amortization of nuclear fuel	6,714	6,657
Deferred income taxes	(54,805)	6,191
Investment tax credit	(5,031)	(4,879)
Unrealized loss on ACES	189,320	
Fuel surcharge	21,966	31,239
Fuel cost (under) recovery	(28,381)	(39,828)
Changes in other assets and liabilities:		
Accounts receivable - net	193,598	8,365
Accounts receivable - IRS	140,532	
Inventory	31,389	9,138
Other current assets	35,222	9,831
Accounts payable	(154,132)	(55,588)
Interest and taxes accrued	(75,694)	(103,121)
Other current liabilities	(51,188)	(21,743)
Other - net	30,297	1,822
Net cash provided by operating activities	424,069	38,694
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures (including allowance for borrowed funds used during construction)	(108,497)	(44,384)
Non-rate regulated electric power project expenditures (including capitalized interest)	(4,926)	(18,913)
Other - net	(9,225)	(1,880)
Net cash used in investing activities	(122,648)	(65,177)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sale of Company obligated mandatorily redeemable trust preferred securities of subsidiary trusts holding solely subordinated debentures of Company - net		340,810
Payment of matured bonds	(1,000)	(190,000)
Proceeds from issuance of debentures	300,000	
Restricted deposit for bond redemption	(290,000)	
Proceeds from issuance of pollution control revenue bonds	386,757	115,795
Redemption of preferred stock		(127,928)
Payment of common stock dividends	(106,448)	(87,567)
Increase (decrease) in notes payable - net	(390,307)	101,750
Extinguishment of long-term debt	(107,263)	(120,360)
Conversion of convertible securities	(3,255)	
Other - net	(2,551)	1,333
Net cash provided by (used in) financing activities	(214,067)	33,833
NET INCREASE IN CASH AND CASH EQUIVALENTS	87,354	7,350
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	51,712	8,001
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 139,066	$ 15,351
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash Payments:		
Interest (net of amounts capitalized)	$ 145,348	$ 80,721
Income taxes	15,158	27,914

See Notes to Consolidated Financial Statements

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

	Three Months Ended March 31, 1998	Three Months Ended March 31, 1997
Balance at Beginning of Period	$ 2,013,055	$ 1,997,490
Net Income (Loss) for the Period	(31,337)	59,620
Total	1,981,718	2,057,110
Common Stock Dividends	(106,505)	(87,656)
Balance at End of Period	$ 1,875,213	$ 1,969,454

See Notes to Consolidated Financial Statements.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) BASIS OF PRESENTATION

The interim financial statements and notes (Interim Financial Statements) in this joint Form 10-Q (Form 10-Q) include the accounts of Houston Industries Incorporated (Company) and its wholly owned and majority owned subsidiaries including, effective as of August 6, 1997 (Acquisition Date), the accounts of NorAm Energy Corp. (NorAm) and its wholly owned and majority owned subsidiaries. For information regarding the Company's acquisition of NorAm, see Note 1(b) to the joint Annual Report on Form 10-K of the Company (File No. 1-3187) (Company's Form 10-K) and NorAm (File No. 1-13265) (NorAm's Form 10-K) for the fiscal year ended December 31, 1997. The Interim Financial Statements are unaudited, omit certain information included in financial statements prepared in accordance with generally accepted accounting principles and should be read in combination with the Company's Form 10-K and NorAm's Form 10-K . For additional information regarding the presentation of interim period results, see Note 11 below.

The following notes to the financial statements in the Company's Form 10-K and NorAm's Form 10-K relate to material contingencies. These notes, as updated by the notes contained in the Interim Financial Statements, are incorporated herein by reference:

Company: Note 1(c) (Regulatory Assets and Other Long-Lived Assets), Note 1(n) (Investments in Time Warner Securities), Note 2 (Derivative Financial Instruments (Risk Management)), Note 3 (Rate Matters), Note 4 (Jointly Owned Electric Utility Plant), Note 5 (Equity Investments in Foreign Affiliates) and Note 12 (Commitments and Contingencies).

NorAm: Note 1(c) (Regulatory Assets and Regulation), Note 2 (Derivative Financial Instruments (Risk Management)) and Note 8 (Commitments and Contingencies).

(2) PRO FORMA COMBINED RESULTS OF OPERATIONS DATA

The Company's results of operations incorporate NorAm's results of operations only for the period beginning on the Acquisition Date. The following table presents certain unaudited pro forma information for the quarter ended March 31, 1997, as if the acquisition of NorAm had occurred on January 1, 1997.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

COMBINED RESULTS OF OPERATIONS
(IN MILLIONS, EXCEPT PER SHARE DATA)

	QUARTER ENDED MARCH 31,	
	1998	1997
	ACTUAL	PRO FORMA
	(UNAUDITED)	
Revenues	$ 2,637	$ 2,802
Net Income (Loss)(1)	$ (31)	$ 110
Basic Earnings Per Share (1)	$ (0.11)	$ 0.39
Diluted Earnings Per Share (1)	$ (0.11)	$ 0.39

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(1) Includes a $123 million or .43 per share (after-tax) non-cash unrealized accounting loss recorded in the first quarter of 1998 relating to the Company's Automatic Common Exchange Securities (ACES). For additional information, see Note 5.

These and other pro forma results appearing in this Form 10-Q are based on assumptions deemed appropriate by the Company's management, have been prepared for informational purposes only and are not necessarily indicative of the combined results that would have resulted had the acquisition of NorAm occurred at the beginning of 1997. Purchase related adjustments to results of operations include amortization of goodwill and the effects on depreciation, amortization, interest expense and deferred income taxes of the revaluation, on a preliminary basis, of the fair value of certain NorAm assets and liabilities. For information regarding the recording of the NorAm acquisition under the purchase method of accounting, see Note 1(b) to the Company's Form 10-K.

(3) COMPREHENSIVE INCOME

Effective January 1, 1998, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income" (SFAS No. 130). SFAS No. 130 requires that all items that meet the definition of a component of comprehensive income (as defined below) be reported in a financial statement for the fiscal period in which they are recognized and the total amount of comprehensive income be prominently displayed in that same financial statement. Comprehensive income is defined to include not only net income (loss), but also the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. The Company's total comprehensive loss of $30 million for the first quarter of 1998 reflects the Company's $31 million net loss for the quarter offset by a foreign currency gain and an unrealized gain on the Company's investment in shares of Itron, Inc., a marketable equity security. For the first quarter of 1997, total comprehensive income was $63 million reflecting the Company's $60 million net income in the quarter and the unrealized gain on the Company's investment in Time Warner common stock offset by a foreign currency loss.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(4) DEPRECIATION

The Company calculates depreciation using the straight-line method. The Company's depreciation expense for the first quarter of 1998 was $127 million, compared to $90 million for the same period in 1997.

(5) INVESTMENT IN TIME WARNER SECURITIES

The Company owns 11 million shares of non-publicly traded Time Warner, Inc. (Time Warner) convertible preferred stock (TW Preferred). The TW Preferred is convertible into approximately 22.9 million shares of Time Warner common stock. For additional information regarding TW Preferred (including its dividend rate, liquidation preference and voting rights), see Note 1(n) to the Company's Form 10-K.

The Company has recorded its $990 million investment in the TW Preferred under the cost method. Dividends on these securities are recognized as income at the time they are earned. The Company recorded pre-tax dividend income with respect to these securities of $10.3 million in the first quarters of 1998 and 1997.

To monetize its investment in the TW Preferred, the Company sold in July 1997, 22.9 million of its unsecured 7% ACES. As a result of the issuance of the ACES, a portion of the increase in the market value above $55.5844 per share of Time Warner common stock (the security into which the TW Preferred is convertible) results in unrealized accounting losses to the Company for the ACES, pending the conversion of the Company's TW Preferred into Time Warner common stock. For example, prior to the conversion of the TW Preferred into Time Warner common stock, when the market price of Time Warner common stock increases above $55.5844, the Company records in Other Income (Expense) an accounting loss for the ACES equal to (i) the aggregate amount of such increase as applicable to all ACES multiplied by (ii) 0.8264. In accordance with generally accepted accounting principles, this accounting loss (which reflects the unrealized increase in the Company's indebtedness with respect to the ACES) may not be offset by accounting recognition of the increase in the market value of the Time Warner common stock that underlies the TW Preferred. Upon conversion of the TW Preferred, the Company will begin recording unrealized net changes in the market prices of the Time Warner common stock and the ACES as a component of common stock equity and other comprehensive income.

As of March 31, 1998, the market price of Time Warner common stock was $72.00 per share. Accordingly, the Company recognized an increase of $189 million during the first quarter of 1998 in the unrealized liability relating to its ACES indebtedness (which resulted in an after-tax earnings reduction of $123 million or $.43 per share). The Company believes that the cumulative unrealized loss for the ACES of $311 million is more than economically offset by the approximately $659 million unrecorded unrealized gain at March 31, 1998 relating to the increase in the fair value of the Time Warner common stock underlying the investment in TW Preferred since the date of its acquisition. For the quarter ended March 31, 1998, there was an increase in the unrecorded unrealized gain in the fair value of Time Warner common stock underlying the investment in TW Preferred of $229 million. Any gain related to the increase in the fair value of Time Warner common stock would be recognized upon the sale of the TW Preferred or the shares of common

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

stock into which such TW Preferred is converted.

(6) CAPITAL STOCK

(a) Common Stock.

At March 31, 1998, the Company had 283,719,977 shares of common stock issued and outstanding (out of a total of 700,000,000 authorized shares). At December 31, 1997, the Company had 282,875,266 shares of common stock issued and outstanding. Outstanding common shares excluded (i) shares pledged to secure a loan to the Company's Employee Stock Ownership Plan (11,984,708 and 12,388,551 at March 31, 1998 and December 31, 1997, respectively) and (ii) treasury shares (98,866 and 93,459 at March 31, 1998 and December 31, 1997, respectively).

(b) Earnings Per Share.

Effective December 31, 1997, the Company adopted SFAS No. 128, "Earnings per Share" (SFAS No. 128). This statement requires restatement of all prior period earnings per share (EPS) data presented herein. SFAS No. 128 requires dual presentation of basic and diluted EPS on the face of the Statements of Consolidated Income and requires a reconciliation of the numerators and denominators used in the basic and diluted earnings per share calculations.

The following table presents a reconciliation of the Company's numerators and denominators of basic and diluted earnings per share calculations:

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

	FOR THE QUARTER ENDED MARCH 31, 1998	1997
	(In thousands, except per share amounts)	
Basic EPS Calculation:		
Income (loss) before preferred dividends	$ (31,240)	$ 59,620
Less: Preferred dividends	97	
Net income (loss) attributable to common stock	$ (31,337)	$ 59,620
Weighted average shares outstanding	283,528	233,689
Basic EPS:		
Income (loss) before preferred dividends	$ (0.11)	$ 0.26
Less: Preferred dividends		
Net income (loss) attributable to common stock	$ (0.11)	$ 0.26
Diluted EPS Calculation:		
Income (loss) before preferred dividends	$ (31,240)	$ 59,620
Plus: Income impact of assumed conversions:		
Interest on 6 1/4% convertible debentures	118	
Income (loss) before preferred dividends assuming dilution	$ (31,122)	$ 59,620
Less: Preferred dividends	97	
Net income (loss) attributable to common stock	$ (31,219)	$ 59,620
Weighted average shares outstanding	283,528	233,689
Plus: Incremental shares from assumed conversions:		
Stock options	235	32
Restricted stock	492	369
6 1/4% convertible debentures	359	
Weighted average shares assuming dilution	284,614	234,090
Diluted EPS:		
Income (loss) before preferred dividends	$ (0.11)	$ 0.26
Less: Preferred dividends		
Net income (loss) attributable to common stock	$ (0.11)	$ 0.26

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Options to purchase 85,837 shares of common stock at prices ranging from $29.13 to $35.18 per share were outstanding at March 31, 1998 but were not included in the computation of diluted EPS because, during the reporting period, the options' exercise prices were greater than the average market price of the common shares of $26.375 and would thus be anti-dilutive if conversion were assumed.

(c) Preferred Stock.

At March 31, 1998 and December 31, 1997, the Company had 10,000,000 authorized shares of preferred stock, of which 97,397 shares of $4.00 Preferred Stock were outstanding. The $4.00 Preferred Stock pays an annual dividend of $4.00 per share, is redeemable at $105 per share and has a liquidation price of $100 per share.

(d) Preference Stock.

At March 31, 1998 and December 31, 1997, the Company had 10,000,000 authorized shares of preference stock, of which 700,000 shares are designated as Series A Preference Stock and 27,000 shares are designated as Series B Preference Stock. On March 27, 1998, the Company designated 1,575 shares of its preference stock as Series C Preference Stock. As of March 31, 1998, there were no shares of Series A Preference Stock issued and outstanding (such shares being issuable in accordance with the Company's Shareholder Rights Agreement upon the occurrence of certain events). The number of shares of Series B Preference Stock and Series C Preference Stock issued as of March 31, 1998 was 17,000 and 1,575, respectively. The Series B and Series C Preference Stock are not deemed outstanding for financial reporting purposes, because the sole holders of such series are wholly owned financing subsidiaries of the Company.

(7) COMPANY/NORAM OBLIGATED MANDATORILY REDEEMABLE TRUST PREFERRED SECURITIES OF SUBSIDIARY TRUSTS HOLDING SOLELY SUBORDINATED DEBENTURES OF THE COMPANY AND NORAM

For information regarding (i) $250 million of preferred securities and $100 million of capital securities issued by two statutory business trusts formed by the Company and (ii) $177.8 million of convertible preferred securities issued by a statutory business trust formed by NorAm, of which $11.6 million were outstanding at March 31, 1998, see Note 9 to the Company's Form 10-K. The sole asset of each trust consists of junior subordinated debentures of the Company or NorAm (as the case may be) having interest rates and maturity dates corresponding to each issue of preferred or capital securities, and the principal amounts corresponding to the common and preferred or capital securities issued by such trust.

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

(a) Consolidated Debt.

The Company's consolidated long-term and short-term debt outstanding is summarized in the following table. Of the amount of long-term and short-term debt outstanding as of March 31, 1998, $1.8

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

billion represents debt of NorAm. The Company adjusted the recorded value of NorAm debt to fair market value as of the Acquisition Date.

CONSOLIDATED LONG-TERM DEBT AND SHORT-TERM BORROWINGS
(IN MILLIONS)

	MARCH 31, 1998		DECEMBER 31, 1997	
	Long-Term	Current	Long-Term	Current
Short-Term Borrowings:				
Commercial Paper.........................		$ 1,286		$ 1,435
Lines of Credit..........................		150		390
NorAm Receivables Facility...............		300		300
Notes Payable............................		2		
Total Short-Term Borrowings................		1,738		2,125
Long-Term Debt - net:				
ACES.....................................	$ 1,363		$ 1,174	
Debentures(1)(2).........................	969		669	
First Mortgage Bonds(1)..................	1,931	460	2,495	
Pollution Control Bonds..................	513	5	118	5
NorAm Medium-Term Notes(2)...............	182	78	182	79
Notes Payable(2).........................	561	164	565	166
Capital Leases...........................	15	1	15	1
Total Long-Term Debt.......................	5,534	708	5,218	251
Total Long-Term and Short-Term Debt......	$ 5,534	$ 2,446	$ 5,218	$ 2,376

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(1) Includes unamortized discount related to debentures of approximately $1 million at March 31, 1998 and December 31, 1997 and unamortized discount related to first mortgage bonds of approximately $14 million at March 31, 1998 and December 31, 1997, respectively.

(2) Includes unamortized premium related to fair value adjustments of approximately $15.5 million and $15.8 million for debentures at March 31, 1998 and December 31, 1997, respectively. The unamortized premium for NorAm long-term and current medium-term notes at March 31, 1998 was approximately $15.6 million and $2.6 million, respectively, and $16.7 million and $2.8 million at December 31, 1997, respectively. The unamortized premium for long-term and current notes payable was approximately $10.6 million and $2.4 million, respectively, at March 31, 1998 and $13.7 million and $3.3 million at December 31, 1997.

Consolidated maturities of long-term debt and sinking fund requirements for the Company (including NorAm) are approximately $242 million for the remainder of 1998, not including funds that were on deposit in trust accounts at March 31, 1998 of $290 million.

(b) FinanceCo and FinanceCo II Credit Facilities.

In August 1997, a limited partnership special purpose subsidiary of the Company (FinanceCo), established a five-year, $1.644 billion revolving credit facility with a consortium of commercial banks (FinanceCo Facility). The FinanceCo Facility supported $1.167 billion in commercial paper borrowings by FinanceCo at March 31, 1998 recorded as notes payable in the Consolidated Balance Sheet. The weighted average interest rate of these borrowings at March 31, 1998 was 5.85%. For more information regarding the FinanceCo Facility, see Note 8(c) to the Company's Form 10-K. In the first quarter of 1998, the FinanceCo

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Facility was amended to, among other things, release certain collateral previously pledged under the agreement (including the shares of common stock of NorAm held by the Company and the capital stock of Houston Industries Energy, Inc. (HI Energy)) and to ease restrictions on repurchases of common stock and certain types of investments in subsidiaries.

In March 1998, another limited partnership special purpose subsidiary of the Company (FinanceCo II), entered into a $150 million credit agreement with a bank (FinanceCo II Facility). The FinanceCo II Facility terminates September 30, 1998, but may be extended. Borrowings under the FinanceCo II Facility were used to fund a portion of four electric generation plants acquired by Houston Industries Power Generation, Inc. (HIPG), a wholly owned subsidiary of the Company, in April 1998. Borrowings under the FinanceCo II Facility bear interest at a rate based upon either LIBOR plus a margin or a base rate. At March 31, 1998, FinanceCo II had $150 million of borrowings under this facility at an interest rate of 5.94%. For additional information regarding HIPG's acquisition of the generation plants, see Note 10(b) below.

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

Subject to certain conditions and limitations, the Company is required, pursuant to a support agreement entered into in connection with the FinanceCo II Facility, to make cash payments from time to time to FinanceCo II from the Company's excess cash flow (as defined) to the extent necessary to enable FinanceCo II to meet its obligations. Borrowings under the FinanceCo II Facility are secured by pledges of 1,575 shares of Series C Preference Stock of the Company, which have an aggregate liquidation amount of $157.5 million, and all rights of FinanceCo II under the support agreement. The obligations under the FinanceCo II Facility are not secured by the utility assets of the Company or NorAm or by the Company's investment in TW Preferred.

(c) Pollution Control Revenue Bonds.

In January 1998, the Matagorda County Navigation District Number One (MCND) issued on behalf of the Company $104.7 million aggregate principal amount of pollution control revenue refunding bonds with $29.7 million at 5.25% and $75 million at 5.15%. The MCND bonds will mature in 2029. The Company used the proceeds from the sale of these securities to redeem during the quarter ended March 31, 1998 all outstanding 7 7/8% MCND Series 1989A pollution control revenue bonds ($29.7 million) and 7.70% MCND Series 1989B pollution control revenue bonds ($75 million) at a redemption price of 102% of the aggregate principal amount of each series.

In February 1998, the Brazos River Authority (BRA) issued on behalf of the Company $290 million aggregate principal amount of pollution control revenue refunding bonds. The BRA bonds will mature in May 2019 ($200 million at 5 1/8%) and November 2020 ($90 million at 5 1/8%). In May of 1998, the Company used the proceeds from the sale of these securities to redeem all outstanding 8.25% BRA Series 1988A pollution control revenue bonds ($100 million), 8.25% BRA Series 1988B pollution control revenue

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

bonds ($90 million), and 8.10% BRA Series 1988C pollution control revenue bonds ($100 million) at a redemption price of 102% of the aggregate principal amount of each series. Although the proceeds of the bond offerings were deposited into trust accounts for the redemption in May 1998 of $290 million principal amount of bonds (as reflected on the Consolidated Balance Sheets and Statements of Consolidated Cash Flows), such bonds were deemed for financial reporting purposes to be outstanding at March 31, 1998.

(d) NorAm Short-Term and Long-Term Debt.

In March 1998, NorAm replaced its $400 million revolving credit facility with a five-year $350 million revolving credit facility (NorAm Credit Facility). Borrowings under the NorAm Credit Facility are unsecured and bear interest at a rate based upon either LIBOR plus a margin, a base rate or a rate determined through a bidding process. The NorAm Credit Facility is expected to be used to support NorAm's issuance of up to $350 million of commercial paper. There were no loans outstanding under the NorAm Credit Facility at March 31, 1998.

In February 1998, NorAm issued $300 million principal amount of 6 1/2% debentures due February 1, 2008. The 6 1/2% debentures are not redeemable prior to maturity and are not subject to any sinking fund requirements. The proceeds from the sale of the 6 1/2% debentures were used to repay short-term indebtedness of NorAm, including the indebtedness incurred in connection with the 1997 purchase of $101 million aggregate principal amount of NorAm's 10% debentures and the repayment of $53 million aggregate principal amount of NorAm debt that matured in December 1997 and January 1998.

In the first quarter of 1998, NorAm repaid at maturity $1 million of its 9.30% medium-term notes and satisfied the $6.5 million sinking fund requirement for its 6% convertible subordinated debentures due 2012 using debentures purchased in 1996 and 1997.

(9) RATE MATTERS

In May 1998, the Public Utility Commission of Texas (Texas Utility Commission) issued an order approving the transition to competition plan filed by Electric Operations in December 1997 (Transition Plan). The order establishes the Company's tariffs to be in effect through 1999, subject to certain force majeure and other events. The order provides final approval for the base rate credits to residential customers of 4% in 1998 and an additional 2% in 1999. Commercial customers whose monthly billing kva is 1000 kva or less will receive base rate credits of 2% in 1998 which remains in effect for 1999. The Company implemented the terms of the Transition Plan effective January 1, 1998.

In addition, in order to reduce the Company's exposure to potential stranded costs, the order permits the Company to redirect depreciation expenses normally taken from transmission, distribution and general assets to generation assets. The Texas Utility Commission made one modification to the original Transition Plan related to the earnings cap. The Transition Plan originally contemplated that all earnings by Electric Operations above a 9.95% overall rate of return would be calculated pursuant to a return cap formula to be used to write-down Electric Operation's investment in generation assets. The Texas Utility Commission modified the percentage to 9.84% to reflect the impact of $11 million of imputed revenues from the discount rates offered by the Company. It is not expected that the change in the Transition Plan ordered by the Texas Utility Commission will have a material adverse impact on the Company's financial statements.

For additional information regarding the Transition Plan, see Note 3(b) to the Company's Form 10-K.

HOUSTON INDUSTRIES INCORPORATED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

(10) SUBSEQUENT EVENTS

(a) International Operations -- Privatization of Brazilian Electric Utility.

In April 1998, Light Servicos de Eletricidade S.A. (Light), a Brazilian corporation in which HI Energy owns an 11.57% common stock interest, purchased 74.88% of the common stock of Metropolitana Electricidade de Sao Paulo S.A. (Metropolitana), the utility that provides electric transmission and distribution services to the metropolitan area of Sao Paulo, Brazil. The purchase price for the shares was approximately $1.8 billion. Light financed the purchase of the shares of Metropolitana with proceeds from bank borrowings made on a non-recourse basis by Light's shareholders (including HI Energy).

For additional information regarding HI Energy's investment in Light, see Note 5 to the Company's Form 10-K.

(b) HIPG Purchase of Generating Assets

In April 1998, HIPG completed its $230 million acquisition of four California gas-fired generating plants totaling 2,276 megawatts of capacity from Southern California Edison Company (SCE). The acquisition was financed with the proceeds from borrowings made by subsidiaries of the Company. In addition HIPG has contracted to purchase SCE's Ormond Beach Generating Station for $43 million. The Ormond Beach facility has two natural gas-fired units totaling 1,500 megawatts of capacity. HIPG expects to close the acquisition of the Ormand Beach Generating Station in June 1998.

(11) INTERIM PERIOD RESULTS: RECLASSIFICATIONS

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

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

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

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

HOUSTON INDUSTRIES INCORPORATED

Houston Industries Incorporated (Company) is a diversified international energy services company. It operates the nation's tenth largest electric utility in terms of kilowatt-hour (KWH) sales, and NorAm's three natural gas distribution divisions together form the nation's third largest natural gas distribution operation in terms of customers served. The Company also invests in international electric utility privatizations, gas distribution projects and the development of non-rate regulated power generation projects. The Company, through NorAm, is also a major interstate natural gas pipeline and energy services company, providing gas transportation, supply, gathering and storage, and wholesale natural gas and electric power marketing services.

The Company is exempt from regulation as a public utility holding company based upon an order granted in July 1997 by the Securities and Exchange Commission under Section 3(a)(2) of the Public Utility Holding Company Act of 1935, as amended (1935 Act), except with respect to the acquisition of certain voting securities of other domestic public utility companies and utility holding companies.

CONSOLIDATED RESULTS OF OPERATIONS

In 1997, the Company acquired NorAm, a natural gas gathering, transmission, marketing and distribution company. Because the acquisition was accounted for as a purchase, the Company's results of operations include NorAm's results of operations only for the period beginning on August 6, 1997

(Acquisition Date). To enhance comparability between reporting periods, certain consolidated and business segment information in Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company is presented on a pro forma basis as if the acquisition of NorAm had occurred as of January 1, 1997. The Company believes that the presentation of pro forma data provides a more meaningful basis for comparing revenues and earnings trends. The pro forma information is not necessarily indicative of the results of operations of the Company and its business segments that would have occurred had these events occurred at the beginning of such period.

The Company's first quarter of 1998 results of operations and first quarter of 1997 pro forma results of operations reflect the effects of the acquisition of NorAm, which include (i) significant increases in amortization attributable to purchase accounting, (ii) increases in shares outstanding and interest expense, and (iii) the impact of additional revenues and operating expenses from the newly acquired NorAm businesses.

CONSOLIDATED RESULTS OF OPERATIONS

	QUARTER ENDED MARCH 31,		QUARTER ENDED MARCH 31,		
	1998	1997	1998	1997	% Change
		(Actual)	(Actual)	(Pro Forma)	
	(in millions, except per share data)				
Revenues	$ 2,637	$ 878	$ 2,637	$ 2,802	(6%)
Operating Expenses	2,356	722	2,356	2,509	(6%)
Operating Income	281	156	281	293	(4%)
Other Expenses, Net (1)	309	76	309	123	251%
Income Taxes	3	20	3	60	(95%)
Net Income (1)	(31)	60	(31)	110	--
Basic Earnings Per Share (1)	(0.11)	0.26	(0.11)	0.39	--
Diluted Earnings Per Share (1)	(0.11)	0.26	(0.11)	0.39	--

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(1) Includes a $189 million ($123 million after-tax) or $.43 per share non-cash unrealized accounting loss recorded in the first quarter of 1998 relating to the Company's 7% Automatic Common Exchange Securities (ACES). See Note 5 to the Company's Form 10-Q.

First Quarter of 1998 Compared to First Quarter of 1997 (Actual). The Company had a consolidated net loss for the first quarter of 1998 of $31 million ($0.11 per share) compared to net income of $60 million ($0.26 per share) in the same period in 1997. The Company's results of operations for the first quarter of 1998 reflect a $123 million (after-tax) non-cash, unrealized accounting loss on the ACES. For a discussion of the accounting loss in connection with the ACES, see Note 5 to the Company's Form 10-Q. Excluding the ACES accounting loss, the Company would have had consolidated earnings of $92 million ($0.32 per share). The increase in earnings is primarily a result of additional earnings from the business segments acquired in the NorAm acquisition and improved results from HI Energy. These earnings were partially offset by milder weather, base rate credits implemented by Electric Operations pursuant to its Transition Plan (as described below) and increased interest expense primarily related to the NorAm acquisition.

The consolidated tax expense in the first quarter of 1998 takes into account the impact of non-deductible goodwill expense, higher state tax expense arising from the NorAm acquisition, and the loss of the dividends received deduction on the TW Preferred.

First Quarter of 1998 Actual Compared to First Quarter of 1997 Pro Forma. The Company's consolidated net loss for the first quarter of 1998 was $31 million ($0.11 per share) compared with pro forma consolidated earnings of $110 million ($0.39 per share) in the first quarter of 1997.

Excluding the ACES accounting loss described above, the Company's first quarter of 1998 adjusted net income would have been $92 million ($0.32 per share) compared to $110 million ($0.39 per share) in the first quarter of 1997. The decrease in adjusted earnings is primarily the result of: (i) decreased operating income at Electric Operations due to milder weather and the implementation of base rate credits; (ii) decreased operating income at Natural Gas Distribution due to warmer weather; and (iii) increased operating expenses at the Company's Corporate segment.

Partially offsetting the decrease in earnings is increased operating income from International due to increased equity earnings. In addition, pro forma net income in the first quarter of 1997 reflects non-recurring hedging losses and losses from sale of gas at Energy Marketing in that quarter.

RESULTS OF OPERATIONS BY BUSINESS SEGMENT

The Company's operating activities include the following segments: Electric Operations, Natural Gas Distribution, Interstate Pipeline, Energy Marketing, International and Corporate.

The following table presents operating income on (i) an actual basis for the quarters ended March 31, 1998 and 1997 and (ii) a pro forma basis for the quarter ended March 31, 1997 (assuming the NorAm acquisition had occurred on January 1, 1997) for each of the Company's business segments (other than Electric Operations):

OPERATING INCOME (LOSS) BY BUSINESS SEGMENT

	QUARTER ENDED MARCH 31, (1)		
	1998 (ACTUAL)	1997 (ACTUAL)	1997 (PRO FORMA)
		(in millions)	
Electric Operations	$ 143	$ 160	$ 160
Natural Gas Distribution	102		107
Interstate Pipeline	32		35
Energy Marketing	10		(1)
International	11	3	2
Corporate	(17)	(7)	(10)
Total Consolidated	$ 281	$ 156	$ 293

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(1) PRO FORMA ADJUSTMENTS GIVE RETROACTIVE EFFECT TO PURCHASE-RELATED ADJUSTMENTS, INCLUDING AMORTIZATION OF GOODWILL AND THE REVALUATION ON A PRELIMINARY BASIS OF THE FAIR MARKET VALUE OF CERTAIN NORAM ASSETS AND LIABILITIES.

ELECTRIC OPERATIONS

Electric Operations are conducted under the name "Houston Lighting & Power Company" or "HL&P" (HL&P), an unincorporated division of the Company. Electric Operations provides electric generation, transmission, distribution and sales to approximately 1.6 million customers in a 5,000 square mile area on the Texas Gulf Coast, including Houston (the nation's fourth largest city).

The following table provides summary data regarding the actual results of operations of Electric Operations, including operating statistics, for the quarters ended March 31, 1998 and 1997.

	QUARTER ENDED MARCH 31, 1998	QUARTER ENDED MARCH 31, 1997	PERCENT CHANGE
	(in millions)		
Base Revenues (1)	$ 534	$ 553	(3%)
Transmission Revenues	21		
Reconcilable Fuel Revenues (2)	292	304	(4%)
Operating Expenses:			
Fuel and Purchased Power	305	320	(5%)
Operation and Maintenance	214	184	16%
Depreciation and Amortization	130	130	
Other Taxes	55	63	(14%)
Operating Income	$ 143	$ 160	(11%)
Electric Sales (MWH):			
Residential	3,597,021	3,955,258	(9%)
Commercial	3,424,350	3,398,796	1%
Industrial - Firm	6,367,979	6,456,671	(1%)
Total Firm Sales	14,298,521	14,202,623	1%
Average Cost of Fuel (Cents/MMBtu)	172.6	187.5	(8%)

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(1) Includes miscellaneous revenues, certain non-reconcilable fuel revenues and certain purchased power-related revenues.

(2) Includes revenues collected through a fixed fuel factor and surcharge, net of the over/under recovery of fuel. See "-- Operating Revenues - Electric Operations."

Operating Income - Electric Operations. In the first quarter of 1998, Electric Operations' operating income decreased by $17 million from operating income for the first quarter of 1997. The decrease in operating income was due to decreases in base revenues primarily due to milder weather and the implementation of the base rate credits pursuant to Electric Operations' Transition Plan (Transition Plan).

Operating Revenues - Electric Operations. Electric Operations' decrease in base revenue for the first quarter of 1998 compared to the first quarter of 1997 is primarily the result of milder weather and the implementation of the Transition Plan. These factors were partially offset by customer growth. Beginning in January 1998, Electric Operations implemented base rate credits under the Transition Plan, which resulted in lower base revenues of $11 million for the quarter. For information regarding the Transition Plan, see Note 9 to the Company's Form 10-Q.

Electric Operations' transmission revenues (which are considered miscellaneous revenues) in the first quarter of 1998 were $21 million but were offset by transmission expenses of $22 million. Electric Operations began recording transmission revenues and expenses in the second quarter of 1997 as a result of the implementation of wholesale transmission tariffs within the Electric Reliability Council of Texas (ERCOT). For information regarding these tariffs, see "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company--Results of Operations by Business--Certain Factors Affecting Future Earnings of the Company and its Subsidiaries--Competition--Electric Operations--Competition in Wholesale Market" in the Company's Form 10-K.

Electric Operation's first quarter of 1998 firm KWH sales decreased 3% compared to the same period in 1997 due to milder weather, partially offset by steady growth in the number of customers.

Electric Operations' 4% decrease in reconcilable fuel revenue resulted primarily from decreased natural gas prices. The Texas Utility Commission provides for recovery of certain fuel and purchased power costs through a fixed fuel factor included in electric rates. The fixed fuel factor is established during either a utility's general rate proceeding or its fuel factor proceeding and is generally effective for a minimum of six months. Revenues collected through such factor are adjusted monthly to equal expenses; therefore, such revenues and expenses have no effect on earnings unless fuel costs are determined not to be recoverable. The adjusted over/under recovery of fuel costs is recorded on the Company's Consolidated Balance Sheets as fuel- related credits or fuel-related debits, respectively. Fuel costs are reviewed during periodic fuel reconciliation proceedings, which are required at least every three years. Electric Operations filed a fuel reconciliation proceeding with the Texas Utility Commission on January 30, 1998 for the three year period ending July 31, 1997.

In January 1998, Electric Operations implemented (i) a $102 million temporary fuel surcharge (inclusive of interest) for under recoveries that occurred from March 1997 through August 1998, with recovery extending from 8 months to 16 months depending on the customer class. Electric Operations requested the surcharge in order to recover its under-recovery of fuel expenses for the period March 1997 through August 1997. In April 1998, Electric Operations filed a petition to revise the fuel factor and implement a surcharge for under-collected fuel costs of $128 million, (inclusive of the previously existing fuel surcharge balance) to be collected over a 24 to 30 month period. This surcharge will replace the one implemented in January and will recover its remaining uncollected balance, as well as, the under-recovery balance from September 1997 through February 1998. As of March 31, 1998, Electric Operations cumulative under-recovery of fuel costs was $165 million, including interest. For information regarding the recovery of fuel costs, see "Business Electric Operations - Fuel - Recovery of Fuel Costs" in Item 1 of the Company's Form 10-K.

Fuel and Purchased Power Expenses - Electric Operations. Fuel and purchased power expenses in the first quarter of 1998 decreased by $15 million compared to the same period in 1997. The decrease was driven by decreases in the average unit cost of natural gas, which declined to $2.43 per MMBtu in 1998 from $3.09 per MMBtu in 1997 and the cost of purchased power (see Note 12(c) to the Company's Form 10-K for information on Electric Operations' joint dispatching agreement with the City of San Antonio for purchased power).

Operation and Maintenance Expenses - Electric Operations. Operation and Maintenance expenses increased $31 million in the first quarter of 1998, including $22 million due to transmission tariffs within ERCOT. These transmission tariff expenses are largely offset by $21 million of revenue associated with wholesale transmission services discussed above.

Maintenance expense increased by $2 million in the first quarter of 1998 compared to the same period of 1997 primarily due to the scheduling of routine plant and line maintenance and inspection outages.

NATURAL GAS DISTRIBUTION

NorAm's domestic natural gas distribution operations (Natural Gas Distribution) are conducted through its Arkla, Entex and Minnegasco divisions. These operations consist of natural gas sales to, and natural gas transportation for, residential, commercial and certain industrial customers in six states: Arkansas, Louisiana, Minnesota, Mississippi, Oklahoma and Texas.

The following table provides summary data regarding the results of operations of Natural Gas Distribution, including operating statistics, for the quarters ended March 31, 1998 and 1997 on an actual basis for the first quarter of 1998 and on a pro forma basis for the first quarter of 1997 (as if the acquisition of NorAm had occurred as of January 1, 1997).

	QUARTER ENDED MARCH 31, 1998 (ACTUAL)	1997 (PRO FORMA)	PERCENT CHANGE
	(in millions)		
Operating Revenues	$717	$881	(19%)
Operating Expenses:			
Natural Gas	458	616	(26%)
Operation and Maintenance	98	97	1%
Depreciation and Amortization	32	30	7%
Other Operating Expenses	27	31	(10%)
Total Operating Expenses	615	774	(20%)
Operating Income	$102	$107	(5%)
Throughput Data (in Bcf):			
Residential and Commercial Sales	126	137	(8%)
Industrial Sales	15	15	
Transportation	13	12	8%
Total Throughput	154	164	(6%)

Natural Gas Distribution operating income decreased $5 million in the first quarter of 1998 compared to pro forma operating income in the first quarter of 1997 due primarily to weather-related factors. This decrease in operating income is partially offset by the favorable impact of Arkla's charges associated with the applicable state regulatory commission's methodology of calculating the price of gas charged to customers (the purchased gas adjustment) in the first quarter of 1998 as compared to the first quarter of 1997.

Natural Gas Distribution operating revenue decreased $164 million for the first quarter of 1998 compared to pro forma operating revenue for the corresponding period of 1997 due principally to the warmer weather, which resulted in lower customer usage at Entex and Minnegasco, and a decrease in gas prices.

Operating expenses decreased $159 million in the first quarter of 1998 compared to pro forma operating expenses in the same period of 1997 due to the same factors that affected operating revenues as discussed above.

INTERSTATE PIPELINE

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

The following table provides summary data regarding the results of operations of Interstate Pipeline, including operating statistics, on an actual basis for the first quarter of 1998 and on a pro forma basis for the first quarter of 1997 (as if the acquisition of NorAm had occurred as of January 1, 1997).

	QUARTER ENDED MARCH 31,		PERCENT
	1998	1997	CHANGE
	(ACTUAL)	(PRO FORMA)	
	(in millions)		
Operating Revenues	$ 71	$ 84	(15%)
Operating Expenses:			
Natural Gas	8	11	(27%)
Operation and Maintenance	17	22	(23%)
Depreciation and Amortization	9	13	(31%)
Other Operating Expenses	5	3	67%
Total Operating Expenses	39	49	(20%)
Operating Income	$ 32	$ 35	(8%)
Throughput Data (in million MMBtu):			
Natural Gas Sales	4	5	(20%)
Transportation	237	250	(5%)
Elimination (1)	(4)	(4)	--
Total Throughput	237	251	(5%)

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(1) Elimination refers to volumes of natural gas both transported and sold by Interstate Pipeline and, therefore, excluded from total throughput.

Interstate Pipeline operating income decreased $3 million in the first quarter of 1998 compared to pro forma operating income in the first quarter of 1997 due primarily to non-recurring items occurring in the first quarter of 1997 and milder weather in the first quarter of 1998. These factors were partially offset by lower operating expenses in the first quarter of 1998.

Operating revenues for Interstate Pipeline decreased by $13 million for the first quarter of 1998 compared to pro forma operating revenues for the same period in 1997. The decrease in revenues is primarily due to $7 million of non-recurring transportation revenues recognized in the first quarter of 1997 upon completion of settlement negotiations with Arkla related to service provided in several of its operating jurisdictions. In addition, the decrease in revenues is also attributable to a reduction in natural gas volumes and decreased gas prices.

Operation and maintenance expenses decreased $5 million in the first quarter of 1998 compared to pro forma operation and maintenance expenses for the same period of 1997 primarily due to decreased maintenance due to milder weather and lower costs resulting from cost control initiatives.

Depreciation and amortization expenses decreased $4 million in the first quarter of 1998 in comparison to pro forma depreciation and amortization expenses for the same period of 1997 due to a $4.8 million rate settlement recorded in the first quarter of 1998. The rate settlement, effective January 1998, provided for a reduction of MRT's depreciation rates retroactive to July 1996.

ENERGY MARKETING

NorAm's energy marketing and gathering business (Energy Marketing) includes the operations of NorAm's wholesale and retail energy marketing businesses and natural gas gathering activities (conducted, respectively, by NorAm Energy Services, Inc. (NES), NorAm Energy Management, Inc. and NorAm Field Services Corp., three wholly owned subsidiaries of NorAm).

The following table provides summary data regarding the unaudited pro forma results of operations of Energy Marketing, including operating statistics, on an actual basis for the first quarter of 1998 and on a pro forma basis for the first quarter of 1997 (as if the acquisition of NorAm had occurred as of January 1, 1997).

	QUARTER ENDED MARCH 31,		
	1998 (ACTUAL)	1997 (PRO FORMA)	PERCENT CHANGE
	(in millions)		
Operating Revenues	$ 1,046	$ 1,045	--
Operating Expenses:			
Natural Gas and Purchased Power, net	1,009	1,023	(1%)
Operation and Maintenance	22	19	16%
Depreciation and Amortization	3	3	--
Other Operating Expenses	2	1	--
Total Operating Expenses	1,036	1,046	(1%)
Operating Income (loss)	$ 10	$ (1)	
Operations Data:			
Natural Gas (in Bcf):			
Sales	337	320	5%
Transportation	7	7	--
Gathering	58	60	(3%)
Total	402	387	4%
Electricity:			
Wholesale Power Sales (in thousand MWH)	13,770	4,584	200%

Energy Marketing operating income increased $11 million in the first quarter of 1998 in comparison to pro forma operating income for the same period in 1997. This increase is primarily attributed to hedging losses and losses from the sale of gas in 1997 partially offset by increased operating expenses in 1998 as discussed below. After adjusting for these prior losses, operating income decreased for the first quarter of 1998 by approximately $6 million compared to the same period in 1997, as explained below.

Operating Revenues. Operating revenues for Energy Marketing remained substantially unchanged because: (i) increases in natural gas volumes at NES were more than offset by decreases in the price of natural gas and (ii) substantial increases in wholesale power volumes (200%) offset gas sales declines at NES.

Operating Expenses. Operation and maintenance expenses increased $3 million when compared to pro forma operation expenses for the first quarter of 1997 largely due to increased staffing and marketing activities made in support of the increased sales and expanded marketing efforts at NES. The Company believes that NES' energy marketing and risk management services have the potential of complementing the Company's strategy of developing and/or acquiring unregulated generation assets in other markets. As a result, the Company has made, and expects to continue to make, significant investments in developing NES' internal software, trading and personnel resources.

Natural gas and purchased power expense decreased $14 million in the first quarter of 1998 when compared to the first quarter of 1997 primarily due to the nonrecurrence of 1997 losses related to: (i) hedging losses associated with anticipated first quarter 1997 sales under peaking contracts and (ii) losses from the sale of natural gas held in storage and unhedged in the first quarter of 1997 totaling $17 million. Partially offsetting these losses were increased gas and electricity marketing activities. Excluding the 1997 hedging losses described above, natural gas and purchased power expenses increased $3 million, primarily attributable to approximately $2 million in losses on wholesale power sales.

To minimize fluctuations in the price of natural gas and transportation, the Company, primarily through NES, enters into futures transactions, swaps and options in order to hedge against market price changes affecting (i) certain commitments to buy, sell and transport natural gas, (ii) existing gas storage inventory and (iii) certain anticipated transactions, some of which carry off-balance sheet risk. NES also enters into natural gas derivatives for trading purposes and electricity derivatives for hedging and trading purposes. For a discussion about the Company's accounting treatment of derivative instruments, see Note 2 to the Company's Form 10-K and Item 7A (Quantitative and Qualitative Disclosure About Market Risk) in the Company's Form 10-K.

INTERNATIONAL

The Company's international business segment (International) includes the results of operations of HI Energy, a wholly owned subsidiary of the Company that participates in the development and acquisition of foreign independent power projects and the privatization of foreign generation and distribution facilities, and the international operations of NorAm. Substantially all of International's operations to date have been in Central and South America.

Results of operations data for International are presented in the following table on an actual basis for the quarter ended March 31, 1998 and on a pro forma basis for the quarter ended March 31, 1997 as if the NorAm acquisition had occurred as of January 1, 1997. The primary pro forma adjustment gives effect to project development costs and other expenditures incurred by NorAm prior to the Acquisition Date. The adjustment had no effect on operating revenues.

	QUARTER ENDED MARCH 31, 1998 (ACTUAL)	QUARTER ENDED MARCH 31, 1997 (PRO FORMA)	PERCENT CHANGE
	(in millions)		
Operating Revenues	$27	$20	35%
Operating Expenses:			
Fuel	5	4	25%
Operation and Maintenance	10	13	(23%)
Depreciation and Amortization	1	1	--
Total Operating Expenses	16	18	(11%)
Operating Income	$11	$ 2	--

International operating income increased $9 million in the first quarter of 1998 compared to pro forma operating income in the first quarter of 1997. Operating revenues increased $7 million in the first quarter of 1998 due primarily to increased equity earnings from HI Energy's investment in Light, the electric utility serving Rio de Janeiro, Brazil and HI Energy's interest in EPSA, a Colombian electric utility acquired in June 1997. Operation and maintenance expenses decreased $3 million when compared to proforma operating and maintenance expenses as a result of the timing of development costs.

In April 1998, a bidding consortium comprised of HI Energy and a Mexican co-investor submitted bids for two natural gas distribution concessions in and around Mexico City. If successful, the consortium would be required to purchase the existing natural gas distribution assets of one of the concessions ($79.7 million or $104.9 million, depending on the concession) and undertake to construct and operate an expanded natural gas distribution network.

For additional information regarding International's foreign investments and investment strategies, see Note 10(a) to the Company's Form 10-Q, Note 5 to the Company's Form 10-K and "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company--Results of Operations by Business Segment--International," "--Certain Factors Affecting Future Earnings of the Company and its Subsidiaries," and "--Liquidity and Capital Resources--Company's Consolidated Capital Resources" in the Company's Form 10-K.

CORPORATE

Corporate. The Company's corporate and other business segment (Corporate) includes the operations of HIPG, which is engaged in the acquisition, development and operation of domestic non-rate regulated power generation facilities, the Company's unregulated retail services business, certain real estate holdings of the Company, corporate costs and inter-unit eliminations.

In the first quarter of 1998, Corporate's operating loss of $17 million reflects an increase of $7 million when compared to pro forma results for the first quarter of 1997. The increase in pro forma operating loss was primarily due to (i) losses associated with the Company consumer services business; (ii) start-up costs associated with the Company's non-rate regulated retail electric services business; and (iii) expenses related to the development of domestic power generation projects.

HIPG. HIPG was formed in March 1997 to pursue the acquisition of domestic electric generation assets as well as the development of new domestic non-rate regulated power generation facilities. For the quarter ended March 31, 1998, HIPG had an operating loss of $3.4 million primarily as a result of business development activities.

HIPG expect to spend approximately $339 million in 1998 pursuant to commitments entered into with respect to bids previously awarded to HIPG and existing development construction activities by HIPG. This amount includes $230 million for the acquisition of four gas-fired generating plants which was completed on April 7, 1998. For additional information, see Note 10(b) to the Company's Form 10-Q.

HIPG expects to finance its acquisitions and construction projects primarily by borrowings obtained by one or more subsidiaries of the Company.

CERTAIN FACTORS AFFECTING FUTURE EARNINGS OF THE COMPANY AND ITS SUBSIDIARIES

For information on developments, factors and trends that may have an impact on the Company's future earnings, reference is made to Item 7 of the Company's Form 10-K, "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company--Certain Factors Affecting Future Earnings of the Company and its Subsidiaries."

RATE PROCEEDINGS -- ELECTRIC OPERATIONS

The Texas Utility Commission has jurisdiction (or, in some cases, appellate jurisdiction) over the electric rates of Electric Operations and, as such, monitors Electric Operations' earnings to ensure that Electric Operations is not earning in excess of a reasonable rate of return.

For information regarding the Transition Plan, see Note 8 of the Interim Financial Statements.

ACCOUNTING TREATMENT OF ACES

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

For additional information regarding the accounting treatment of the TW Preferred, see Note 5 to the Company's Form 10-Q.

LIQUIDITY AND CAPITAL RESOURCES

The Company and its subsidiaries generated $424 million in cash flow from operations in the first quarter of 1998. Overall, the Company's cash flow from operating activities for the first quarter 1998 exceeded its cash flow used in investing activities by $301 million. Investing activities were primarily due to capital expenditures of $70 million and $39 million at the electric operations and gas distribution segments, respectively.

COMPANY CONSOLIDATED SOURCES OF CAPITAL RESOURCES AND LIQUIDITY

Company. In January 1998, pollution control revenue refunding bonds aggregating $104.7 million with $29.7 million bearing an interest rate of 5.25% and $75 million bearing an interest rate of 5.15%, were issued on behalf of the Company by the MCND. The bonds will mature in 2029. Proceeds from the issuances were used in February 1998 to redeem, at 102% of the aggregate principal amount, pollution control revenue bonds aggregating $104.7 million.

In February 1998, pollution control revenue bonds aggregating $290 million were issued on behalf of the Company by the BRA. The BRA bonds bear an interest rate of 5 1/8% and mature in May 2019 ($200 million) and November 2020 ($90 million). Proceeds from the issuances were used in May 1998 to redeem, at 102% of the aggregate principal amount, pollution control revenue bonds aggregating $290 million.

At March 31, 1998, the Company, exclusive of subsidiaries, had a revolving credit facility of $200 million which supported $131 million of commercial paper having a weighted average interest rate of 5.92%. In addition, at March 31, 1998, the Company had shelf registration statements providing for the future issuance, subject to market and other conditions, of $230 million aggregate liquidation value of its preferred stock and $580 million aggregate principal amount of its debt securities.

NorAm. In February 1998, NorAm issued $300 million principal amount of 6.5% debentures due February 1, 2008. The proceeds from the sale of the debentures were used to repay short-term indebtedness of NorAm, including the indebtedness incurred in connection with the purchase of $101.4 million aggregate principal amount of its 10% debentures and the repayment of $53 million aggregate principal amount of NorAm debt that matured in December 1997 and January 1998.

In the first quarter of 1998, NorAm repaid at maturity $1 million of its 9.3% medium-term notes and satisfied the $6.5 million sinking fund requirement for its 6% convertible subordinated debentures due March 2012 using debentures purchased in 1996 and 1997.

In March 1998, NorAm replaced its $400 million revolving credit facility with a five-year $350 million revolving credit facility. Borrowings under the NorAm Credit Facility are unsecured. There were no loans outstanding under the NorAm Credit Facility at March 31, 1998. The NorAm Credit Facility is expected to be used to support NorAm's issuance of up to $350 million of commercial paper. At March 31, 1998, NorAm also had a trade receivables facility of $300 million under which receivables of $300 million had been sold and a shelf registration statement providing for the future issuance of debt securities of up to $200 million aggregate principal amount.

Financing Subsidiaries. At March 31, 1998, Houston Industries FinanceCo LP's (FinanceCo) $1.6 billion revolving credit facility supported $1.2 billion in commercial paper borrowings having a weighted average interest rate of 5.85%. Proceeds from the initial issuances of commercial paper by FinanceCo in 1997 were used to fund the cash portion of the consideration paid to stockholders of the Former NorAm Energy Corp. For additional information regarding the FinanceCo Facility, see Note 8(c) to the Company's Form 10-K.

In March 1998, FinanceCo II, a limited partnership subsidiary of the Company, entered into the FinanceCo II Facility, a six-month $150 million credit facility. At March 31, 1998, borrowings from the FinanceCo II Facility totaled $150 million. Proceeds from borrowings under the FinanceCo II Facility were used to fund a portion of HIPG's April 1998 purchase of four electric generation plants. For additional information regarding the FinanceCo II Facility, see Note 7(b) to the Interim Financial Statements.

General. The Company has established a "money fund" through which its subsidiaries can borrow or invest on a short-term basis. The funding requirements of individual subsidiaries are aggregated ,and borrowing or investing is based on the net cash position. At March 31, 1998, NorAm had invested $110 million in the money fund at 6.375%. The money fund's net funding requirements are met with commercial paper. At March 31, 1998, temporary external investments aggregated $54 million and had a rate of 6%.

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

NEW ACCOUNTING ISSUES

The FASB issued SFAS No. 130, "Reporting Comprehensive Income" (SFAS No. 130), which is required to be implemented for financial statements issued for fiscal periods beginning after December 15, 1997. For further discussion, see Note 3 to the Interim Financial Statements.

The FASB recently issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS No. 131) and SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" (SFAS No. 132) effective for financial statements issued for fiscal periods beginning after December 15, 1997. SFAS No. 131 requires that companies report financial and descriptive information about reportable operating segments in financial statements. Segments are to be defined based upon the way in which management reviews its operations in order to assess performance and allocate its resources. SFAS No. 132 revises employers' disclosures about pension and other postretirement benefit plans. The Company and NorAm will adopt SFAS No. 131 and SFAS No. 132 for the 1998 fiscal year.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK OF THE COMPANY

The Company and its subsidiaries have financial instruments that involve various market risks and uncertainties. For information regarding the Company's exposure to risks associated with interest rates, equity market prices and energy commodity prices see Item 7A of the Company's Form 10-K.

In the first quarter of 1998, the Company recorded an additional $123 million unrealized loss (net of tax) related to the ACES. For further discussion of this loss see Note 5 to the Company's Form 10-Q. The Company believes that this additional unrealized loss for the ACES is more than economically hedged by the unrecorded unrealized gain relating to the increase in the fair value of the Time Warner common stock underlying the investment in TW Preferred since the date of its acquisition. An increase of 15% in the price of the Time Warner common stock above its March 31, 1998 market value of $72.00 per share would result in the recognition of an additional unrealized accounting loss (net of tax) of approximately $133 million.

The Company's risk associated with interest rates, equity market prices (other than those related to ACES) and energy commodity prices have not materially changed from the market risks faced by the Company at December 31, 1997.

ITEM 1. FINANCIAL STATEMENTS.

NORAM ENERGY CORP. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME
(THOUSANDS OF DOLLARS)
(UNAUDITED)

	CURRENT NORAM THREE MONTHS ENDED MARCH 31, 1998	FORMER NORAM THREE MONTHS ENDED MARCH 31, 1997
Revenues:	$ 1,759,931	$ 1,924,182
Expenses:		
Natural gas and purchased power, net	1,388,349	1,579,178
Operation and maintenance	151,609	127,640
Depreciation and amortization	44,730	35,988
Taxes other than income taxes	33,672	36,155
	1,618,360	1,778,961
Operating Income	141,571	145,221
Other Income (Expense):		
Interest expense, net	(26,900)	(35,472)
Distributions on trust securities	(268)	(2,705)
Other - net	2,556	6,309
	(24,612)	(31,868)
Income Before Income Taxes	116,959	113,353
Income Taxes	56,353	44,943
Income Before Extraordinary Item	60,606	68,410
Extraordinary gain on early retirement of debt, less taxes		237
Net Income	$ 60,606	$ 68,647

See Notes To NorAm's Consolidated Financial Statements.

NORAM ENERGY CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

ASSETS

	MARCH 31, 1998	DECEMBER 31, 1997
Property, Plant and Equipment		
Natural gas distribution	$1,351,870	$1,326,442
Interstate pipeline	1,259,530	1,258,087
Energy marketing	167,573	162,519
Other	13,367	14,972
Total	2,792,340	2,762,020
Less accumulated depreciation and amortization	85,852	59,531
Property, plant and equipment-- net	2,706,488	2,702,489
Current Assets		
Cash and cash equivalents	51,665	35,682
Accounts and notes receivable, principally customer	774,140	969,248
Accounts receivable - affiliated companies	116,809	10,161
Gas in underground storage	31,423	63,702
Materials and supplies	31,271	29,611
Gas purchased in advance of delivery	6,200	6,200
Other current assets	8,001	24,386
Total current assets	1,019,509	1,138,990
Other Assets		
Goodwill, net	2,013,907	2,026,395
Prepaid pension asset	91,478	92,064
Investment in marketable equity securities	29,206	27,046
Regulatory asset for environmental costs	21,248	21,745
Gas purchased in advance of delivery	22,765	29,048
Deferred debits, net	71,479	93,010
Total other assets	2,250,083	2,289,308
Total Assets	$5,976,080	$6,130,787

See Notes to NorAm's Consolidated Financial Statements

NORAM ENERGY CORP. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

LIABILITIES AND STOCKHOLDER'S EQUITY

	MARCH 31, 1998	DECEMBER 31, 1997
Stockholder's Equity:		
Common stock	$ 1	$ 1
Paid-in capital	2,463,831	2,463,831
Retained earnings	81,453	20,847
Unrealized loss on marketable equity securities, net of tax	(4,255)	(5,634)
Total	2,541,030	2,479,045
NorAm-Obligated Mandatorily Redeemable Convertible Trust Preferred Securities of Subsidiary Trust Holding Solely Subordinated Debentures of NorAm, net	15,021	21,290
Long-Term Debt, less Current Maturities	1,211,440	916,703
Current Liabilities:		
Current maturities of long-term debt	230,590	232,145
Notes payable to banks		390,000
Notes payable to parent		22,100
Receivables facility	300,000	300,000
Accounts payable, principally trade	532,617	668,269
Accounts payable - affiliated companies	2,578	
Income taxes payable	47,505	
Interest payable	20,402	27,273
General taxes	41,936	41,315
Customer deposits	36,985	36,626
Other current liabilities	117,702	133,278
Total current liabilities	1,330,315	1,851,006
Deferred Credits and Other Liabilities:		
Accumulated deferred income taxes	503,084	488,299
Estimated environmental remediation costs	21,248	21,745
Payable under capacity lease agreement	41,000	41,000
Benefit liabilities	173,623	182,687
Estimated obligations under indemnification provisions of sale agreements	9,919	11,391
Other	129,400	117,621
Total	878,274	862,743
Commitments and Contingencies		
Total Liabilities and Stockholder's Equity	$ 5,976,080	$ 6,130,787

See Notes to NorAm's Consolidated Financial Statements

NORAM ENERGY CORP. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED CASH FLOWS
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS
(THOUSANDS OF DOLLARS)
(UNAUDITED)

	CURRENT NORAM THREE MONTHS ENDED MARCH 31, 1998	FORMER NORAM THREE MONTHS ENDED MARCH 31, 1997
Cash Flows from Operating Activities:		
Net income	$ 60,606	$ 68,647
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	44,730	35,988
Deferred income taxes	14,785	7,360
Extraordinary (gain), less taxes		(237)
Changes in other assets and liabilities, net of the effects of the acquisition:		
Accounts and notes receivable-net	198,560	179,133
Accounts receivable - affiliated companies	(110,100)	
Inventories	29,930	45,500
Other current assets	16,238	6,529
Accounts payable	(133,074)	(249,848)
Interest and taxes accrued	41,255	30,776
Other current liabilities	(15,216)	(37,204)
Other - net	29,724	10,956
Net cash provided by operating activities	177,438	97,600
Cash Flows from Investing Activities:		
Capital expenditures	(38,639)	(26,700)
Other - net	2,371	4,987
Net cash used in investing activities	(36,268)	(21,713)
Cash Flows from Financing Activities:		
Retirements and reacquisitions of long-term debt	(1,000)	(5,515)
Proceeds from sale of debentures	300,000	
Decrease in notes payable	(417,027)	(28,000)
Decrease in receivables facility		(10,000)
Common and preferred stock dividends		(9,631)
Conversion of convertible securities	(3,255)	
Other-net	(3,905)	(16,123)
Net cash used in financing activities	(125,187)	(69,269)
Net Increase In Cash And Cash Equivalents	15,983	6,618
Cash and Cash Equivalents at Beginning of the Period	35,682	27,981
Cash and Cash Equivalents at End of the Period	$ 51,665	$ 34,599
Supplemental Disclosure of Cash Flow Information:		
Interest (net of amounts capitalized)	$ 39,194	$ 36,120
Income taxes, net	(13,792)	3,770

See Notes To NorAm's Consolidated Financial Statements

NORAM ENERGY CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(THOUSANDS OF DOLLARS)
(UNAUDITED)

	COMMON STOCK(1)				UNREALIZED	
	SHARES	AMOUNT	PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	INVESTMENT GAIN (LOSS) NET OF TAX	TOTAL
FORMER NORAM:						
Balance at January 1, 1997.......	137,908,173	$ 86,193	$ 1,001,053	$ (286,703)	$ 5	$ 800,548
Net income.......................				68,647		68,647
Cash dividends:						
Common stock -- $0.07 per share....................				(9,631)		(9,631)
Change in Market Value of Marketable Equity Securities, net of tax.........					1,199	1,199
Other Issuances..................	321,152	200	3,757			3,957
Balance at March 31, 1997........	138,229,325	86,393	1,004,810	(227,687)	1,204	864,720
Net Income.......................				(22,535)		(22,535)
Cash Dividends:						
Common Stock -- $0.07 per share....................				(9,650)		(9,650)
Change in Market Value of Marketable Equity Securities, Net of Tax.........					4,675	4,675
Conversion of NorAm-Obligated Mandatorily Redeemable Convertible Trust Preferred Securities of Subsidiary Trust Holding Solely Subordinated Debentures of Noram to Common Stock..........................	11,428,262	7,143	131,425			138,568
Other Issuances..................	26,375	16	2,039			2,055
Balance at July 31, 1997.......	149,683,962	93,552	1,138,274	(259,872)	5,879	977,833
CURRENT NORAM (POST MERGER):						
Adjustments due to Merger:						
Eliminate Former NorAm Balances.....................	(149,683,962)	(93,552)	(1,138,274)	259,872	(5,879)	(977,833)
Capital Contribution from Parent.........................	1,000	1	2,463,831			2,463,832
Net Income.......................				20,847		20,847
Change in Market Value of Marketable Equity Securities, Net of Tax.........					(5,634)	(5,634)
Balance at December 31, 1997.....	1,000	$ 1	$ 2,463,831	$ 20,847	$ (5,634)	$2,479,045

(continued on next page)

NORAM ENERGY CORP. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY - (CONTINUED)
(THOUSANDS OF DOLLARS)
(UNAUDITED)

	COMMON STOCK(1)					
	SHARES	AMOUNT	PAID-IN CAPITAL	RETAINED EARNINGS (DEFICIT)	UNREALIZED INVESTMENT GAIN(LOSS) NET OF TAX	TOTAL
Net Income........................				60,606		60,606
Change in Market Value of Marketable Equity Securities, net of tax.....					1,379	1,379
Balance at March 31, 1998...........................	1,000	$ 1	$2,463,831	$ 81,453	$ (4,255)	$ 2,541,030

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(1) $.625 par, authorized 250,000,000 shares. On the Acquisition Date, NorAm's pre-merger common stock was canceled and replaced with 1,000 shares of common stock (all of which are owned by Houston Industries).

See Notes to NorAm's Consolidated Financial Statements.

NORAM ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

(1) BASIS OF PRESENTATION

On August 6, 1997 (Acquisition Date), Houston Industries Incorporated (Former HI) merged with and into Houston Lighting & Power Company, which was renamed "Houston Industries Incorporated" (Houston Industries), and NorAm Energy Corp. (Former NorAm) merged with and into a subsidiary of Houston Industries, HI Merger, Inc., which was renamed "NorAm Energy Corp." (NorAm). Effective upon the mergers (collectively, the Merger), each outstanding share of common stock of Former NorAm was converted into the right to receive $16.3051 cash or 0.74963 shares of common stock of Houston Industries. For more information regarding the Merger, see Note 2 below.

The interim financial statements and notes (NorAm's Interim Financial Statements) in this Form 10-Q (NorAm's Form 10-Q) include the accounts of NorAm and its wholly owned subsidiaries. NorAm's Interim Financial Statements are unaudited, omit certain information included in financial statements prepared in accordance with generally accepted accounting principles and should be read in combination with the joint Annual Report on Form 10-K (NorAm's Form 10-K) for the year ended December 31, 1997 (File No. 1-13265) and Houston Industries Annual Report on Form 10-K (Houston Industries Form 10-K) for the year ended December 31, 1997 (File No. 1-3187). For additional information regarding the presentation of interim period results, see Note 6 below.

The following notes to the financial statements in NorAm's Form 10-K relate to material contingencies. These notes, as updated by the notes contained in the NorAm Form 10-Q, are incorporated herein by reference and include the following:

NorAm: Note 1(c) (Regulatory Assets and Regulation), Note 2 (Derivative Financial Instruments (Risk Management)) and Note 8 (Commitments and Contingencies).

(2) ACQUISITION OF NORAM

The aggregate consideration paid to Former NorAm stockholders in connection with the Merger consisted of $1.4 billion in cash and 47.8 million shares of Houston Industries common stock valued at approximately $1.0 billion. The overall transaction was valued at $4.0 billion consisting of $2.4 billion paid for Former NorAm's common stock and common stock equivalents and $1.6 billion of Former NorAm's debt ($1.3 billion of which was long-term debt).

The Merger was recorded under the purchase method of accounting with assets and liabilities of NorAm reflected at their estimated fair values as of the Acquisition Date, resulting in a "new basis" of accounting. In NorAm's Interim Financial Statements, periods which reflect the new basis of accounting are labeled as "Current NorAm" and periods which do not reflect the new basis of accounting are labeled as "Former NorAm."

NorAm's Consolidated Balance Sheets for periods after the Acquisition Date reflect adjustments associated with Houston Industries' assignment of the purchase price, principally consisting of (1) the revaluation of certain property, plant and equipment and long-term debt to their estimated fair market value, (2) the recognition of certain pension and postretirement benefit obligations previously being recognized through amortization, (3) the recognition of goodwill as described above, (4) the elimination of NorAm's historical goodwill, (5) the elimination of NorAm's historical stockholders' equity balances and accumulated depreciation and amortization as of the Acquisition Date and (6) the recognition of the associated deferred income tax effects. In addition, NorAm's pre-merger common stock was canceled and replaced with 1,000 shares of common stock (all of which are owned by Houston Industries), rendering presentation of per share data no longer meaningful. Houston Industries' debt to fund the cash portion of the purchase consideration has not been allocated or "pushed down" to NorAm and is not reflected on NorAm's Interim Financial Statements.

NorAm's Statements of Consolidated Income for periods after the Acquisition Date are principally affected by (1) the amortization (over 40 years) of the newly-recognized goodwill, partially offset by the elimination of the amortization of NorAm's historical goodwill, (2) the amortization (to interest expense) of the revaluation of long-term debt, (3) the removal of the amortization (to operating expense) previously associated with the pension and postretirement obligations as described above and (4) the deferred income tax expense associated with these adjustments. Interest expense on Houston Industries' debt which was used to fund the cash portion of the acquisition has not been allocated or "pushed down" to NorAm and is not reflected on NorAm's Interim Financial Statements. For these reasons, among others, certain financial information for periods before and after the Acquisition Date is not comparable.

Assuming the Merger occurred on January 1, 1997, NorAm's unaudited pro forma net income for the first quarter of 1997 is $63.1 million. Pro forma results are based on assumptions deemed appropriate by NorAm's management, have been prepared for informational purposes only and are not necessarily indicative of the results which would have resulted had the Merger actually taken place on the date indicated.

(3) COMPREHENSIVE INCOME

Effective January 1, 1998, NorAm adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income" (SFAS No. 130). SFAS No. 130 requires that all items that meet the definition of a component of comprehensive income (as defined below) be reported in a financial statement for the fiscal period in which they are recognized and the total amount of comprehensive income be prominently displayed in that same financial statement. Comprehensive income is defined to include not only net income but also the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. NorAm's total comprehensive income which includes unrealized gain on marketable equity securities for the quarters ended March 31, 1998 and 1997 is $62 million and $70 million, respectively. Adoption of SFAS No.130 has no impact on NorAm's net income or stockholders' equity.

(4) DEPRECIATION

NorAm calculates depreciation using the straight-line method. NorAm's depreciation expense for the first quarter of 1998 was $34 million.

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

In March 1998, NorAm replaced its $400 million revolving credit facility with a five-year $350 million revolving credit facility (NorAm Credit Facility). Borrowings under the NorAm Credit Facility are unsecured and bear interest at a rate based upon either the London interbank offered rate (LIBOR) plus a margin, a base rate or a rate determined through a bidding process. The NorAm Credit Facility is expected to be used to support NorAm's issuance of up to $350 million of commercial paper. There were no loans outstanding under the NorAm Credit Facility at March 31, 1998.

In February 1998, NorAm issued $300 million principal amount of its 6 1/2% Debentures due February 1, 2008 (6 1/2% Debentures). The 6 1/2% Debentures are not redeemable prior to maturity and are not subject to any sinking fund requirements. The proceeds from the sale of the 6 1/2% Debentures were used to repay short-term indebtedness of NorAm, including the indebtedness incurred in connection with the 1997 purchase of $101 million aggregate principal amount of its 10% Debentures and the repayment of $53 million aggregate principal amount of NorAm debt that matured in December 1997 and January 1998.

In the first quarter of 1998, NorAm repaid at maturity $1 million of its 9.30% medium-term notes and satisfied the $6.5 million sinking fund requirement for its 6% Debentures due 2012 using debentures purchased in 1996 and 1997.

(6) NORAM OBLIGATED MANDATORILY REDEEMABLE TRUST SECURITIES OF SUBSIDIARY TRUSTS HOLDING SOLELY SUBORDINATED DEBENTURES OF NORAM.

For information regarding $177.8 million of convertible preferred securities issued by a statutory business trust formed by Former NorAm, of which $11.6 million were outstanding at March 31, 1998, see Note 5 to NorAm's Form 10-K. The sole asset of the trust consists of junior subordinated debentures of NorAm having interest rates and maturity dates corresponding to the preferred securities, and the principal amount corresponding to the common and preferred securities issued by the trust.

(7) INTERIM PERIOD RESULTS: RECLASSIFICATIONS

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

ITEM 2. MANAGEMENT'S NARRATIVE ANALYSIS OF THE RESULTS OF OPERATIONS OF NORAM ENERGY CORP. AND CONSOLIDATED SUBSIDIARIES.

NorAm meets the conditions specified in General Instruction H to Form 10-Q and is thereby permitted to use the reduced disclosure format for wholly owned subsidiaries of reporting companies specified therein. Accordingly, NorAm has omitted from this Form 10-Q the information called for by Item 3 of Part I and the following Part II items of Form 10-Q: Item 2 (changes in securities and use of proceeds), Item 3 (defaults upon senior securities), and Item 4 (submission of matters to a vote of security holders). In lieu of the information called for by Item 2 (management's discussion and analysis of financial condition and results of operations) of Form 10-Q, NorAm has included the following Management's Narrative Analysis of the Results of Operations of NorAm Energy Corp. and Consolidated Subsidiaries to explain material changes in the amount of revenue and expense items of NorAm between the first quarter of 1998 and the first quarter of 1997. Reference is made to Management's Narrative Analysis of the Results of Operations in Item 7 of NorAm's Form 10-K, NorAm's consolidated financial statements and notes contained in Item 8 of NorAm's Form 10-K and NorAm's Interim Financial Statements contained in this Form 10-Q.

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

NORAM ENERGY CORP.

NorAm conducts operations primarily in the natural gas industry, including gathering, transmission, marketing, storage and distribution. Collectively, these operations accounted for in excess of 90% of NorAm's total revenues, income or loss and identifiable assets in the first quarter of 1998. Accordingly, NorAm is not required to report on a "segment" basis, although NorAm is organized into, and the following business description focuses on, the operating units described below. NorAm also makes sales of electricity, non-energy sales and provides certain non-energy services, primarily to retail gas distribution customers. In recognition of the manner in which NorAm manages its portfolio of businesses, NorAm has segregated its results of operations into: Natural Gas Distribution, Interstate Pipeline, Energy Marketing and Corporate.

On August 6, 1997 (Acquisition Date), NorAm became a wholly owned subsidiary of Houston Industries Incorporated (Houston Industries) in a transaction involving the merger (Merger) of NorAm Energy Corp. (Former NorAm) with and into a subsidiary of Houston Industries. For additional information regarding Houston Industries' acquisition of NorAm, see Note 2 to NorAm's Interim Financial Statements.

CONSOLIDATED RESULTS OF OPERATIONS

Seasonality and Other Factors. NorAm's results of operations are seasonal due to seasonal fluctuations in the demand for and, to a lesser extent, the price of natural gas. NorAm's results of operations are also affected by, among other things, the actions of various federal and state governmental authorities having jurisdiction over rates charged by NorAm and its subsidiaries, competition in NorAm's various business operations, debt service costs and income tax expense. For a discussion of certain other factors that may affect NorAm's future earnings see "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company--Certain Factors affecting Future Earnings of the Company and its Subsidiaries" in the Company's Form 10-K.

Accounting Impact of the Merger. The Merger created a new basis of accounting for NorAm, resulting in new carrying values for certain of NorAm's assets, liabilities and equity commencing upon the Acquisition Date. NorAm's Statements of Consolidated Income for periods after the Acquisition Date are principally affected by (1) the amortization (over 40 years) of the newly-recognized goodwill, partially offset by the elimination of the amortization of NorAm's historical goodwill, (2) the amortization (to interest expense) of the revaluation of long-term debt, (3) the removal of the amortization (to operating expense) previously associated with the pension and post-retirement obligations and (4) the deferred income tax expense associated with these adjustments. Interest expense on Houston Industries' debt which was used to fund the cash portion of the acquisition has not been allocated or "pushed down" to NorAm and is not reflected on NorAm's Interim Financial Statements. For these reasons, among others, certain financial information for periods before and after the Acquisition Date is not comparable.

Because results of operations and other financial information for periods before and after the Acquisition Date are not comparable, NorAm is presenting certain financial data on an actual basis and on a pro forma basis as if the Merger had taken place at the beginning of the period presented. These results do not necessarily reflect the results which would have been obtained if the Merger had actually occurred on the dates indicated or the results that may be expected in the future.

The following table sets forth selected financial and operating data on an actual basis for the quarters ended March 31, 1998 and 1997 and on a pro forma basis for the quarter ended March 31, 1997, followed by a discussion of significant variances in period-to-period results:

SELECTED FINANCIAL RESULTS:

	ACTUAL QUARTER ENDED MARCH 31,		QUARTER ENDED MARCH 31,		
	1998 (ACTUAL)	1997 (ACTUAL)	1998 (ACTUAL)	1997 (PRO FORMA)(1)	PERCENT CHANGE
	(THOUSANDS OF DOLLARS)				
Operating Revenues:					
Natural Gas Distribution	$ 716,896	$ 881,251	$ 716,896	$ 881,251	(19%)
Interstate Pipeline	70,981	84,284	70,981	84,284	(16%)
Energy Marketing	1,045,619	1,045,466	1,045,619	1,045,466	
Corporate and Other	21,116	16,759	21,116	16,759	26%
Elimination of Intersegment Revenues (2)	(94,681)	(103,578)	(94,681)	(103,578)	(9%)
	$ 1,759,931	$ 1,924,182	$ 1,759,931	$1,924,182	(9%)
Operating Income (Loss):					
Natural Gas Distribution	101,604	112,652	101,604	106,751	(5%)
Interstate Pipelines	32,073	38,851	32,073	34,915	(8%)
Energy Marketing	9,581	682	9,581	(1,042)	
Corporate and Other	(1,687)	(6,964)	(1,687)	(4,012)	(58%)
Consolidated	141,571	145,221	141,571	136,612	4%
Interest Expense, Net	26,900	35,472	26,900	30,564	(12%)
Distributions on Subsidiary Trust Securities	268	2,705	268	514	(48%)
Other (Income) and Deductions	(2,556)	(6,309)	(2,556)	(6,309)	(59%)
Income Tax Expense	56,353	44,943	56,353	48,712	16%
Net Income	$ 60,606	$ 68,410	$ 60,606	$ 63,131	(4%)

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(1) Pro forma results reflect purchase accounting adjustments as if the Merger had occurred on January 1, 1997. Adjustments for goodwill have been allocated to the respective business units.

(2) Elimination of operating revenues derived from sales to affiliated business units.

First Quarter of 1998 Compared to First Quarter of 1997 (Pro Forma). Noram's operating income increased $5 million in the first quarter of 1998 compared to pro forma operating income for the first quarter of 1997. This increase is primarily attributed to hedging losses and losses from the sale of gas in the first quarter of 1997, partially offset by increased operating expenses in 1998 as discussed below. After adjusting for these prior losses, operating income in the first quarter of 1998 decreased by approximately $12 million compared to the same period of 1997 as explained below.

Operating revenues decreased $164 million in the first quarter of 1998 compared to pro forma operating revenues for the first quarter of 1997. Operating expenses for the first quarter of 1998 were $1,618 million compared to pro forma operating expenses of $1,788 million for the same period of 1997 resulting in a decrease of $170 million. This decrease in operating income (adjusted, as explained above) is principally the result of (i) a weather-related decline in sales volumes of approximately $10 million on an operating income basis from natural gas distribution, (ii) increased administrative and general expense of approximately $3 million associated with increased staffing and marketing in connection with increasing the scope of energy marketing activities and (iii) non-recurring transportation revenues recognized in the first quarter of 1997 of $7 million. These factors were partially offset by decreases in depreciation and amortization expenses due to a $4.8 Million rate settlement recorded in the first quarter of 1998 by Interstate Pipeline and lower natural gas costs at Arkla of $4 million attributable to the purchase gas adjustments recorded in the first quarter of 1998 as discussed below. For a more detailed comparative discussion regarding pro forma operating revenue and expense items, see "Results of Operations by Business Unit" below.

First Quarter of 1998 Compared to First Quarter of 1997 (Actual). Noram had actual operating revenues of $1.8 Billion in the first quarter of 1998 compared to $1.9 Million in the first quarter of 1997. Actual operating expenses for the first quarter of 1998 were $1.6 Billion compared to operating expenses of $1.8 Billion in the first quarter of 1997. Noram's operating income decreased $4 million in the first quarter of 1998 compared to operating income for the first quarter of 1997. Noram's operating income for the first quarter of 1998 includes expenses associated with purchase accounting of approximately $9 million. Adjusting for these purchase accounting expenses, the change in operating income was caused by the same factors referenced in the discussion of pro forma operating income.

RESULTS OF OPERATIONS BY BUSINESS UNIT

NATURAL GAS DISTRIBUTION

NorAm's domestic natural gas distribution operations (Natural Gas Distribution) are conducted through its Arkla, Entex and Minnegasco divisions. These operations consist of natural gas sales to, and natural gas transportation for, residential, commercial and certain industrial customers in six states: Arkansas, Louisiana, Minnesota, Mississippi, Oklahoma and Texas.

The following table provides summary data regarding the results of operations of Natural Gas Distribution, including operating statistics, for the quarters ended March 31, 1998 and 1997 on an actual basis for the first quarter of 1998 and on a pro forma basis for the first quarter of 1997 (as if the acquisition of NorAm had occurred as of January 1, 1997).

	Quarter Ended MARCH 31, 1998 (ACTUAL)	1997 (PRO FORMA)	PERCENT CHANGE
	(in millions)		
Operating Revenues	$717	$881	(19%)
Operating Expenses:			
Natural Gas	458	616	(26%)
Operation and Maintenance	98	97	1%
Depreciation and Amortization	32	30	7%
Other Operating Expenses	27	31	(10%)
Total Operating Expenses	615	774	(20%)
Operating Income	$102	$107	(5%)
Throughput Data (in Bcf):			
Residential and Commercial Sales	126	137	(8%)
Industrial Sales	15	15	
Transportation	13	12	8%
Total Throughput	154	164	(6%)

Natural Gas Distribution operating income decreased $5 million in the first quarter of 1998 compared to pro forma operating income in the first quarter of 1997 due primarily to weather-related factors. This decrease in operating income is partially offset by the favorable impact of Arkla's charges associated with the applicable state regulatory commission's methodology of calculating the price of gas charged to customers (the purchased gas adjustment) in the first quarter of 1998 as compared to the first quarter of 1997.

Natural Gas Distribution operating revenue decreased $164 million for the first quarter of 1998 compared to pro forma operating revenue for the corresponding period of 1997 due principally to the warmer weather, which resulted in lower customer usage at Entex and Minnegasco, and a decrease in gas prices.

Operating expenses decreased $159 million in the first quarter of 1998 compared to pro forma operating expenses in the same period of 1997 due to the same factors that affected operating revenues as discussed above.

INTERSTATE PIPELINE

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

The following table provides summary data regarding the results of operations of Interstate Pipeline, including operating statistics, on an actual basis for the first quarter of 1998 and on a pro forma basis for the first quarter of 1997 (as if the acquisition of NorAm had occurred as of January 1, 1997).

	QUARTER ENDED MARCH 31,		
	1998 (ACTUAL)	1997 (PRO FORMA)	PERCENT CHANGE
	(in millions)		
Operating Revenues	$ 71	$ 84	(15%)
Operating Expenses:			
Natural Gas	8	11	(27%)
Operation and Maintenance	17	22	(23%)
Depreciation and Amortization	9	13	(31%)
Other Operating Expenses	5	3	67%
Total Operating Expenses	39	49	(20%)
Operating Income	$ 32	$ 35	(8%)
Throughput Data (in million MMBtu):			
Natural Gas Sales	4	5	(20%)
Transportation	237	250	(5%)
Elimination (1)	(4)	(4)	--
Total Throughput	237	251	(5%)

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(1) Elimination refers to volumes of natural gas both transported and sold by Interstate Pipeline and, therefore, excluded from total throughput.

Interstate Pipeline operating income decreased $3 million in the first quarter of 1998 compared to pro forma operating income in the first quarter of 1997 due primarily to non-recurring items occurring in the first quarter of 1997 and milder weather in the first quarter of 1998. These factors were partially offset by lower operating expenses in the first quarter of 1998.

Operating revenues for Interstate Pipeline decreased by $13 million for the first quarter of 1998 compared to pro forma operating revenues for the same period in 1997. The decrease in revenues is primarily due to $7 million of non-recurring transportation revenues recognized in the first quarter of 1997 upon completion of settlement negotiations with Arkla related to service provided in several of their operating jurisdictions. In addition, the decrease in revenues is also attributable to a reduction in natural gas volumes and decreased gas prices.

Operation and maintenance expenses decreased $5 million in the first quarter of 1998 compared to pro forma operation and maintenance expenses for the same period of 1997 primarily due to decreased maintenance due to milder weather and lower costs resulting from cost control initiatives.

Depreciation and amortization expenses decreased $4 million in the first quarter of 1998 in comparison to pro forma depreciation and amortization expenses for the same period of 1997 due to a $4.8 million rate settlement recorded in the first quarter of 1998. The rate settlement, effective January 1998, provided for a reduction of MRT's depreciation rates retroactive to July 1996.

ENERGY MARKETING

NorAm's energy marketing and gathering business (Energy Marketing) includes the operations of NorAm's wholesale and retail energy marketing businesses and natural gas gathering activities (conducted, respectively, by NorAm Energy Services, Inc. (NES), NorAm Energy Management, Inc. and NorAm Field Services Corp., three wholly owned subsidiaries of NorAm).

The following table provides summary data regarding the unaudited pro forma results of operations of Energy Marketing, including operating statistics, on an actual basis for the first quarter of 1998 and on a pro forma basis for the first quarter of 1997 (as if the acquisition of NorAm had occurred as of January 1, 1997).

	QUARTER ENDED MARCH 31,		PERCENT
	1998 (ACTUAL)	1997 (PRO FORMA)	CHANGE
	(in millions)		
Operating Revenues	$ 1,046	$ 1,045	--
Operating Expenses:			
Natural Gas and Purchased Power, net	1,009	1,023	(1%)
Operation and Maintenance	22	19	16%
Depreciation and Amortization	3	3	--
Other Operating Expenses	2	1	--
Total Operating Expenses	1,036	1,046	(1%)
Operating Income (loss)	$ 10	$ (1)	
Operations Data:			
Natural Gas (in Bcf):			
Sales	337	320	5%
Transportation	7	7	--
Gathering	58	60	(3%)
Total	402	387	4%
Electricity:			
Wholesale Power Sales (in thousand MWH)	13,770	4,584	200%

Energy Marketing operating income increased $11 million in the first quarter of 1998 in comparison to pro forma operating income for the same period in 1997. This increase is primarily attributed to hedging losses and losses from the sale of gas in 1997 partially offset by increased operating expenses in 1998 as discussed below. After adjusting for these prior losses, operating income decreased for the first quarter of 1998 by approximately $6 million compared to the same period in 1997, as explained below.

Operating Revenues. Operating revenues for Energy Marketing remained substantially unchanged because: (i) increases in natural gas volumes at NES were more than offset by decreases in the price of natural gas and (ii) substantial increases in wholesale power volumes (200%) offset gas sales declines at NES.

Operating Expenses. Operation and maintenance expenses increased $3 million when compared to pro forma operation expenses for the first quarter of 1997 largely due to increased staffing and marketing activities made in support of the increased sales and expanded marketing efforts at NES. Houston Industries believes that NES' energy marketing and risk management services have the potential of complementing Houston Industries' strategy of developing and/or acquiring unregulated generation assets in other markets. As a result, Houston Industries has made, and expects to continue to make, significant investments in developing NES' internal software, trading and personnel resources.

Natural gas and purchased power expense decreased $14 million in the first quarter of 1998 when compared to the first quarter of 1997 primarily due to the nonrecurrence of 1997 losses related to: (i) hedging losses associated with anticipated first quarter 1997 sales under peaking contracts and (ii) losses from the sale of natural gas held in storage and unhedged in the first quarter of 1997 totaling $17 million. Partially offsetting these losses were increased gas and electricity marketing activities. Excluding the 1997 hedging losses described above, natural gas and purchased power expenses increased $3 million, primarily attributable to approximately $2 million in losses on wholesale power sales.

To minimize fluctuations in the price of natural gas and transportation, NorAm, primarily through NES, enters into futures transactions, swaps and options in order to hedge against market price changes affecting (i) certain commitments to buy, sell and transport natural gas, (ii) existing gas storage inventory and (iii) certain anticipated transactions, some of which carry off-balance sheet risk. NES also enters into natural gas derivatives for trading purposes and electricity derivatives for hedging and trading purposes. For a discussion about NorAm's accounting treatment of derivative instruments, see Note 2 to NorAm's Form 10-K and Item 7A (Quantitative and Qualitative Disclosure About Market Risk) in Houston Industries' Form 10-K.

CORPORATE

NorAm's corporate and other business (Corporate) includes the operations of NorAm's unregulated retail services business, international operations, certain real estate investments, corporate costs and elimination of transactions between affiliated business units.

Corporate operating revenues increased $4 million and operating loss decreased $2 million in the first quarter of 1998 when compared to pro forma operating revenues and operating loss for the same period in 1997. The increased revenues and reduced operations loss were due to increased activities associated with NorAm's utility services and consumer services businesses and reduced corporate expenses.

NON-OPERATING INCOME AND EXPENSE

The increase of $7.6 million in income tax expense in comparison to pro forma income tax expense for the first quarter of 1997 is primarily due to the impact of higher state tax expense and miscellaneous other non-deductible items.

Reference is made to Note 5 of NorAm's Interim Financial Statements for a discussion of NorAm's short- and long-term debt.

NEW ACCOUNTING ISSUES

Reference is made to "Management's Discussion and Analysis of Financial Condition and Results of Operations of the Company -- New Accounting Issues" in Item 2 of Houston Industries' Form 10-Q, which has been jointly filed with the NorAm Form 10-Q, for a discussion of certain new accounting issues.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

For a description of legal proceedings affecting the Company and its subsidiaries, including NorAm, reference is made to Item 3 of the Company's Form 10-K, Notes 3 and 5 to the Company's Form 10-K and Note 8 to NorAm's Form 10-K, which information is incorporated herein by reference. For information regarding a franchise fee lawsuit pending against the Company, see Note 12(h) to the financial statements in the Company's Form 10-K. In December 1997, a similar lawsuit (pending in the 239th District Court, Brazoria County, Texas) was filed against NorAm by the City of Pearland, Texas, and similarly situated cities in Entex's service areas.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS.

On March 31, 1998, the Company sold 1,575 shares of its Series C Preference Stock, without par value, to Houston Industries FinanceCo II, LP, a limited partnership financing subsidiary of the Company, for $150,000,000. The transaction was exempt from registration under the Securities act of 1933, as amended, pursuant to Section 4(2) thereunder. For additional information regarding this transaction, see Note 6(d) to the Company's Form 10-Q.

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

(a) Exhibits.

Houston Industries Incorporated:

Exhibit 3 - Statement of Resolution Establishing Series of Shares designated Series C Preference Stock.

Exhibit 27 - Financial Data Schedule. (Houston Industries)

Exhibit 99(a) - Notes 1(c), 1(n), 2, 3, 4, 5 and 12 to the Company's Interim Financial Statements included on pages 64, 68, pages 69 through 77, and pages 92 through 94 of the Company's Form 10-K.

NorAm Energy Corp.:

Exhibit 27 - Financial Data Schedule (NorAm Energy).

Exhibit 99(a) - Notes 1(c), 2 and 8 to NorAm's Interim Financial Statements included on pages 116, 117 and pages 118 through 121, and pages 132 through 135 of NorAm's Form 10-K. (NorAm)

(b) Reports on Form 8-K.

Form 8-K of NorAm dated February 5, 1998. (Items 5 and 7)

SIGNATURE

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

HOUSTON INDUSTRIES INCORPORATED
(Registrant)

/s/ Mary P. Ricciardello

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

Date: May 14, 1998

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.

NORAM ENERGY CORP.
(Registrant)

/s/ Mary P. Ricciardello

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

Date: May 14, 1998

(a) Exhibits.

Houston Industries Incorporated:

Exhibit 3	-	Statement of Resolution Establishing Series of Shares designated Series C Preference Stock.
Exhibit 27	-	Financial Data Schedule (Houston Industries)
Exhibit 99(a)	-	Notes 1(c), 1(n), 2, 3, 4, 5 and 12 to the Company's Interim Financial Statements included on pages 64, 68, pages 69 through 77, and pages 92 through 94 of the Company's Form 10-K.

NorAm Energy Corp.:

Exhibit 27	-	Financial Data Schedule. (NorAm Energy)
Exhibit 99(a)	-	Notes 1(c), 2 and 8 to NorAm's Interim Financial Statements included on pages 116, 117 and pages 118 through 121, and pages 132 through 135 of NorAm's Form 10-K.

(b) Reports on Form 8-K.

EXHIBIT 3

STATEMENT OF RESOLUTION ESTABLISHING SERIES OF SHARES

designated

SERIES C PREFERENCE STOCK

of

HOUSTON INDUSTRIES INCORPORATED

Pursuant to Article 2.13D of
the Texas Business Corporation Act

Pursuant to the provisions of Article 2.13D of the Texas Business Corporation Act, the undersigned corporation submits the following statement for the purpose of establishing and designating a series of shares of its Preference Stock, without par value, designated "Series C Preference Stock" and fixing and determining the relative rights and preferences thereof:

1. The name of the corporation is HOUSTON INDUSTRIES INCORPORATED (the "Corporation").

2. The following resolution establishing and designating a series of shares and fixing and determining the relative rights and preferences thereof, was duly adopted by all necessary action on the part of the Corporation on March 27, 1998:

> RESOLVED, that pursuant to the authority vested in the Board of Directors of this Corporation in accordance with the provisions of the Restated Articles of Incorporation, a series of Preference Stock, without par value, of the Corporation be and hereby is created, and that the designation and number of shares thereof and the preferences, limitations and relative rights, including voting rights, of the shares of such series and the qualifications, limitations and restrictions thereof are as follows:

SERIES C PREFERENCE STOCK

1. Designation and Amount. There shall be a series of Preference Stock that shall be designated as "Series C Preference Stock," and the number of shares constituting such series shall be 1,575. Such number of shares may be increased or decreased by resolution of the Board of Directors; provided, however, that no decrease shall reduce the number of shares of Series C Preference Stock to less than the number of shares then issued and outstanding plus the number of shares issuable upon exercise of outstanding rights, options or warrants or upon conversion of outstanding securities issued by the Corporation.

2. Certain Defined Terms.

Capitalized terms not otherwise defined herein shall have the respective meanings ascribed to them in that certain Credit Agreement (the "Credit Agreement") to be entered into among Houston Industries FinanceCo II, LP, a Delaware limited partnership to be the Borrower thereunder, Houston Industries Incorporated, a Texas corporation, and the Bank(s) parties thereto, including Credit Suisse First Boston, as the Initial Bank thereunder, as in effect at the time of the initial funding thereunder, and as such terms may be amended in the Credit Agreement to the extent approved by the affirmative vote of the holders of two-thirds or more of the outstanding shares of Series C Preference Stock, voting separately as a class. In addition, the following terms are used herein as defined below:

(i) "Computed Dividend Portion" means, within any Dividend Interval Period, an amount equal to the interest expense accrued on the indebtedness for borrowed money of the Borrower from the prior Dividend Payment Date to the Determination Date for the current Dividend Interval Period.

(ii) "Determination Date" means the date occurring five Business Days prior to a Dividend Declaration Date.

(iii) "Dividend" means the dividend on the Series C Preference Stock declared by the Corporation's Board of Directors with respect to a Dividend Interval Period.

(iv) "Dividend Declaration Amount" means, as of any Determination Date, the Preliminary Dividend Amount, less the sum of (a) the Interest Reconciliation Amount, (b) the Support Agreement Reconciliation Amount, and (c) the Other Sources Reconciliation Amount. The Dividend Declaration Amount may be greater than or less than the Preliminary Dividend Amount.

(v) "Dividend Declaration Date" means the date on which Dividends on the Series C Preference Stock are declared (or would have been declared but for the fact that the amount of the Dividend determined in accordance herewith would have been zero) during a Dividend Interval Period by the Corporation's Board of Directors.

(vi) "Dividend Interval Period" means the period beginning on a Dividend Payment Date and extending to the next Dividend Payment Date.

(vii) "Dividend Payment Date" means the date occurring five Business Days after a Dividend Declaration Date.

(viii) "Interest Reconciliation Amount" means an amount equal to (a) the Preliminary Dividend Amount computed for the prior Dividend Interval Period, less (b) the actual interest expense accrued on the indebtedness for borrowed money of the Borrower during such period.

(ix) "Other Sources Reconciliation Amount" means the sum of (a) to the extent applied to pay interest on the indebtedness for borrowed money of the Borrower or available in cash on the current Determination Date therefor, the amount of income or cash proceeds received by the Borrower from sources other than pursuant to the Support Agreement (including, without limitation, interest received on loans to Affiliates), and (b) the cash proceeds of new borrowings under the Credit Agreement that are utilized to pay interest on outstanding borrowings thereunder, from the Determination Date occurring in the Prior Dividend Interval Period to the Determination Date occurring in the current Dividend Interval Period.

(x) "Preliminary Dividend Amount" means the sum of the Computed Dividend Portion and the Projected Dividend Portion.

(xi) "Projected Dividend Portion" means, within any Dividend Interval Period, an amount equal to the projected interest expense that will be accrued on the indebtedness for borrowed money of the Borrower from the Determination Date for such Dividend Interval Period to the Dividend Payment Date.

(xii) "Support Agreement Reconciliation Amount" means the amount of cash payments made pursuant to the Support Agreement by the Corporation to the Borrower from the Determination Date occurring in the immediately prior Dividend Interval Period to the Determination Date occurring in the current Dividend Interval Period.

3. Dividends and Distributions.

(A) Subject to the prior and superior rights of the holders of (i) any shares of any series of Preference Stock ranking prior and superior to the shares of Series C Preference Stock with respect to dividends and (ii) any shares of Preferred Stock, the holders of shares of Series C Preference Stock, in preference to the holders of shares of any class or series of stock of the Corporation ranking junior to the Series C Preference Stock, shall be entitled to receive the amounts set forth below, when, as and if declared by the Board of Directors in the manner described below out of assets of the Corporation legally available for the purpose:

(a) On every regularly scheduled meeting of the Corporation's Board of Directors while any shares of Series C Preference Stock remain outstanding, the Board of Directors shall declare an aggregate Dividend (if a positive amount) equal the lesser of (i) the Dividend Declaration Amount or (ii) the Excess Cash Flow projected to be available as of the applicable Dividend Payment Date with respect to the then current Dividend Interval Period.

(b) If, with respect to any Dividend Interval Period, the aggregate Dividend declared by the Corporation's Board of Directors is less than the Dividend Declaration Amount for such Dividend Interval Period because the Excess Cash Flow projected to be available as of the applicable Dividend Payment Date is less than the Dividend Declaration Amount, the amount of such deficiency shall be added to the Dividend Declaration Amount computed for the next Dividend Interval Period and such aggregate amount shall become the

Dividend Declaration Amount for such period. The Dividend for such succeeding Dividend Interval Period shall equal the Dividend Declaration Amount unless such amount would exceed the Excess Cash Flow projected to be available as of the applicable Dividend Payment Date, in which case the Dividend shall be the amount of the projected Excess Cash Flow.

(c) The aggregate Dividends paid on the shares of Series C Preference Stock in accordance with this Section 3(A) shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding.

(B) Accrued but unpaid dividends shall not bear interest. The Board of Directors may fix a record date for the determination of holders of shares of Series C Preference Stock entitled to receive payment of a dividend or distribution declared thereon.

4. Voting Rights. Except as otherwise required by law or the Restated Articles of Incorporation of the Corporation or as otherwise provided herein, the holders of shares of Series C Preference Stock shall have no voting rights.

5. Certain Restrictions. At any time when dividends or distributions payable on the Series C Preference Stock as provided in Section 3 are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series C Preference Stock outstanding shall have been paid in full, the Corporation shall not:

(i) declare dividends on, or redeem or purchase or otherwise acquire for consideration any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series C Preference Stock; or

(ii) declare dividends on any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up) with the Series C Preference Stock, except dividends declared ratably on the Series C Preference Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled.

6. Reacquired Shares. Any shares of Series C Preference Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of Preference Stock and may be reissued as part of a new series of Preference Stock to be created by resolution or resolutions of the Board of Directors, subject to any conditions and restrictions on issuance set forth herein.

7. Liquidation, Dissolution or Winding Up.

(A) Upon any liquidation (voluntary or otherwise), dissolution or winding up of the Corporation, no distribution shall be made to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series C Preference Stock unless, prior thereto, the holders of shares of Series C Preference Stock shall have received $100,000 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment (the "Series C Liquidation Preference"). Following the payment of the full amount of the Series C Liquidation Preference, no additional distributions shall be made to the holders of shares of Series C Preference Stock.

(B) In the event that there are not sufficient assets available to permit payment in full of the Series C Liquidation Preference and the liquidation preferences of all other series of Preference Stock, if any, that rank on a parity with the Series C Preference Stock, then such remaining assets shall be distributed ratably to the holders of such parity shares in proportion to their respective liquidation preferences.

(C) Neither the merger or consolidation of the Corporation into or with another corporation nor the merger or consolidation of any other corporation into or with the Corporation shall be deemed to be a liquidation, dissolution or winding up of the Corporation within the meaning of this Section 7, but the sale, lease or conveyance of all or substantially all of the Corporation's assets shall be deemed to be a liquidation, dissolution or winding up of the Corporation within the meaning of this Section 7.

8. Redemption.

(A) The Corporation, at its option, may redeem shares of the Series C Preference Stock in whole at any time and in part from time to time, at a redemption price equal to $100,000 per share, plus, in the event all outstanding shares of the Series C Preference Shares are to be redeemed, unpaid accumulated dividends to the date of redemption.

(B) In the event that fewer than all the outstanding shares of the Series C Preference Stock are to be redeemed, (i) the number of shares to be redeemed shall be determined by the Board of Directors and the shares to be redeemed shall be determined by lot or pro rata as may be determined by the Board of Directors or by any other method that may be determined by the Board of Directors in its sole discretion to be equitable.

(C) Except to the extent notice is waived in accordance with applicable law, notice of any such redemption shall be given by mailing to the holders of the shares of Series C Preference Stock to be redeemed a notice of such redemption, first class postage prepaid, not later than the twentieth day and not earlier than the sixtieth day before the date fixed for redemption, at their last address as the same shall appear upon the books of the Corporation. Each such notice shall state: (i) the redemption date; (ii) the number of shares to be redeemed and, if fewer than all the shares held by such holder are to be redeemed, the number of such shares to be redeemed from such holder; (iii) the redemption price; (iv) the place or places where certificates for such shares are to be surrendered for payment of the redemption price; and (v) that dividends on the shares to be redeemed will cease to accrue on the close of business on such redemption date. Any notice that is mailed in the manner herein provided shall be conclusively presumed to have been duly given, whether or not the shareholder received such notice, and failure duly to give such notice by mail, or any defect in such notice, to any holder of Series C Preference Stock shall not affect the validity of the proceedings for the redemption of any other shares of Series C Preference Stock that are to be redeemed. On or after the date fixed for redemption as stated in such notice, each holder of the shares called for redemption shall surrender the certificate evidencing such shares to the Corporation at the place designated in such notice and shall thereupon be entitled to receive payment of the redemption price. If fewer than all the shares represented by any such surrendered certificate are redeemed, a new certificate shall be issued representing the unredeemed shares.

(D) The shares of Series C Preference Stock shall not be subject to the operation of any purchase, retirement or sinking fund.

9. Ranking. The Series C Preference Stock shall rank junior to all series of the Corporation's Preferred Stock and pari passu with all other series of the Corporation's Preference Stock (other than any such series of Preference Stock the terms of which shall provide otherwise) in respect to dividend and liquidation rights and shall rank senior to the Common Stock as to such matters.

10. Amendment. At any time that any shares of Series C Preference Stock are outstanding, the Restated Articles of Incorporation of the Corporation shall not be amended in any manner which would materially alter or change the powers, preferences or special rights of the Series C Preference Stock so as to affect them adversely without the affirmative vote of the holders of two-thirds or more of the outstanding shares of Series C Preference Stock, voting separately as a class.

11. Fractional Shares. Series C Preference Stock may be issued in fractions of a share that shall entitle the holder, in proportion to such holder's fractional shares, to exercise any voting rights, receive dividends, participate in distributions and to have the benefit of all other rights of holders of Series C Preference Stock.

IN WITNESS WHEREOF, HOUSTON INDUSTRIES INCORPORATED has caused this Statement to be executed on its behalf by the undersigned officer this 27th day of March, 1998.

HOUSTON INDUSTRIES INCORPORATED

/s/ Marc Kilbride

Name: Marc Kilbride
Title: Treasurer

UT
0000048732
HOUSTON INDUSTRIES INCORPORATED

3-MOS
DEC-31-1998
MAR-31-1998
PER-BOOK
9,702,717
3,240,341
1,514,373
3,894,451
0
18,351,882
2,888,732
0
1,875,213
4,763,945
0
9,740
5,874,889
0
451,700
1,286,304
707,269
0
15,364
1,152
5,241,519
18,351,882
2,636,712
3,575
2,355,743
2,355,743
280,969
(171,793)
109,176
136,841
(31,240)
97
(31,337)
106,505
87,612
424,069
(0.11)
(0.11)

UT
0001042773
NORAM ENERGY CORP.

3-MOS
DEC-31-1998
MAR-31-1998
PER-BOOK
1,308,159
1,427,535
1,019,509
2,220,877
0
5,976,080
1
2,459,576
81,453
2,541,030
0
0
1,226,461
0
300,000
0
230,590
0
0
0
1,677,999
5,976,080
1,759,931
56,353
1,618,360
1,618,360
141,571
2,556
144,127
26,900
60,606
0
60,606
0
26,900
177,438
0
0

These and other pro forma results appearing in this Form 10-K are based on assumptions deemed appropriate by the Company's management, have been prepared for informational purposes only and are not necessarily indicative of the combined results that would have resulted had the Merger occurred at the beginning of the 1996 and 1997 reporting periods presented. Purchase related adjustments to results of operations include amortization of goodwill and the effects on depreciation, amortization, interest expense and deferred income taxes of the revaluation, on a preliminary basis, of the fair value of certain NorAm assets and liabilities.

As a result of the Merger, the Company has organized its financial reporting into the following segments: Electric Operations, Natural Gas Distribution, Interstate Pipeline, Energy Marketing, International and Corporate. For segment information, see Note 15.

(c) Regulatory Assets and Other Long-Lived Assets.

The Company and certain subsidiaries of NorAm apply the accounting policies established in SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," to the accounts of Electric Operations, Natural Gas Distribution and the Interstate Pipeline operations of MRT. In general, SFAS No. 71 permits a company with cost-based rates to defer certain costs that would otherwise be expensed to the extent that the rate regulated company is recovering or expects to recover such costs in rates charged to its customers.

The following is a list of regulatory assets and liabilities reflected on the Company's Consolidated Balance Sheet as of December 31, 1997, detailed by Electric Operations and other segments.

	ELECTRIC OPERATIONS	OTHER	TOTAL COMPANY
	(MILLIONS OF DOLLARS)		
Deferred plant costs -- net	$ 562		$ 562
Recoverable project costs -- net	78		78
Regulatory tax asset -- net	357		357
Unamortized loss on reacquired debt	127		127
Deferred debits	71	$48	119
Accumulated deferred income taxes -- regulatory tax asset	(99)		(99)
Total	$1,096	$48	$1,144

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

Effective January 1, 1996, the Company and NorAm adopted SFAS No. 121. SFAS No. 121 requires that long-lived assets and certain identifiable intangibles to be held and used or disposed of by an entity be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Adoption of the standard did not result in a write-down of the carrying amount of any asset on the books of the Company or NorAm.

In July 1997, the Emerging Issues Task Force (EITF) of the FASB reached a consensus on Issue No. 97-4, "Deregulation of the Pricing of Electricity -- Issues Related to the Application of FASB Statements No. 71, Accounting for the Effects of Certain Types of Regulation, and No. 101, Regulated Enterprises -- Accounting for the Discontinuation of Application of FASB Statement No. 71" (EITF 97-4). EITF 97-4 concluded that the application of SFAS No. 71 to a segment which is subject to a deregulation reporting period, the options' exercise prices were greater than the average market price of the common shares of $21.875 and would thus be anti-dilutive if conversion were assumed.

(k) Statements of Consolidated Cash Flows.

For purposes of reporting cash flows, cash equivalents are considered to be short-term, highly liquid investments readily convertible to cash.

(l) Derivative Financial Instruments (Risk Management).

For information regarding the Company's accounting for derivative financial instruments associated with its subsidiaries' natural gas, electric power and transportation risk management activities, see Note 2.

(m) Income Taxes.

The Company and its subsidiaries file a consolidated federal income tax return. The Company follows a policy of comprehensive interperiod income tax allocation. Investment tax credits were deferred and are being amortized over the estimated lives of the related property. For additional information regarding income taxes, see Note 11.

(n) Investments in Time Warner Securities.

The Company owns 11 million shares of non-publicly traded Time Warner convertible preferred stock (TW Preferred). The TW Preferred is redeemable after July 6, 2000, has an aggregate liquidation preference of $100 per share (plus accrued and unpaid dividends), is entitled to annual dividends of $3.75 per share until July 6, 1999, is currently convertible by the Company and after July 6, 1999 is exchangeable by Time Warner into approximately 22.9 million shares of Time Warner common stock. Each share of preferred stock is entitled to two votes (voting together with the holders of the Time Warner common stock as a single class).

The Company has recorded its investment in these securities at a value of $990 million on the Company's Consolidated Balance Sheets. Investment in the TW Preferred is accounted for under the cost method. Dividends on these securities are recognized as income at the time they are earned. The Company recorded pre-tax dividend income with respect to the Time Warner securities of $41.3 million, $41.6 million and $20.1 million in 1997, 1996 and 1995, respectively.

To monetize its investment in the TW Preferred, the Company sold in July 1997, 22.9 million of its unsecured 7% ACES. For additional information about the offering of ACES, see Note 8(e). As a result of the issuance of the ACES, a portion of the increase in the market value above $55.5844 per share of Time Warner common stock (the security into which the TW Preferred is convertible) results in unrealized accounting losses to the Company for the ACES, pending the conversion of the Company's TW Preferred into Time Warner common stock. For example, prior to the conversion of the TW Preferred into Time Warner common stock, when the market price of Time Warner common stock increases above $55.5844, the Company records in Other Income (Expense) an accounting loss for the ACES equal to (i) the aggregate amount of such increase as applicable to all ACES multiplied by (ii) 0.8264. In accordance with generally accepted accounting principles, this accounting loss (which reflects the unrealized increase in the Company's indebtedness with respect to the ACES) may not be offset by accounting recognition of the increase in the market value of the Time Warner common stock that underlies the TW Preferred. Upon conversion of the TW Preferred, the Company will begin recording unrealized net changes in the market prices of the Time Warner common stock and the ACES as a component of common stock equity.

As of December 31, 1997, the market price of Time Warner common stock was $62.00 per share. Accordingly, the Company recognized an increase of $121 million in the unrealized liability relating to its ACES indebtedness (which resulted in an after-tax earnings reduction of $79 million or $.31 per share). The

Company believes that this unrealized loss for the ACES is more than economically hedged by the approximately $430 million unrecorded unrealized gain at December 31, 1997 relating to the increase in the fair value of the Time Warner common stock underlying the investment in TW Preferred since the date of its acquisition. As of February 28, 1998, the price of Time Warner common stock was $67.50 per share which would have resulted in the Company recognizing an additional increase of $104 million in the unrealized liability represented by its indebtedness under the ACES. The related unrecorded unrealized gain as of February 28, 1998 would have been computed as an additional $126 million.

(o) Investment in Other Debt and Equity Securities.

The securities held in the Company's nuclear decommissioning trust are classified as "available-for-sale" and, in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," (SFAS No. 115) are reported at estimated fair value of $92.9 million as of December 31, 1997 and $67 million as of December 31, 1996 on the Company's Consolidated Balance Sheets under deferred debits. The liability for nuclear decommissioning is reported on the Company's Consolidated Balance Sheets under deferred credits. Any unrealized gains or losses are accounted for in accordance with SFAS No. 71 as a regulatory asset/liability and reported on the Company's Consolidated Balance Sheets as a deferred debit/ credit.

The Company, through its subsidiary, NorAm, holds certain equity securities classified as "available-for-sale" and in accordance with SFAS No. 115 reports such investments at estimated fair values on the Company's Consolidated Balance Sheets as deferred debits and any unrealized gain or loss, net of tax, as a separate component of stockholders' equity. At December 31, 1997, the unrealized loss relating to these equity securities was approximately $5.6 million, net of tax.

(p) Discontinued Operations.

In July 1995, the Company sold KBLCOM, its cable television subsidiary. The Company's 1995 earnings include a one-time after-tax gain of $708 million related to the sale, which includes the net loss for discontinued operations of KBLCOM through the date of sale (July 6, 1995).

(q) Reclassifications and Use of Estimates.

Certain amounts from the previous years have been reclassified to conform to the 1997 presentation of financial statements. Such reclassifications do not affect earnings.

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

(r) Other.

For information regarding executive incentive compensation, pensions and other benefits, see Note 10.

(2) DERIVATIVE FINANCIAL INSTRUMENTS (RISK MANAGEMENT)

(a) Trading Activities.

The Company, through NES, a subsidiary of NorAm, offers price risk management services primarily in the natural gas and electric industries. NES provides these services through, and by utilizing, a variety of derivative financial instruments, including fixed-price swap agreements, variable-price swap agreements, exchange-traded energy futures and option contracts, and swaps and options traded in the over-the-counter financial markets. Fixed-price swap agreements require payments to, or receipts of payments from, counterparties based on the differential between a fixed and variable price for the commodity. Variable-price swap agreements require payments to, or receipts of payments from, counterparties based on the differential between either industry pricing publications or exchange quotations.

Certain trading transactions qualify for hedge accounting and accordingly unrealized gains and losses associated with these transactions are deferred. For trading transactions that do not qualify for hedge accounting, NES uses mark-to-market accounting. Accordingly, such financial instruments are recorded at fair value with realized and unrealized gains (losses) recorded as a component of operating revenues in the Company's Consolidated Statements of Income. The recognized, unrealized balance is recorded as a deferred debit on the Company's Consolidated Balance Sheets.

The notional quantities and maximum terms of derivative financial instruments held for trading purposes at December 31, 1997 are presented below (volumes in billions of British thermal units equivalent (Bbtue)):

	VOLUME-FIXED PRICE PAYOR	VOLUME-FIXED PRICE RECEIVER	MAXIMUM TERM (YEARS)
Natural gas	85,701	64,890	4
Electricity	40,511	42,976	1

In addition to the fixed-price notional volumes above, NES also has variable-price swap agreements, as discussed above, totaling 101,465 Bbtue. Notional amounts reflect the volume of transactions but do not represent the amounts exchanged by the parties to the financial instruments. Accordingly, notional amounts do not accurately measure the Company's exposure to market or credit risks.

The estimated fair value of derivative financial instruments held for trading purposes at December 31, 1997 are presented below (dollars in millions):

	FAIR VALUE		AVERAGE FAIR VALUE(A)	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES
Natural gas	$46	$39	$56	$48
Electricity	$ 6	$ 6	$ 3	$ 2

- ---------------

(a) Computed using the ending balance of each month.

Substantially all of the fair value shown in the table above at December 31, 1997 has been recognized in income. The fair value as of and for the year ended December 31, 1997 was estimated using quoted prices where available and considering the liquidity of the market for the derivative financial instruments. The prices are subject to significant changes based on changing market conditions. The derivative financial instruments included in the NES trading portfolio as of and for the year ended December 31, 1996 were immaterial.

The weighted-average term of the trading portfolio, based on volumes, is less than one year. The maximum and average terms disclosed herein are not indicative of likely future cash flows as these positions may be changed by new transactions in the trading portfolio at any time in response to changing market conditions, market liquidity and the Company's risk management portfolio needs and strategies. Terms regarding cash settlements of these contracts vary with respect to the actual timing of cash receipts and payments.

(b) Non-Trading Activities.

To reduce the risk from market fluctuations in the price of electric power, natural gas and related transportation, NorAm and certain of its subsidiaries enter into futures transactions, swaps and options (Energy Derivatives) in order to hedge certain natural gas in storage, as well as certain expected purchases, sales and transportation of natural gas and electric power (a portion of which are firm commitments at the inception of the hedge). Energy Derivatives are also utilized to fix the price of compressor fuel or other future operational gas requirements, although usage to date for this purpose has not been material. Usage of electricity derivative financial instruments by the Company and its subsidiaries for purposes other than trading is immaterial.

Certain subsidiaries of the Company also utilize interest-rate derivatives (principally interest-rate swaps) in order to adjust the portion of its overall borrowings which are subject to interest-rate risk, and also utilize such derivatives to effectively fix the interest rate on debt expected to be issued for refunding purposes.

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

In the case of interest-rate swaps associated with existing obligations, cash flows and expenses associated with the interest-rate derivative transactions are matched with the cash flows and interest expense of the obligation being hedged, resulting in an adjustment to the effective interest rate. When interest rate swaps are utilized to effectively fix the interest rate for an anticipated debt issuance, changes in the market value of the interest-rate derivatives are deferred and recognized as an adjustment to the effective interest rate on the newly issued debt.

Unrealized changes in the market value of Energy Derivatives utilized as hedges are not generally recognized in the Company's Consolidated Statements of Income until the underlying hedged transaction occurs. Once it becomes probable that an anticipated transaction will not occur, deferred gains and losses are recognized. In general, the financial impact of transactions involving these Energy Derivatives is included in the Company's Statement of Consolidated Income under the captions (i) fuel expenses, in the case of natural gas transactions, and (ii) purchased power, in the case of electric power transactions. Cash flows resulting from these transactions in Energy Derivatives are included in the Company's Statements of Consolidated Cash Flows in the same category as the item being hedged.

At December 31, 1997, subsidiaries of NorAm were fixed-price payors and fixed-price receivers in Energy Derivatives covering 38,754 Bbtu and 7,647 Bbtu of natural gas, respectively. Also, at December 31, 1997 subsidiaries of NorAm were parties to variable-priced Energy Derivatives totaling 3,630 Bbtu of natural gas. The weighted average maturity of these instruments is less than one year.

The notional amount is intended to be indicative of the Company and its subsidiaries' level of activity in such derivatives, although the amounts at risk are significantly smaller because, in view of the price movement correlation required for hedge accounting, changes in the market value of these derivatives generally are offset by changes in the value associated with the underlying physical transactions or in other derivatives. When Energy Derivatives are closed out in advance of the underlying commitment or anticipated transaction, however, the market value changes may not offset due to the fact that price movement correlation ceases to exist when the positions are closed as further discussed below. Under such circumstances, gains (losses) are deferred and recognized as a component of income when the underlying hedged item is recognized in income.

The average maturity discussed above and the fair value discussed in Note 13 are not necessarily indicative of likely future cash flows as these positions may be changed by new transactions in the trading portfolio at any time in response to changing market conditions, market liquidity and the Company's risk management portfolio needs and strategies. Terms regarding cash settlements of these contracts vary with respect to the actual timing of cash receipts and payments.

(c) Trading and Non-trading -- General Policy.

In addition to the risk associated with price movements, credit risk is also inherent in the Company and its subsidiaries' risk management activities. Credit risk relates to the risk of loss resulting from non-performance of contractual obligations by a counterparty. While, as yet, the Company and its subsidiaries have experienced no significant losses due to the credit risk associated with these arrangements, the Company has off-balance sheet risk to the extent that the counterparties to these transactions may fail to perform as required by the terms of each such contract. In order to minimize this risk, the Company and/or its subsidiaries, as the case may be, enter into such contracts primarily with those counterparties with a minimum Standard & Poor's or Moody's rating of BBB- or Baa3, respectively. For long-term arrangements, the Company and its subsidiaries periodically review the financial condition of such firms in addition to monitoring the effectiveness of these financial contracts in achieving the Company's objectives. Should the counterparties to these arrangements fail to perform, the Company would seek to compel performance at law or otherwise, or obtain compensatory damages in lieu thereof. The Company might be forced to acquire alternative hedging arrangements or be required to honor the underlying commitment at then current market prices. In such event, the Company might incur additional loss to the extent of amounts, if any, already paid to the counterparties. In view of its criteria for selecting counterparties, its process for monitoring the financial strength of these counterparties and its experience to date in successfully completing these transactions, the Company believes that the risk of incurring a significant financial statement loss due to the non-performance of counterparties to these transactions is minimal.

The Company's policies prohibit the use of leveraged financial instruments.

The Company has established a Risk Oversight Committee to oversee all corporate price and credit risk, including NES' risk management and trading activities. The Risk Oversight Committee's responsibilities include reviewing the Company and its subsidiaries' overall risk management strategy and monitoring risk management activities to ensure compliance with the Company's risk management limitations, policies and procedures.

(3) RATE MATTERS

(a) Electric Proceedings.

The Texas Utility Commission has original (or in some cases appellate) jurisdiction over Electric Operations' electric rates and services. Texas Utility Commission orders may be appealed to a District Court in Travis County, and from that court's decision an appeal may be taken to the Court of Appeals for the 3rd District at Austin (Austin Court of Appeals). Discretionary review by the Supreme Court of Texas may be sought from decisions of the Austin Court of Appeals. In the event that the courts ultimately reverse actions of the Texas Utility Commission, such matters are remanded to the Texas Utility Commission for action in light of the courts' orders.

(b) Transition and Price Reduction Plan.

In 1997, the Texas legislature considered but did not pass legislation intended to address various issues concerning the restructuring of the electric utility industry, including proposals that would permit Texas retail electric customers to choose their own electric suppliers beginning on December 31, 2001. The legislative proposals included provisions relating to full stranded cost recovery; rate reductions; rate freezes; the unbundling of generation operations, transmission and distribution and customer service operations; securitization of regulatory assets; and consumer protections. Although the Company and certain other parties (including the Texas Utility Commission) supported the bill, it was not enacted prior to the expiration of the legislative session.

In October 1997, the Company announced a proposed transition to competition plan intended to address certain aspects of the proposals contained in the legislation formerly pending before the Texas legislature. By mid December 1997, negotiations resulted in a settlement agreement (Settlement Agreement) executed by the Company, the staffs of the Texas Utility Commission and the City of Houston, representatives of the state's principal consumer and industrial groups and others. The Settlement Agreement was subsequently filed with the Texas Utility Commission, where it is currently under consideration.

Under the terms of the Settlement Agreement, residential customers will receive a 4% credit to the base cost of electricity in 1998, increasing to 6% in 1999. Small and mid-sized businesses will receive a 2% credit to their base costs beginning in 1998. The combined effect of these reductions is expected to decrease base revenues by $166 million over a two year period. In addition, the Company (over the next two years) will be permitted, as a way to assist the Company in mitigating its potentially stranded costs, to (i) redirect to production property all of its current depreciation expenses that would otherwise be credited to accumulated depreciation for transmission and distribution property, and (ii) apply any and all earnings above a rate of return cap of 9.95% to increase the depreciation of production property. The Company estimates that redirected depreciation over the two-year period of 1998 and 1999 will be approximately $364 million. As part of the Settlement Agreement, the Company agreed to support proposed legislation in the 1999 Texas legislative session that includes provisions providing for retail customer choice effective December 31, 2001 and other provisions consistent with those in the 1997 proposed legislation.

The Settlement Agreement is currently under consideration by the Texas Utility Commission, the City of Houston and other cities served by HL&P. In December 1997, the Texas Utility Commission approved the petition filed by the Company to implement the requested base rate credits on a temporary basis beginning January 1, 1998, and pending final Texas Utility Commission consideration. The approval also included the accounting order necessary to permit the Company to begin redirecting depreciation from its transmission and distribution facilities to production property on a temporary basis pending final Texas Utility Commission consideration. A procedural schedule has been developed by the Texas Utility Commission whereby a final decision regarding the Settlement Agreement would be reached by the end of March 1998.

(c) 1995 Rate Case.

In August 1995, the Texas Utility Commission unanimously approved a settlement resolving the Company's most recent rate case (Docket No. 12065) as well as a separate proceeding (Docket No. 13126) regarding the prudence of operation of the South Texas Project.

See Note 1(f) regarding additional depreciation and amortization that is permitted under the 1995 Rate Case Settlement with respect to the South Texas Project and the Company's investment in certain lignite reserves associated with a canceled generating station.

(d) Docket No. 6668.

In September 1997, the Company received a judgment dismissing all outstanding appeals of the Texas Utility Commission's order in Docket No. 6668, an inquiry into the prudence of the planning and construction of the South Texas Project. In that order, the Texas Utility Commission had determined that $375.5 million of the Company's $2.8 billion investment in the South Texas Project had been imprudently incurred. That ruling was incorporated into Electric Operations' 1988 and 1991 rate cases. As a result of this judgment, all outstanding appeals of prior rate cases involving the Company have now been dismissed and the orders granted in such cases are now final.

(4) JOINTLY OWNED ELECTRIC UTILITY PLANT

(a) Investment in South Texas Project.

The Company has a 30.8% interest in the South Texas Project, which consists of two 1,250 MW nuclear generating units, and bears a corresponding 30.8% share of capital and operating costs associated with the project. As of December 31, 1997, the Company's investment in the South Texas Project was $1.8 billion (net of $714 million accumulated depreciation). The Company's investment in nuclear fuel (including AFUDC) was $51 million (net of $205 million amortization) as of such date.

Effective November 1997, the Company and the other three owners of the South Texas Project completed the transfer of the Company's responsibilities for operation of the South Texas Project to a new Texas non-profit corporation formed by the four owners and known as the STP Nuclear Operating Company (STPNOC). STPNOC was formed exclusively for the purpose of operating the South Texas Project, and the Company's officers and employees who had been responsible for day-to-day operation and management of the South Texas Project were transferred to the operating company in October, 1997 and the related employee benefit obligations were transferred in December, 1997. The operating company is managed by a board of directors composed of one director from each of the four owners, along with the chief executive officer of STPNOC. Formation of STPNOC did not affect the underlying ownership of the South Texas Project, which continues as a tenancy in common among the four owners, with each owner retaining its undivided ownership interest in the two nuclear-fueled generating units and the electrical output from those units. The four owners continue to provide overall oversight of the operations of the South Texas Project through an owners' committee composed of representatives of each of the owners and through the board of directors of STPNOC.

(b) 1996 Settlement of South Texas Project Litigation.

In 1996, the Company recorded an aggregate $95 million ($62 million net of tax) charge in connection with various settlements of lawsuits filed by co-owners of the South Texas Project. The formation of STPNOC by the four co-owners (including the Company) of the South Texas Project was contemplated by these settlements. For information about the execution of an operations agreement with the City of San Antonio in connection with one of these settlements, see Note 12(c).

(c) Nuclear Insurance.

The Company and the other owners of the South Texas Project maintain nuclear property and nuclear liability insurance coverage as required by law and periodically review available limits and coverage for additional protection. The owners of the South Texas Project currently maintain $2.75 billion in property damage insurance coverage, which is above the legally required minimum, but is less than the total amount of insurance currently available for such losses. This coverage consists of $500 million in primary property damage insurance and excess property insurance in the amount of $2.25 billion. With respect to excess property insurance, the Company and the other owners of the South Texas Project are subject to assessments, the maximum aggregate assessment under current policies being $11.5 million during any one policy year. The application of the proceeds of such property insurance is subject to the priorities established by the Nuclear Regulatory Commission (NRC) regulations relating to the safety of licensed reactors and decontamination operations.

Pursuant to the Price Anderson Act (Act), the maximum liability to the public of owners of nuclear power plants, such as the South Texas Project, was $8.72 billion as of December 1997. 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 $79.3 million per reactor, subject to indexing for inflation, a possible 5% surcharge (but no more than $10 million per reactor per incident in any one year) and a 3% state premium tax. The Company 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 the Company's financial condition and results of operations.

(d) Nuclear Decommissioning.

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

(e) Assessment Fees for Spent Fuel Disposal and Enrichment and Decommission

By contract, the United States Department of Energy (DOE) has committed itself ultimately to take possession of all spent fuel generated by the South Texas Project. The DOE contract currently requires payment of a spent fuel disposal fee on nuclear plant-generated electricity of one mill (one-tenth of a cent) per net KWH sold. This fee is subject to adjustment to ensure full cost recovery by the DOE. The Energy Policy Act also includes a provision that assesses a fee upon domestic utilities that purchased nuclear fuel enrichment services from the DOE before October 24, 1992. The South Texas Project's assessment is approximately $2 million per year (subject to escalation for inflation). The Company has a remaining estimated liability of $5.5 million for such assessments.

(5) EQUITY INVESTMENTS IN FOREIGN AFFILIATES

HI Energy, a wholly owned subsidiary of the Company formed in 1993, participates primarily in the development and acquisition of foreign independent power projects and the privatization of foreign generating and distribution companies.

The Company accounts for affiliate investments of its subsidiaries under the equity method of accounting where: (i) the subsidiary's ownership interest in the affiliate ranges from 20% to 50%, (ii) the ownership interest is less than 20% but the subsidiary exercises significant influence over operating and financial policies of such affiliate or (iii) the subsidiary's ownership interest in the affiliate exceeds 50% but the subsidiary does not exercise control over the affiliate. The Company's proportionate share of the equity in net income in these affiliates for the years ended December 31, 1997, 1996 and 1995 was $48.6 million, $17 million and $.5 million, respectively, which amounts are included on the Company's Statements of Consolidated Income in Revenues -- International.

The Company's and its subsidiaries' equity investments in foreign and non-regulated affiliates at December 31, 1997 and 1996 were $704 million and $502 million, respectively.

(a) Acquisitions.

In May 1996, a subsidiary of HI Energy acquired 11.35% of the common stock of Light, a publicly held Brazilian corporation, for $393 million which includes the direct costs of the acquisition. Light is the operator under a 30-year concession agreement of an integrated electric power and distribution system that serves a portion of the state of Rio de Janeiro, Brazil, including the city of Rio de Janeiro. The winning bidders in the government-sponsored auction of Light, including a subsidiary of HI Energy, formed a consortium whose aggregate ownership interest of 50.44% represents a controlling interest in Light.

In June 1997, a consortium of investors which included a subsidiary of HI Energy, acquired for $496 million a 56.7% controlling ownership interest in Empresa de Energia del Pacifico S.A.E.S.P. (EPSA), an electric utility system serving the Valle de Cauca region of Colombia, including the area surrounding the city of Cali. HI Energy contributed $152 million of the purchase price for a 28% ownership interest in EPSA. In addition to its distribution facilities, EPSA owns 850 MW of electric generation capacity.

In May 1997, HI Energy increased its indirect ownership interest in Empresa de la Plata S.A. (EDELAP), an Argentina electric utility, from 48% to 63%. The purchase price of the additional interest was $28 million. HI Energy has recorded its investment in EDELAP using the equity method because of the significance of the participatory rights held by a minority shareholder.

HI Energy has accounted for these transactions under purchase accounting and has recorded its investments and its interest in the affiliates' earnings after the acquisition dates using the equity method. The purchase prices were allocated on the basis of the estimated fair market values of the assets acquired and the liabilities assumed as of the dates of acquisition. The differences between the amounts paid and the underlying fair values of the net assets acquired are being amortized as a component of earnings attributable to unconsolidated affiliates over the estimated lives of the projects ranging from 30 to 40 years. Purchase price adjustments to fixed assets are being amortized over the underlying assets' estimated useful lives.

(b) Valuation Allowance.

HI Energy is an investor in two waste tire-to-energy projects in the State of Illinois. The projects had been developed by HI Energy in reliance upon a state subsidy intended to encourage development of energy project facilities for the disposal of solid waste. In March 1996, the State of Illinois repealed the subsidy. As a result of the loss of the subsidy, the Company recorded (i) a $28 million valuation allowance effective in the fourth quarter of 1995 (resulting in an $18 million after-tax charge in that year) and (ii) an additional $8 million valuation allowance in the first quarter of 1996 (resulting in a $5 million after-tax charge in that year). At the time of the Illinois legislature's actions, construction work on one of the waste-to-energy projects had been substantially completed.

The valuation allowance reflects the combined amounts lent to the projects on a subordinated basis by HI Energy. HI Energy also is a party to two separate note purchase agreements committing it, under certain circumstances, to lend up to an additional $16 million. The Company has entered into a support agreement to enable HI Energy to honor its obligation under these note purchase agreements. In the Company's opinion, it is unlikely that additional loans would be required to be made under the note purchase agreements relating to the facility for which construction had been substantially completed (Ford Heights Project). In March 1996, a subsidiary of HI Energy purchased from a senior lending bank all notes relating to the project for which construction had not yet commenced (Fulton Project) (approximately $4.1 million). As a consequence, HI Energy has discretion over when, if ever, the construction activities for the Fulton project will resume and, in turn, control over future obligations of HI Energy to acquire additional subordinated notes for the Fulton project.

The Company and HI Energy are defendants in various lawsuits filed in connection with the Ford Heights Project. CGE Ford Heights, L.L.C., (CGE Ford Heights) the owner of the project, has filed for reorganization under Chapter 11 of the Federal Bankruptcy Code. In October 1997, CGE Ford Heights filed a lawsuit against First Trust National Association, HI Energy and Zurn Industries, Inc. (Zurn). CGE Ford Heights is seeking a determination of the funding obligations of HI Energy and Zurn. In addition, the trustee for the holders of the bonds issued to finance the project has filed suit against the Company, HI Energy and Zurn. The trustee alleges that the Company and HI Energy are obligated to contribute to CGE Ford Heights approximately $15 million in the form of subordinated debt obligations. The Company and HI Energy are vigorously contesting the matter. The Company does not believe that the litigation will have a material adverse impact on the Company's or HI Energy's financial statements.

(6) COMMON STOCK

At December 31, 1997, the Company had 282,875,266 shares of common stock issued and outstanding (out of a total of 700,000,000 authorized shares). At December 31, 1996, the number of shares of outstanding common stock of Former HI was 233,335,481.

Outstanding common shares excluded (i) shares pledged to secure a loan to the Company's Employee Stock Ownership Plan (12,388,551 and 13,370,939 at December 31, 1997 and 1996, respectively) and (ii) treasury shares (93,459 and 16,042,027 at December 31, 1997 and 1996, respectively). Treasury shares at December 31, 1996 represent shares purchased under a common stock repurchase program prior to the Merger. In connection with the Merger, these treasury shares were canceled and retired in August 1997. At December 31, 1997, the Company held 93,459 shares, which shares were received from holders of Company stock options, who surrendered shares of Company stock as partial payment for the exercise price of their stock options.

In 1997, the Company paid four regular quarterly dividends aggregating $1.50 per share on its common stock pursuant to dividend declarations made in December 1996, March 1997, June 1997 and September 1997. In December 1997, the Company declared its regular quarterly dividend of $0.375 per share to be paid in March 1998. For information regarding certain restrictions on payments of dividends, see Note 8(c).

(7) PREFERRED AND PREFERENCE STOCK

(a) Preferred Stock.

At December 31, 1997, the Company had 10,000,000 authorized shares of preferred stock, of which 97,397 shares were outstanding. As of such date, the Company's only outstanding series of preferred stock was its $4.00 Preferred Stock. The $4.00 Preferred Stock pays an annual dividend of $4.00 per share, is redeemable at $105 per share and has a liquidation price of $100 per share.

In April 1997, the Company redeemed all remaining 257,000 shares of its $9.375 cumulative preferred stock pursuant to mandatory sinking fund requirements at a cost of $25.7 million, plus accrued dividends. In February 1997, the Company redeemed the following three series of its cumulative preferred stock at the redemption prices, plus accrued dividends, indicated:

SERIES	NUMBER OF SHARES	REDEMPTION PRICE PER SHARE
$6.72	250,000	$102.51
$7.52	500,000	$102.35
$8.12	500,000	$102.25

$6.4 million was recorded at the Acquisition Date. In addition, NorAm has approximately $58 million of federal alternative minimum tax credits which are available to reduce future federal income taxes payable, if any, over an indefinite period (although not below the tentative minimum tax otherwise due in any year), and approximately $2.6 million of state alternative minimum tax credits which are available to reduce future state income taxes payable, if any, through the year 2001.

(12) COMMITMENTS AND CONTINGENCIES

(a) Commitments.

The Company has various commitments for capital expenditures, fuel, purchased power, cooling water and operating leases. Commitments in connection with Electric Operations' capital program are generally revocable by the Company, subject to reimbursement to manufacturers for expenditures incurred or other cancellation penalties. The Company's and its subsidiaries' other commitments have various quantity requirements and durations. However, if these requirements could not be met, various alternatives are available to mitigate the cost associated with the contracts' commitments.

(b) Fuel and Purchased Power.

The Company is a party to several long-term coal, lignite and natural gas contracts which have various quantity requirements and durations. Minimum payment obligations for coal and transportation agreements are approximately $200 million in 1998, $203 million in 1999 and $177 million in 2000. Additionally, minimum payment obligations for lignite mining and lease agreements are approximately $9 million for 1998, $9 million for 1999 and $10 million for 2000. Minimum payment obligations for both natural gas purchase and storage contracts associated with Electric Operations are approximately $9 million annually in 1998, 1999 and 2000.

The Company also has commitments to purchase firm capacity from cogenerators of approximately $22 million in both 1998 and 1999. Texas Utility Commission rules currently allow recovery of these costs through Electric Operations' base rates for electric service and additionally authorize the Company to charge or credit customers through a purchased power cost recovery factor for any variation in actual purchased power costs from the cost utilized to determine its base rates. In the event that the Texas Utility Commission, at some future date, does not allow recovery through rates of any amount of purchased power payments, the two principal firm capacity contracts contain provisions allowing the Company to suspend or reduce payments and seek repayment for amounts disallowed.

(c) Operations Agreement with City of San Antonio.

As part of the settlement with the City of San Antonio, the Company entered into a 10-year joint operations agreement under which the Company and the City of San Antonio, acting through the City Public Service Board of San Antonio (CPS), share savings resulting from the joint dispatching of their respective generating assets in order to take advantage of each system's lower cost resources. Under the terms of the joint operations agreement entered into between CPS and Electric Operations, the Company has guaranteed CPS minimum annual savings of $10 million and a minimum cumulative savings of $150 million over the 10-year term of the agreement. Based on current forecasts and other assumptions regarding the combined operation of the two generating systems, the Company anticipates that the savings resulting from joint operations will equal or exceed the minimum savings guaranteed under the joint operating agreement. In 1996, savings generated for CPS' account for a partial year of joint operations were approximately $14 million. In 1997, savings generated for CPS' account for a full year of operation were approximately $22 million.

(d) Transportation Agreement.

NorAm had an agreement (the ANR Agreement) with ANR Pipeline Company (ANR) which contemplated a transfer to ANR of an interest in certain of NorAm's pipeline and related assets, representing capacity of 250 Mmcf/day, and pursuant to which ANR had advanced $125 million to the Company. The ANR Agreement has been restructured and, after refunds of $84 million through December 31, 1997, NorAm currently retains $41 million (recorded as a liability) in exchange for ANR's or its affiliates' use of 130 Mmcf/ day of capacity in certain of NorAm's transportation facilities. The level of transportation will decline to 100 Mmcf/day in the year 2003 with a refund of $5 million to ANR and the ANR Agreement will terminate in 2005 with a refund of the remaining balance.

(e) Lease Commitments.

The following table sets forth certain information concerning NorAm's obligations under operating leases:

Minimum Lease Commitments at December 31, 1997(1)

	(MILLIONS OF DOLLARS)
1998	$ 24
1999	19
2000	16
2001	15
2002	9
2003 and beyond	22
Total	$105

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

NorAm has a master leasing agreement which provides for the lease of vehicles, construction equipment, office furniture, data processing equipment and other property. For accounting purposes, the lease is treated as an operating lease. At December 31, 1997, NorAm had leased assets with a value of approximately $58.1 million under this lease with a basic term of one year. NorAm does not expect to lease additional property under this lease agreement.

Lease payments related to NorAm's master leasing agreement are included in the preceding table for only their basic term. Total rental expense for all leases since the Acquisition Date was approximately $15 million in 1997.

(f) Letters of Credit.

At December 31, 1997, NorAm had letters of credit incidental with its ordinary business operations totaling approximately $42 million under which NorAm is obligated to reimburse drawings, if any.

(g) Indemnity Provisions.

At December 31, 1997, NorAm has $11.4 million accounting reserve on the Company's Consolidated Balance Sheet in Other Deferred Credits for possible indemnity claims asserted in connection with its disposition of NorAm's former subsidiaries or divisions, including the sale of (i) Louisiana Intrastate Gas Corporation, a former NorAm subsidiary engaged in the intrastate pipeline and liquids extraction business; (ii) Arkla Exploration Company, a former NorAm subsidiary engaged in oil and gas exploration and production activities; and (iii) Dyco Petroleum Company, a former NorAm subsidiary engaged in oil and gas exploration and production.

(h) Other.

Electric Operations' service area is heavily dependent on oil, gas, refined products, petrochemicals and related businesses. Significant adverse events affecting these industries would negatively affect the revenues of the Company. The Company and NorAm are involved in legal, tax and regulatory proceedings before various courts, regulatory commissions and governmental agencies regarding matters arising in the ordinary course of business, some of which involve substantial amounts. The Company's management regularly analyzes current information and, as necessary, provides accruals for probable liabilities on the eventual disposition of these matters. The Company's management believes that the effect on the Company's and NorAm's respective financial statements, if any, from the disposition of these matters will not be material.

In February 1996, the cities of Wharton, Galveston and Pasadena filed suit, for themselves and a proposed class, against the Company and Houston Industries Finance Inc. (formerly a wholly owned subsidiary of the Company) citing underpayment of municipal franchise fees. The plaintiffs claim, among other things, that from 1957 to the present, franchise fees should have been paid on sales taxes collected by HL&P on non-electric receipts as well as electric sales. Plaintiffs advance their claims notwithstanding their failure to notice such claims over the previous four decades. Because all of the franchise ordinances affecting HL&P expressly impose fees only on electric sales, the Company regards plaintiffs' allegations as spurious and is vigorously contesting the matter. The plaintiffs' pleadings assert that their damages exceed $250 million. No trial date is currently set. Although the Company believes the claims to be without merit, the Company cannot at this time estimate a range of possible loss, if any, from the lawsuit, nor can any assurance be given as to its ultimate outcome

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

depreciation and amortization as of the Acquisition Date and (6) the recognition of the associated deferred income tax effects. In addition, NorAm's pre-merger common stock was canceled and replaced with 1,000 shares of common stock (all of which are owned by Houston Industries), rendering presentation of per share data no longer meaningful. Houston Industries' debt to fund the cash portion of the purchase consideration has not been allocated or "pushed down" to NorAm and is not reflected on NorAm's Financial Statements.

NorAm's Statements of Consolidated Income for periods after the Acquisition Date are principally affected by (1) the amortization (over 40 years) of the newly-recognized goodwill, partially offset by the elimination of the amortization of NorAm's historical goodwill, (2) the amortization (to interest expense) of the revaluation of long-term debt, (3) the removal of the amortization (to operating expense) previously associated with the pension and postretirement obligations as described preceding and (4) the deferred income tax expense associated with these adjustments. Interest expense on Houston Industries' debt which was used to fund the cash portion of the acquisition has not been allocated or "pushed down" to NorAm and is not reflected on NorAm's Financial Statements. For these reasons, among others, certain financial information for periods before and after the Acquisition Date is not comparable.

If the Merger had occurred on January 1, 1997 and 1996, NorAm's unaudited pro forma net income for 1997 and 1996 would have been $68.3 million and $76.9 million, respectively. Pro forma results are based on assumptions deemed appropriate by NorAm's management, have been prepared for informational purposes only and are not necessarily indicative of the results which would have resulted had the Merger actually taken place on the date indicated.

(c) Regulatory Assets and Regulation.

In general, NorAm's interstate pipelines are subject to regulation by the Federal Energy Regulatory Commission, while its natural gas distribution operations are subject to regulation at the state or municipal level. Historically, all of NorAm's rate-regulated businesses have followed the accounting guidance contained in Statement of Financial Accounting Standards (SFAS) No. 71, "Accounting for the Effects of Certain Types of Regulation" . NorAm discontinued application of SFAS No. 71 to NGT in 1992. As a result of the continued application of SFAS No. 71 to MRT and the natural gas distribution operations, NorAm's financial statements contain assets and liabilities which would not be recognized by unregulated entities.

At December 31, 1997 approximately $48 million in regulatory assets are reflected on NorAm's Consolidated Balance Sheet as deferred debits. These assets represent probable future revenue to NorAm associated with certain incurred costs as these costs are recovered through the rate making process. These costs are being recovered through rates over varying periods up to 40 years.

(d) Principles of Consolidation.

NorAm's Consolidated Financial Statements include the accounts of NorAm and its wholly owned subsidiaries (NorAm). All significant intercompany transactions and balances are eliminated in consolidation.

(e) Property, Plant and Equipment.

Property, plant and equipment have been revalued to estimated fair market value as of the Acquisition Date in accordance with the purchase method of accounting, and depreciated or amortized on a straight-line basis over their estimated useful lives; see Note 1(b) above. Prior to the Acquisition Date, such assets were carried at cost. Additions to and betterments of utility property are charged to property accounts at cost, while the costs of maintenance, repairs and minor replacements are charged to expense as incurred. Upon normal retirement of units of utility property, plant and equipment, the cost of such property, together with cost of removal less salvage, is charged to accumulated depreciation.

(f) Depreciation and Amortization Expense.

Goodwill, none of which is being recovered in regulated service rates, is amortized on a straight-line basis over 40 years. Approximately $29.9 million of goodwill was amortized during 1997. Of this amount, $21.6 million represents amortization related to the Merger and incurred during the period from the Acquisition Date through December 31, 1997. Goodwill amortization for 1996 was approximately $14.2 million. NorAm periodically compares the carrying value of its goodwill to the anticipated undiscounted future operating income from the businesses whose acquisition gave rise to the goodwill and, as yet, no impairment is indicated or expected. For additional information regarding the amortization of goodwill in connection with the Merger, see Note 1(b) above.

(g) Fuel Stock and Other Inventories.

Inventories principally follow the average cost method. Gas inventory (at average cost) was $63.7 million and $70.7 million at December 31, 1997 and 1996, respectively. All non-utility inventories held for resale are valued at the lower of cost or market.

(h) Revenues.

NorAm's rate-regulated divisions/subsidiaries bill customers on a monthly cycle billing basis. Revenues are recorded on an accrual basis, including an estimate for gas delivered but unbilled at the end of each accounting period.

(i) Statements of Consolidated Cash Flows.

For purposes of reporting cash flows, cash equivalents are considered to be short-term, highly liquid investments readily convertible into cash.

(j) Derivative Financial Instruments (Risk Management).

For information regarding NorAm's accounting for derivative financial instruments associated with natural gas, electric power and transportation risk management activities, see Note 2.

(k) Income Taxes.

Houston Industries files a consolidated federal income tax return, in which NorAm and its subsidiaries are included (as of the Acquisition Date). Houston Industries follows a policy of comprehensive interperiod income tax allocation. For additional information regarding income taxes, see Note 7.

(l) Investments in Marketable Equity Securities.

A subsidiary of NorAm holds certain equity securities classified as "available-for-sale" and, in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," reports such investments at estimated fair value with any unrealized gain or loss, net of tax, as a separate component of stockholders' equity. At December 31, 1997, NorAm's unrealized loss relating to these marketable equity securities was approximately $5.6 million, net of tax of $3.0 million.

(m) Reclassifications and Use of Estimates.

Certain amounts from the previous years have been reclassified to conform to the 1997 presentation of financial statements. Such reclassifications do not affect earnings.

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

(n) Early Retirement and Severance.

During the first quarter of 1996, NorAm instituted several early retirement and reorganization plans, pursuant to which a total of approximately 400 positions were eliminated resulting in expense for severance payments and enhanced retirement benefits reported as a non-recurring pre-tax charge of approximately $22.3 million (approximately $13.4 million after tax).

(o) Merger Transaction Costs.

"Merger transaction costs" include expenses associated with completion of the business combination with Houston Industries (see Note 1(b)), principally consisting of investment banking and legal fees.

(p) Allowance for Doubtful Accounts.

Accounts and notes receivable, principally customer as presented on NorAm's Consolidated Balance Sheets are net of an allowance for doubtful accounts of $15.3 million and $13.0 million at December 31, 1997 and 1996, respectively.

(q) Accounts Payable.

Certain of NorAm's cash balances reflect credit balances to the extent that checks written have not yet been presented for payment. Such balances included in accounts payable, principally trade on the NorAm Consolidated Balance Sheets were approximately $17.0 million and $53.5 million at December 31, 1997 and 1996, respectively.

(2) DERIVATIVE FINANCIAL INSTRUMENTS (RISK MANAGEMENT)

(a) Trading Activities.

NorAm, through NES, offers price risk management services primarily in the natural gas and electric industries. NES provides these services through, and by utilizing, a variety of derivative financial instruments, including fixed-price swap agreements, variable-price swap agreements, exchange-traded energy futures and option contracts, and swaps and options traded in the over-the-counter financial markets. Fixed-price swap agreements require payments to, or receipts of payments from, counterparties based on the differential between a fixed and variable price for the commodity. Variable-price swap agreements require payments to, or receipts of payments from, counterparties based on the differential between either industry pricing publications or exchange quotations.

Certain trading transactions qualify for hedge accounting and accordingly unrealized gains and losses associated with these transactions are deferred. For trading transactions that do not qualify for hedge accounting, NES uses mark-to-market accounting. Accordingly, such financial instruments are recorded at fair value with realized and unrealized gains (losses) recorded as a component of revenues in NorAm's Statements of Consolidated Income. The recognized, unrealized balance is recorded as a deferred debit on NorAm's Consolidated Balance Sheets.

NORAM ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (Continued)

The notional quantities and maximum terms of derivative financial instruments held for trading purposes at December 31, 1997 are presented below (volumes in billions of British thermal units equivalent (Bbtue)):

	VOLUME-FIXED PRICE PAYOR	VOLUME-FIXED PRICE RECEIVER	MAXIMUM TERM (YEARS)
Natural gas	85,701	64,890	4
Electricity	40,511	42,976	1

In addition to the fixed-price notional volumes above, NES also has variable-price swap agreements, as discussed above, totaling 101,465 Bbtue. Notional amounts reflect the volume of transactions but do not represent the amounts exchanged by the parties to the financial instruments. Accordingly, notional amounts do not accurately measure NorAm's exposure to market or credit risks.

The estimated fair value of derivative financial instruments held for trading purposes at December 31, 1997 are presented below (dollars in millions):

	FAIR VALUE		AVERAGE FAIR VALUE(A)	
	ASSETS	LIABILITIES	ASSETS	LIABILITIES
Natural gas	$46	$39	$56	$48
Electricity	$ 6	$ 6	$ 3	$ 2

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(a) Computed using the ending balance of each month.

Substantially all of the fair value shown in the table above at December 31, 1997 has been recognized in income. The fair value as of and for the year ended December 31, 1997 was estimated using quoted prices where available and considering the liquidity of the market for the derivative financial instruments. The prices are subject to significant changes based on changing market conditions. The derivative financial instruments included in the NES trading portfolio as of and for the year ended December 31, 1996 were immaterial.

The weighted-average term of the trading portfolio, based on volumes, is less than one year. The maximum and average terms disclosed herein are not indicative of likely future cash flows as these positions may be changed by new transactions in the trading portfolio at any time in response to changing market conditions, market liquidity and NorAm's risk management portfolio needs and strategies. Terms regarding cash settlements of these contracts vary with respect to the actual timing of cash receipts and payments.

(b) Non-Trading Activities.

To reduce the risk from market fluctuations in the price of electric power, natural gas and related transportation, NorAm and certain of its subsidiaries enter into futures transactions, swaps and options (Energy Derivatives) in order to hedge certain natural gas in storage, as well as certain expected purchases, sales and transportation of natural gas and electric power (a portion of which are firm commitments at the inception of the hedge). Energy Derivatives are also utilized to fix the price of compressor fuel or other future operational gas requirements, although usage to date for this purpose has not been material. Usage of electricity derivative financial instruments by NorAm and its subsidiaries for purposes other than trading is immaterial.

NorAm also utilizes interest-rate derivatives (principally interest-rate swaps) in order to adjust the portion of its overall borrowings which are subject to interest-rate risk, and also utilizes such derivatives to effectively fix the interest rate on debt expected to be issued for refunding purposes.

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

In the case of interest-rate swaps associated with existing obligations, cash flows and expenses associated with the interest-rate derivative transactions are matched with the cash flows and interest expense of the obligation being hedged, resulting in an adjustment to the effective interest rate. When interest rate swaps are utilized to effectively fix the interest rate for an anticipated debt issuance, changes in the market value of the interest-rate derivatives are deferred and recognized as an adjustment to the effective interest rate on the newly issued debt.

Unrealized changes in the market value of Energy Derivatives utilized as hedges are not generally recognized in NorAm's Statements of Consolidated Income until the underlying hedged transaction occurs. Once it becomes probable that an anticipated transaction will not occur, deferred gains and losses are recognized. In general, the financial impact of transactions involving these Energy Derivatives is included in NorAm's Statements of Consolidated Income under the caption natural gas and purchased power, net. Cash flows resulting from these transactions in Energy Derivatives are included in NorAm's Statements of Consolidated Cash Flows in the same category as the item being hedged.

At December 31, 1997, subsidiaries of NorAm were fixed-price payors and fixed-price receivers in Energy Derivatives covering 38,754 Bbtu and 7,647 Bbtu of natural gas, respectively. At December 31, 1996, subsidiaries of NorAm were fixed-price payors and fixed-price receivers in Energy Derivatives covering approximately 150,300 Bbtu and 66,500 Bbtu of natural gas, respectively. Also, at December 31, 1997, subsidiaries of NorAm were parties to variable-priced Energy Derivatives totaling 3,630 Bbtu of natural gas. The weighted average maturity of these instruments at December 31, 1997 and 1996, respectively, is less than one year.

NorAm has entered into options with various third parties which principally serve to limit the year-to-year escalation from January 1998 to April 1999 in the purchase price of gas which NorAm is committed to deliver to a distribution affiliate. These options, which covered 9,800 Bbtu and 2,400 Bbtu at December 31, 1997 and 1996, respectively, expired in January 1998 unexercised. NorAm previously established a reserve equal to its projected maximum exposure to losses during the term of this commitment and, accordingly, no impact on earnings is expected.

The notional amount is intended to be indicative of NorAm and its subsidiaries' level of activity in such derivatives, although the amounts at risk are significantly smaller because, in view of the price movement correlation required for hedge accounting, changes in the market value of these derivatives generally are offset by changes in the value associated with the underlying physical transactions or in other derivatives. When Energy Derivatives are closed out in advance of the underlying commitment or anticipated transaction, however, the market value changes may not offset due to the fact that price movement correlation ceases to exist when the positions are closed as further discussed below. Under such circumstances gains (losses) are deferred and recognized as a component of income when the underlying hedged item is recognized in income.

The average maturity discussed above and the fair value discussed in Note 10 are not necessarily indicative of likely future cash flows as these positions may be changed by new transactions in the trading portfolio at any time in response to changing market conditions, market liquidity and NorAm's risk management portfolio needs and strategies. Terms regarding cash settlements of these contracts vary with respect to the actual timing of cash receipts and payments.

(c) Trading and Non-trading -- General Policy.

In addition to the risk associated with price movements, credit risk is also inherent in NorAm and its subsidiaries' risk management activities. Credit risk relates to the risk of loss resulting from non performance of contractual obligations by a counterparty. While, as yet, NorAm and its subsidiaries have experienced no significant losses due to the credit risk associated with these arrangements, NorAm has off-balance sheet risk to the extent that the counterparties to these transactions may fail to perform as required by the terms of each such contract. In order to minimize this risk, NorAm and/or its subsidiaries, as the case may be, enter into such contracts primarily with those counterparties with a minimum Standard & Poor's or Moody's rating of BBB- or Baa3, respectively. For long-term arrangements, NorAm and its subsidiaries periodically review the financial condition of such firms in addition to monitoring the effectiveness of these financial contracts in achieving NorAm's objectives. Should the counterparties to these arrangements fail to perform, NorAm would seek to compel performance at law or otherwise, or obtain compensatory damages in lieu thereof. NorAm might be forced to acquire alternative hedging arrangements or be required to honor the underlying commitment at then-current market prices. In such event, NorAm might incur additional loss to the extent of amounts, if any, already paid to the counterparties. In view of its criteria for selecting counterparties, its process for monitoring the financial strength of these counterparties and its experience to date in successfully completing these transactions, NorAm believes that the risk of incurring a significant financial statement loss due to the non-performance of counterparties to these transactions is minimal.

NorAm's policies prohibit the use of leveraged financial instruments.

Houston Industries has established a Risk Oversight Committee that oversees all price and credit risk, including NES's risk management and trading activities. The Risk Oversight Committee's responsibilities include reviewing NorAm's overall risk management strategy and monitoring risk management activities to ensure compliance with Houston Industries' risk management limitations, policies and procedures.

(3) CAPITAL STOCK

(a) Earnings Per Share.

As a result of the Merger, NorAm is no longer required to present earnings per share (EPS) data as its common shares (all of which are owned by Houston Industries) are not publicly held. EPS data for 1996 and 1995 has not been included because NorAm believes it is no longer meaningful.

(b) Equity Transactions Prior to the Merger.

In June 1996, NorAm issued 11,500,000 shares of NorAm common stock to the public at a price of $9.875 per share, yielding net cash proceeds of approximately $109 million. The net proceeds from the offering principally were used to retire debt as described in Note 4(b).

(c) Direct Stock Purchase Plan and Dividend Reinvestment Plan.

The Direct Stock Purchase Plan and Dividend Reinvestment Plan were suspended and canceled in connection with the Merger.

(4) LONG-TERM AND SHORT-TERM FINANCING

(a) Short-Term Financing.

In 1997 and 1996, NorAm met its short-term financing needs primarily through a bank facility, bank lines of credit and a receivables facility. NorAm's principal short-term credit facility (NorAm Credit Facility) of $400 million expires in December 1998. Borrowings under the NorAm Credit Facility are unsecured. The weighted average interest rate at December 31, 1997 and 1996 was 6.3%. NorAm pays a facility fee on the $400 million facility of .14% per annum which is subject to increase based on NorAm's debt rating. Borrowings under the credit facility at December 31, 1997 and 1996 were $340 million and $115 million, respectively. In addition, NorAm had $50 million of outstanding loans under uncommitted lines of credit at December 31, 1997 having a weighted average interest rate of 6.82%.

(8) COMMITMENTS AND CONTINGENCIES

(a) Lease Commitments.

The following table sets forth certain information concerning NorAm's obligations under operating leases:

Minimum Lease Commitments at December 31, 1997(1)

	(MILLIONS OF DOLLARS)
1998	$ 24
1999	19
2000	16
2001	15
2002	9
2003 and beyond	22
Total	$105

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

NorAm has a master leasing agreement which provides for the lease of vehicles, construction equipment, office furniture, data processing equipment and other property. For accounting purposes, the lease is treated as an operating lease. At December 31, 1997, NorAm had leased assets with a value of approximately $58.1 million under this lease with a basic term of one year. NorAm does not expect to lease additional property under this lease agreement.

Lease payments related to NorAm's leasing agreements are included in the preceding table for only their basic term. Total rental expense for all leases was $24.0 million, $33.4 million and $48.9 million in 1997, 1996 and 1995, respectively.

(b) Letters of Credit.

At December 31, 1997, NorAm had letters of credit incidental to its ordinary business operations totaling approximately $42 million under which NorAm is obligated to reimburse drawings, if any.

(c) Indemnity Provisions.

At December 31, 1997, NorAm has an $11.4 million accounting reserve on its Consolidated Balance Sheets in "Estimated obligations under indemnification provisions of sale agreements" for possible indemnity claims asserted in connection with its disposition of former subsidiaries or divisions, including the sale of (i) Louisiana Intrastate Gas Corporation, a former subsidiary engaged in the intrastate pipeline and liquids extraction business (1992); (ii) Arkla Exploration Company, a former subsidiary engaged in oil and gas exploration and production activities (June 1991); and (iii) Dyco Petroleum Company, a former subsidiary engaged in oil and gas exploration and production (1991).

(d) Sale of Receivables.

Certain of NorAm's receivables are collateral for receivables which have been sold pursuant to the terms of NorAm's receivables facility, see "Receivables Facility" included in Note 4(a).

(e) Gas Purchase Claims.

In conjunction with settlements of "take-or-pay" claims, NorAm has prepaid for certain volumes of gas, which prepayments have been recorded at their net realizable value and, to the extent that NorAm is unable to realize at least the carrying amount as the gas is delivered and sold, NorAm's earnings will be reduced, although such reduction is not expected to be material. In addition to these prepayments, NorAm is a party to a number of agreements which require it to either purchase or sell gas in the future at prices which may differ from then prevailing market prices or which require it to deliver gas at a point other than the expected receipt point for volumes to be purchased. To the extent that NorAm expects that these commitments will result in losses over the contract term, NorAm has established reserves equal to such expected losses.

(f) Transportation Agreement.

NorAm had an agreement (ANR Agreement) with ANR Pipeline Company (ANR) which contemplated a transfer to ANR of an interest in certain of NorAm's pipeline and related assets, representing capacity of 250 Mmcf/day, and pursuant to which ANR had advanced $125 million to NorAm. The ANR Agreement has been restructured and, after refunds of $50 million and $34 million in 1995 and 1993, respectively, NorAm currently retains $41 million (recorded as a liability) in exchange for ANR's or its affiliates' use of 130 Mmcf/ day of capacity in certain of NorAm's transportation facilities. The level of transportation will decline to 100 Mmcf/day in the year 2003 with a refund of $5 million to ANR and the ANR Agreement will terminate in 2005 with a refund of the remaining balance.

(g) Environmental Matters.

To the extent that potential environmental remediation costs are quantified within a range, NorAm establishes reserves equal to the most likely level of costs within the range and adjusts such accruals as better information becomes available. In determining the amount of the liability, future costs are not discounted to their present value and the liability is not offset by expected insurance recoveries. If justified by circumstances within NorAm's business subject to SFAS No. 71, corresponding regulatory assets are recorded in anticipation of recovery through the rate making process.

Manufactured Gas Plant Sites. NorAm and its predecessors operated a manufactured gas plant (MGP) adjacent to the Mississippi River in Minnesota formerly known as Minneapolis Gas Works (FMGW) until 1960. NorAm has completed remediation of the main site other than ongoing water monitoring and treatment. There are six other former MGP sites in the Minnesota service territory. Remediation has been completed on one site. Of the remaining five sites, NorAm believes that two were neither owned nor operated by NorAm; two were owned by NorAm at one time but were operated by others and are currently owned by others; and one site was previously operated by NorAm but was owned by others. NorAm believes it has no liability with respect to the sites it neither owned nor operated.

At December 31, 1997, NorAm had estimated a range of $15 million to $77 million for possible remediation of the Minnesota sites. The low end of the range was determined based on only those sites presently owned or known to have been operated by NorAm, assuming use of NorAm's proposed remediation methods. The upper end of the range was determined based on the sites once owned by NorAm, whether or not operated by NorAm. The cost estimates for the FMGW site are based on studies of that site. The remediation costs for other sites are based on industry average costs for remediation of sites of similar size. The actual remediation costs will be dependent upon the number of sites remediated, the participation of other potentially responsible parties, if any, and the remediation methods used.

In its 1995 rate case, NorAm's Minnegasco division was allowed to recover approximately $7 million annually for remediation costs. Such costs are subject to a true-up mechanism whereby any over or under recovered amounts, net of certain insurance recoveries, plus carrying charges, would be deferred for recovery or refund in the next rate case. At December 31, 1997 and 1996, Minnegasco had recorded a liability of $20.6 million and $35.9 million, respectively, to cover the cost of future remediation. In addition, at December 31, 1997, Minnegasco had receivables from insurance settlements of $2.9 million. These insurance settlements will be collected through 1999. Minnegasco expects that approximately half of its accrual as of December 31, 1997 will be expended within the next five years. The remainder will be expended on an ongoing basis for an estimated 40 years. In accordance with the provisions of SFAS No. 71, a regulatory asset has been recorded equal to the liability accrued. Minnegasco is continuing to pursue recovery of at least a portion of these costs from insurers. Minnegasco believes the difference between any cash expenditures for these costs and the amount recovered in rates during any year will not be material to NorAm's overall cash requirements, results of operations or cash flows.

At December 31, 1997 and 1996, NorAm had recorded an accrual of $3.3 million (with a maximum estimated exposure of approximately $18 million) and an offsetting regulatory asset for environmental matters in connection with a former fire training facility and a landfill for which future remediation may be required. This accrual is in addition to the accrual for MGP sites as previously discussed.

Issues relating to the identification and remediation of MGPs are common in the natural gas distribution industry. NorAm has received notices from the EPA and others regarding its status as a potentially responsible party for other sites. Based on current information, NorAm has not been able to quantify a range of environmental expenditures for potential remediation expenditures with respect to other MGP sites.

Mercury Contamination. Like other natural gas pipelines, NorAm's pipeline operations have in the past employed elemental mercury in meters used on its pipelines. Although the mercury has now been removed from the meters, it is possible that small amounts of mercury have been spilled at some of those sites in the course of normal maintenance and replacement operations and that such spills have contaminated the immediate area around the meters with elemental mercury. Such contamination has been found by NorAm at some sites in the past, and NorAm has conducted remediation at sites found to be contaminated. Although NorAm is not aware of additional specific sites, it is possible that other contaminated sites exist and that remediation costs will be incurred for such sites. Although the total amount of such costs cannot be known at this time, based on experience by NorAm and others in the natural gas industry to date and on the current regulations regarding remediation of such sites, NorAm believes that the cost of any remediation of such sites will not be material to NorAm's financial position, results of operation or cash flows.

Potentially Responsible Party Notifications. From time to time NorAm and its subsidiaries have been notified that they are potentially responsible parties with respect to properties which environmental authorities have determined warrant remediation under state or federal environmental laws and regulations. In October 1994 the United States Environmental Protection Agency issued such a notice with respect to a landfill site in West Memphis, Arkansas, and in December 1995, the Louisiana Department of Environmental Quality advised that one of NorAm subsidiaries had been identified as a potentially responsible party with respect to a hazardous waste site in Shreveport, Louisiana. Considering the information currently known about such sites and the involvement of NorAm or its subsidiaries in activities at these sites, NorAm does not believe that these matters will have a material adverse effect on NorAm's financial position, results of operation or cash flows.

(h) Other

NorAm Merger Lawsuit. In August 1996, a purported NorAm stockholder filed a lawsuit, Shaw v. NorAm Energy Corp., et al., in the District Court of Harris County, Texas, against NorAm, certain of its officers and directors and the Company to enjoin the Merger or to rescind the Merger and/or to recover damages in the event that the Merger was consummated. In February 1998, the plaintiffs withdrew their lawsuit and the court issued an order of non-suit dismissing the litigation.

NORAM ENERGY CORP. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS -- (Continued)

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