

CITY OF BEACH CITY ORDINANCE NO. 84-5

AN ORDINANCE RELATING TO RATES TO BE CHARGED BY HOUSTON LIGHTING & POWER COMPANY FOR ELECTRIC UTILITY SERVICE WITHIN THE CORPORATE LIMITS OF THE CITY OF BEACH CITY, TEXAS; CONTAINING FINDINGS AND PROVISIONS RELATED TO THE SUBJECT: PROVIDING FOR A REPEALER AND FOR SEVERABILITY: AND DECLARING AN EMERGENCY.

WHEREAS, on or about June 15, 1984, Houston Lighting & Power Company (the "Company"), filed with the City of Beach City a Statement of Intent and Petition for Authority to Change Rates relating to Electric utility service, and proper notice thereof was duly given; and

WHEREAS, by Resolution No. 84-5, the City Council suspended the effective date of such proposed rate increase until October 18, 1984, and

WHEREAS, the City Council, having considered the Company's rate increase at a public hearing for which proper notice was duly given, finds that such request is excessive; and

WHEREAS, the City Council having original jurisdiction over the matter finds that a lesser increase in rates should be prescribed for the Company; NOW, THEREFORE,

BE IT ORDAINED BY THE CITY COUNCIL OF THE CITY OF BEACH CITY:

Section 1. The City Council of the City of Beach City hereby finds the requested rates of the Company to be excessive and unreasonable.

Section 2. The City Council hereby approves and adopts the recommendations set out in Exhibit "A", attached hereto and incorporated herein for all purposes, and additionally finds and determines the following:

I. Findings

1. Cost of Service

The revenue requirement of the Company is \$3,984,671,000.00. Adjustments were made to Operations & Maintenance, Fuel Expenses and Purchased Power, Other Taxes, Federal Income Taxes and the Return component.

a. Operations and Maintenance Expenses

Adjustments to the Company's O & M expenses amounted to \$15,400,000.00.

The major adjustments include a reduction in Salaries and Wages expense of \$5,367,000.00, a reduction of Employee Benefits of \$732,000.00, an increase in Storm Damage of \$318,000.00 a reduction in Self-Insurance of \$485,000.00, a reduction in Rate Case Expenses of \$349,000.00, elimination of EEI dues of \$318,000.00, a reduction in Wheeling Cost of \$592,000.00, a reduction in Uncollectibles of \$1,898,000.00, and a reduction in Franchise Taxes of \$4,566,000.00.

b. Fuel Expenses and Purchased Power

The adjustment of Fuel Expenses is a reduction of \$59,196,000.00.

The adjustment to Purchased Power is a reduction of \$4,535,000.00.

c. Other Taxes

The total adjustment for all Taxes Other than Federal Income Taxes is a net reduction of \$3,985,000.00. The components of this adjustment are the Public Utility Commission fee, State gross receipts taxes, ad valorem taxes, State franchise taxes, State unemployment taxes, and payroll taxes.

d. Federal Income Taxes

The adjustment to the Cost of Service for Federal Income Taxes is a reduction of \$58,526,000.00.

e. Return

The rate of return on equity is 16.00 percent. The rate of return on invested capital is 12.42 percent.

2. Invested Capital

The invested capital is determined to be \$4,212,255,000.00.

3. Adjustments to Invested Capital

The adjustments to invested capital include an increase of \$4,045,000.00 in Accumulated Depreciation, a reduction of \$298,239,000.00 in Construction Work in Progress, a reduction of \$48,880,000.00 in Nuclear Fuel in Process, a reduction of \$22,602,000.00 in Property Held for Future Use, a reduction of \$12,498,000.00 in Fuel Oil Inventory, a reduction of \$17,420,000.00 in Storm Loss, a reduction of \$12,677,000.00 in Prepayments, an increase of \$1,211,000.00 in Insurance Reserve, and an increase of \$60,056,000.00 in deferred Federal Income Taxes.

4. Revenue Deficiency

The overall revenue deficiency is \$126,617,000.00.

II. Conclusions

1. The City has original jurisdiction over this case pursuant to Section 43 of the Public Utility Regulatory Act, TEX. REV. CIV. STAT. ANN., art. 1446c (Vernon Supp. 1984).

2. The Company has the burden of establishing its revenue deficiency under its present rates and of establishing the amount of such deficiency that will be collected under its proposed rates pursuant to Section 40 of the Public Utility Regulatory Act.

3. The rates prescribed herein will allow the Company to recover its operating expenses together with a reasonable return on its invested capital, pursuant to provisions of Section 39 of the Public Utility Regulatory Act.

4. The rates prescribed herein will permit the Company a reasonable opportunity to earn a reasonable return upon the invested capital used and useful in rendering service to the public over and above its reasonably necessary operating expenses as provided by Section 39(a) of the Public Utility Regulatory Act.

5. The rates for electric service set forth in Exhibit "A" provide just and reasonable and not unreasonably preferential, prejudicial, or discriminatory rates, and are sufficient, equitable, and consistent in application to each class of consumer, as provided by Section 38 of the Public Utility Regulatory Act.

Section 3. The City Council hereby determines prescribes, establishes and authorizes increased rates for sale or supply of electric service by the Company within the corporate limits of the City of Beach City. Such increased rates are hereby fixed as set out in "Exhibit A," which is attached hereto, incorporated herein by this reference and made a part hereof for all purposes. Such increased rates shall become effective as to each customer for all of such customer's regular billing periods for electric utility service which begin on or after October 18, 1984. A billing period is the interval between meter readings. The Company shall be authorized to collect such rates until such time as they may be changed, modified, amended or withdrawn in accordance with applicable statutes and ordinances.

Section 4. The City Council hereby authorizes and directs the City Secretary to serve the Company with a certified copy of this ordinance which is the final determination and order of the City.

Section 5. The Company shall, within ten days following the final passage and approval of this ordinance and thereafter whenever required by applicable statutes and ordinances and whenever requested by the Mayor of the City of Beach City, file a complete schedule of rates and tariffs with the said Mayor setting forth all of the Company's rates and charges for utility service then in effect. The Mayor of Beach City, Texas is authorized to review, approve and require revisions to the tariffs if it is determined that said tariff is not in accordance with this ordinance.

Section 6. Nothing contained in this ordinance shall be construed now or hereafter as limiting or modifying, in any manner, the right and power of the City under the law to regulate the rates and charges of the Company.

Section 7. All ordinances or parts of ordinances in conflict herewith are repealed to the extent of the conflict only.

Section 8. In the event that the Company appeals from this order setting electric rates for the Company, the City hereby waives written notice of the hearing before the Public Utility Commission of Texas ("PUC") on such appeal.

With respect to any such appeal, the City Council hereby authorizes the City Attorney or his designees to represent the City and its citizens in any and all matters in connection with such appeal and to take any and all actions necessary and incidental thereto and to the resolution of the matters subject to such appeal, all as may be in the best interests of the City.

Section 9. If any provision, section, subsection, sentence, clause, or phrase of this ordinance, or the application of same to any person or set of circumstances is for any reason held to be unconstitutional, void or invalid, the validity of the remaining portions of this ordinance or their application to other persons or sets of circumstances shall not be affected thereby, it being the intent of the City Council in adopting this ordinance that no portion hereof or provision or regulation contained herein shall become inoperative or fail by reason of any unconstitution-

ality, voidness or invalidity of any other portion hereof, and all provisions of this ordinance are declared to be severable for that purpose.

Section 10. The City Council officially finds, determines, recites and declares that a sufficient written notice of the date, hour, place and subject of this meeting of the City Council was posted at a place convenient to the public for the time required by law preceding this meeting, as required by the Open Meetings Law, Article 6252-17, Texas Revised Civil Statutes Annotated; and that this meeting has been open to the public as required by law at all times during which this ordinance and the subject matter thereof has been discussed, considered and formally acted upon. The City Council further ratifies, approves and confirms such written notice and the contents and posting thereof.

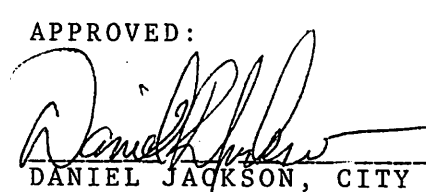
Section 11. Introduced, read, passed and approved by affirmative vote of the City Council of the City of Beach City, Texas in regular meeting of this 12th day of September, 1984.


JIM AINSWORTH, MAYOR

ATTEST:


CHARLOTTE HOFFMAN, CITY SECRETARY

APPROVED:


DANIEL JACKSON, CITY ATTORNEY

REQUEST FOR COUNCIL ACTION

| | | |
|--|--|----------------------------------|
| TO: Mayor via City Secretary | | Agenda Item # <u>1 + 1A</u> |
| SUBJECT: HOUSTON LIGHTING & POWER COMPANY'S Request for a Rate Increase dated June 15, 1984. | | Page 1 of <u>4</u> |
| FROM (Department or other point of origin): Public Service Department | Origination Date August 30, 1984 | Agenda Date SEP <u>4</u> 1984 |
| DIRECTOR'S SIGNATURE: <u>Jane Wilton Cater</u> Assistant Director | Council District affected: All | |
| For additional information contact Jane Wilton Cater Phone 658-0343 | Date and identification of prior authorizing Council action: Ordinance 84-1066 | |
| <p>RECOMMENDATION: Authorize an increase in revenues to HOUSTON LIGHTING & POWER COMPANY in the amount of \$126,617,000 and approve rate design to effect increase.</p> | | |
| <p>Amount and Source of Funding:</p> | | |
| <p>On June 15, 1984, Houston Lighting & Power Company ("HL&P") filed a Petition for Authority to Change Rates and a Statement of Intent with the City of Houston as well as the Public Utility Commission of Texas ("PUC"). The case filed with the City proposes changes in rates identical to those filed with the PUC. The proposed changes are expected to provide an increase of \$288 million, or 7.4%, over fully adjusted revenues for the test year ended March 31, 1984.</p> <p>On June 26, 1984, Council authorized the City Attorney to represent the City of Houston before the Public Utility Commission in Docket No. 5779, the Application of Houston Lighting & Power Company to Increase Rates, and to coordinate the City's efforts in this case with those of other local regulatory authorities. Approximately 40 cities have now regrouped as the Coalition of Cities with Original Jurisdiction.</p> <p>On July 11, 1984, the City Council suspended the proposed rate change for 90 days beyond the originally proposed effective date, such suspension to end on October 18, 1984.</p> <p>Following a thorough review of HL&P's rate filing package and additional information requested from the Company, it is the opinion of the Public Service Department that HL&P's request for a revenue increase is excessive. Rather than an additional \$288,490,000 as requested by HL&P, it is recommended that the City Council approve a \$126,617,000, or 3.28% increase over the test period adjusted revenues.</p> <p>The analysis indicates that the additional revenues will provide HL&P with an opportunity to earn a reasonable return on its invested capital, yet protect the public interest in just and reasonable rates, operations and services. The recommendation is summarized below and explained more fully in the attached letter ("Attachment A") from the consultants who assisted in our analysis.</p> | | |

81-01

EXHIBIT "A"

ite
08/30/84

Subject:

HL&P's Request for a Rate
Increase dated June 15, 1984

Originator's
Initials

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RATE BASE

HL&P has requested an invested capital rate base of \$4,691,632,000. The Public Service Department recommends a rate base of \$4,212,255,000. The recommended decrease of \$479 million is primarily due to the following: in its application, HL&P requested a rate base amount which included 65% of test year end construction work in progress and 100% of test year end nuclear fuel. This has been adjusted to reflect 50% of the balance recorded in the CWIP and nuclear fuel accounts at test year end. This level of CWIP and nuclear fuel is recommended in order to maintain the utility's financial integrity.

Additionally, adjustments to the rate base include adjustments to the balance of accumulated depreciation, plant held for future use, fuel oil inventory, unamortized storm losses, prepayments, property insurance reserve, and deferred Federal income taxes. These adjustments are explained in detail in Attachment A.

COST OF CAPITAL

An overall rate of return on invested capital of 12.42% is recommended for HL&P. HL&P proposed a rate of return of 12.88%; the difference in the rates is solely due to the difference between the recommended return on equity of 16.00% and the 17.00% return on equity requested by HL&P.

FINANCIAL INTEGRITY

Houston Lighting & Power Company's first mortgage bonds are rated A+ by Standard and Poor's Corporation and were recently downrated to A2 by Moody's Investor Service. Duff & Phelps, Inc. has recently placed HL&P on its "Watch List". These rating agencies have expressed concern over HL&P's massive construction commitments, large external financing program and regulatory uncertainty in Texas. Further downgrading would lead to higher interest cost and would limit available financial markets. Therefore, it is important to generate sufficient cash internally to enable to Company to finance the majority of its capital needs through the sale of stocks and bonds. Our recommendation to include 50% of CWIP and nuclear fuel in rate base, combined with a 16% return on equity, allows the Company to recover approximately 36% of next year's construction budget through rates, a level sufficient to maintain current bond ratings.

REVENUE REQUIREMENT

Operating Expenses

In its application, HL&P requested \$69,250,000 in additional operation and maintenance expenses, \$311,008,000 for increased fuel expenses, a \$21,167,000 decrease in purchased power expenses, \$5,385,000 for increases in depreciation and amortization expenses, and \$17,297,000 in additional taxes other than income taxes. As a result of our analysis, it is recommended that the requested operation and maintenance expenses be decreased \$15,400,000, fuel expenses decreased by \$63,731,000, and taxes other than income taxes be decreased by \$3,985,000. These recommended adjustments are explained in detail in Attachment A.

Revenue Deficiency

Based on an invested capital rate base of \$4,212,255,000, a rate of return of 12.42%, and revenue requirements of \$3,984,671,000 (see Schedule I), HL&P has an additional revenue requirement of \$126,617,000 over test period adjusted revenues.

| | | | |
|------------------|---|--------------------------|--------------------------------------|
| Date 09/04/84 | Subject: HL&P's Request for a Rate Increase dated June 15, 1984 | Originator's Initials | REVISED 3 ^{Page} 4 of |
|------------------|---|--------------------------|--------------------------------------|

RATE DESIGN

As recommended, the residential class of customers as a whole will receive a 4.1% increase in rates. From "cluster analyses" studies, the minimum usage level appears to be 400 kilowatt-hours per month. Therefore, a rate block has been established at this level to recognize the high load factor or constant usage level of this group, resulting in more efficient usage of the utility's power production facilities. Under the recommended rate structure, the average cost per kilowatt-hour increases with consumption during the on-peak summer season, thereby encouraging conservation by providing a rate incentive to conserve. On the other hand, the rate recommended for winter heating consumption in excess of 1,000 kilowatt-hours is low, recognizing the base load usage characteristics of such consumption.

The present and proposed residential rate structures are as follows:

Present Rate Structure

Summer:

Customer Charge of \$7.00 per month, which includes 30 kwh*
31-750 kwh at 6.5¢ per kwh
over 750 kwh: all kwh at 8.3¢ per kwh

Winter:

Customer Charge of \$7.00 per month, which includes 30 kwh*
over 30 kwh: at 6.5¢ per kwh

Houston Lighting & Power Company Proposed Rate Structure

Summer:

Customer Charge of \$9.00 per month, which includes 250 kwh*
over 250 kwh: at 9.6¢ per kwh

Winter:

Customer Charge of \$9.00 per month, which includes 250 kwh*
251-1,000 kwh: at 9.6¢ per kwh
over 1,000 kwh: at 6.2¢ per kwh

Public Service Department Recommended Rate Structure

Summer:

Customer Charge of \$7.25 per month, which includes 30 kwh**
31-400 kwh: at 6.2¢ per kwh
over 400 kwh: at 9.1¢ per kwh

Winter:

Customer Charge of \$7.25 per month, which includes 30 kwh**
31-400 kwh: at 6.2¢ per kwh
401-1,000 kwh: at 9.1¢ per kwh
over 1,000 kwh: at 6.3¢ per kwh

* For each minimum, an additional charge will be made for fuel cost.

** For these minimums, an additional charge of 3.8714¢ kwh will be made

The cost of service allocation method proposed by Houston Lighting & Power Company, the Probability of Negative Margins Method, is recommended for adoption in this case. The revenue requirement by class is to be established in accordance with relative rates of return which move each class toward its own cost of service. The rate design for each class, with the exception of the residential class which is discussed above, shall be in the same manner as proposed in HL&P's filing.

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HOUSTON LIGHTING & POWER COMPANY
 COST ALLOCATION
 TEST YEAR ENDING MARCH 31, 1984
 (THOUSANDS OF DOLLARS)
prop rates - city of houston

| LINE NO. | ITEM (a) | REF (b) | RES10 (c) | MGS (d) | LGS (e) | LOS-A (f) | LOS-B (g) | PUB UTIL (h) | SPL (i) | GL (j) | TOT CO (k) |
|---------------|----------------------------|-----------------|--------------|------------|------------|--------------|--------------|-----------------|------------|-----------|---------------|
| ** SUMMARY ** | | | | | | | | | | | |
| 1 | ELECTRIC OPERATING REVENUE | (P1 L11) | 1,332,382 | 937,287 | 572,960 | 315,697 | 608,800 | 193,476 | 22,710 | 1,474 | 3,984,787 |
| 2 | REVENUE DEDUCTIONS | (P5 L21) | 1,124,673 | 796,174 | 506,684 | 284,895 | 556,773 | 173,406 | 17,728 | 1,261 | 3,461,594 |
| 3 | NET INCOME FROM OPERATIONS | (L1 - L2) | 207,709 | 141,113 | 66,276 | 30,802 | 52,028 | 20,070 | 4,982 | 214 | 523,193 |
| 4 | RATE BASE | (P9 L48) | 1,721,824 | 1,102,008 | 518,518 | 229,665 | 418,723 | 160,956 | 59,349 | 1,373 | 4,212,417 |
| 5 | % RATE OF RETURN | (L3/L4) | 12.0633% | 12.8051% | 12.7818% | 13.4115% | 12.4253% | 12.4693% | 8.3942% | 15.5587% | 12.4202% |
| 6 | RELATIVE RATE OF RETURN | (L5/TOT CO, L5) | 97% | 103% | 103% | 108% | 100% | 100% | 68% | 125% | 100% |

| | | | |
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| 08/30/84 | Subject: HL&P's Request for a Rate Increase dated June 15, 1984 | Originator's Initials | Page 4 of 4 |
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OTHER ISSUES

South Texas Nuclear Project

Pursuant to §16(h) of the Public Utility Regulatory Act, the Utility Evaluation Division of the PUC has enlisted a firm to perform a management audit of HL&P. Arthur Young is currently in the process of completing such an audit. In addition, the Engineering Division of the PUC is evaluating the cost and benefits of continuing or cancelling one or both units of the STNP. Further, the participants of STNP (the City of Austin, the City Public Service Board of San Antonio, Central Power & Light Company, and HL&P), are conducting a study to determine the feasibility of converting the nuclear units to coal units.

It is recommended that the City of Houston review ongoing studies of the South Texas Nuclear Project, and if necessary, conduct its own study to determine whether STNP is the most economic and reliable source of electric power to meet the needs of the Houston area. This study should be conducted outside the context of a general rate case.

Conservation, Cogeneration and Competition

In meeting the growing power demands of the Houston area, Houston Lighting & Power Company in all cases should pursue the most economic and reliable source of power, including alternatives to power plant construction such as conservation and debottlenecking of existing power plants. There is a tremendous potential for cogeneration in Houston, however, if a cogenerator is paid based on the full cost avoided by HL&P because the cogenerator is on-line, cogeneration will be the most expensive power available to HL&P.

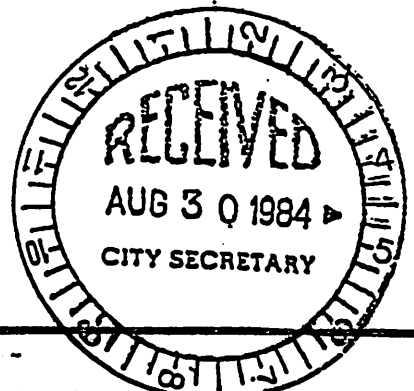
We recommend that the utility seek out the least-costly, yet reliable power supply alternatives, and urge that price competition be used to select among potential power suppliers.

The Public Service Department has completed a study "A Methodology for Comparative Risk Analysis: Introducing Competition Into Avoided Cost Pricing", which was funded by a grant from the Department of Energy. Our findings indicate that competition can be effectively used to select the most economic power sources thereby producing the potential for substantial savings to ratepayers.

SUMMARY

The Public Service Department recommends that Houston Lighting & Power Company be permitted to produce additional revenues in the amount of \$126,617,000 over test period adjusted revenues. The recommended rate design is intended to provide a price incentive to encourage conservation during summer peak periods, and to recognize the efficient use of power production facilities through a lower rate during the winter off-peak period. The typical residential customer receiving an increase of 4.1% would average 1800 kwh in the summer and 600 kwh in the winter. The monthly increase would average \$4.30.

JWC:dm
B-4037-16



CITY OF HOUSTON

Schedule I

HOUSTON LIGHTING & POWER COMPANY

REVENUE REQUIREMENT
(IN 000'S)
TEST YEAR ENDED MARCH 31, 1984

| DESCRIPTION | TEST YEAR PER BOOKS | COMPANY ADJUSTMENTS | COMPANY TEST YEAR | CITY ADJUSTMENTS | CITY TEST YEAR |
|--------------------------------|------------------------|------------------------|----------------------|---------------------|-------------------|
| OPERATION AND MAINTENANCE | 487,039 | 69,250 | 556,289 | (15,400) | 540,889 |
| FUEL AND PURCHASED POWER | 2,114,572 | 289,841 | 2,404,413 | (63,731) | 2,340,682 |
| DEPRECIATION | 158,030 | 5,385 | 163,415 | 0 | 163,415 |
| OTHER TAXES | 123,586 | 17,297 | 140,883 | (3,985) | 136,898 |
| INTEREST ON CUSTOMERS DEPOSITS | 0 | 0 | 0 | 1,411 | 1,411 |
| FEDERAL INCOME TAXES | 227,169 | 109,301 | 336,470 | (58,258) | 278,213 |
| RETURN | 466,860 | 137,410 | 604,270 | (81,108) | 523,162 |
| REVENUE REQUIREMENT | 3,577,256 | 628,484 | 4,205,740 | (221,070) | 3,984,671 |
| LESS: OTHER REVENUE | 0 | 0 | 0 | 0 | 0 |
| PLUS: INCREASE IN BASE | 339,994 | | | | |
| ELECTRIC BASE REVENUE | 3,917,250 | 288,490 | 4,205,740 | (221,070) | 3,984,671 |
| TEST PERIOD REVENUES | | | 3,917,250 | (59,196) | 3,858,054 |
| INCREASE IN REVENUES | | " | 288,490 | | 126,617 |

CITY OF HOUSTON

Schedule II

HOUSTON LIGHTING & POWER COMPANY

INVESTED CAPITAL AND RETURN

(in 000's)

TEST YEAR ENDED MARCH 31, 1984

| | COMPANY AMOUNT (A) | ADJUSTMENTS | AS ADJUSTED |
|--------------------------------|-----------------------|-------------|----------------|
| PLANT IN SERVICE | 4,583,698 | 0 | 4,583,698 |
| ACCUMULATED DEPRECIATION | 1,014,802 | 4,045 | 1,018,847 |
| NET PLANT | 3,568,896 | (4,045) | 3,564,851 |
| CONSTRUCTION IN PROGRESS | 1,292,370 | (298,239) | 994,131 |
| PROPERTY HELD FOR FUTURE USE | 27,012 | (22,602) | 4,410 |
| NUCLEAR FUEL | 97,760 | (48,880) | 48,880 |
| OTHER ASSETS | 106,541 | (29,918) | 76,623 |
| WORKING CASH ALLOWANCE | 55,040 | (1,749) | 53,291 |
| MATERIALS AND SUPPLIES | 59,663 | 0 | 59,663 |
| PREPAYMENTS | 13,605 | (12,677) | 928 |
| LESS: | | | |
| DEFERRED TAXES | 458,297 | 60,056 | 518,353 |
| PRE-1971 INVESTMENT TAX CREDIT | 7,232 | 0 | 7,232 |
| CUSTOMERS DEPOSITS | 23,864 | 0 | 23,864 |
| OTHER DEDUCTIONS | 39,862 | 1,211 | 41,073 |
| INVESTED CAPITAL | 4,691,632 | (479,377) | 4,212,255 |
| RATE OF RETURN | 12.88% | (.46%) | 12.42% |

James P. Jansen, C.P.A.
8610 Stillwood Lane
Austin, Texas 78758
512/458-8038

August 30, 1984

Mrs. Marsha R. Gardner, Director
Public Service Department
City of Houston
612 Gray
Houston, Texas 77002

Dear Mrs. Gardner:

This letter summarizes the results of the analysis and presents the recommendations pertaining to the rate application of Houston Lighting & Power Company (HL&P or Company) filed June 15, 1984. The scope, recommendations, and results of the analysis are summarized below.

SCOPE

The scope of the engagement included the following tasks:

- Review the rate application;
- Prepare additional information requests;
- Review the records and supporting documentation of HL&P;
- Make recommendations as to the proper level of revenues and the design of residential and municipal rates.

RECOMMENDATIONS

Based on the review of the information filed, and as a result of the work performed, the following conclusions are appropriate:

The Company should be allowed a total revenue requirement of \$3,984,671,000 or a rate increase of \$126,617,000 or 3.28% over the test period adjusted revenues. This is a reduction of \$161,873,000 from the additional \$288,490,000 requested by HL&P.

- The Company should be allowed an invested capital or rate base of \$4,212,255,000, which is a decrease of \$479,377,000 from the \$4,691,632,000 requested.

- The Company should be allowed an overall rate of return of 12.42%, which reflects a return on equity of 16.00% as compared to the overall return of 12.88% and

James P. Jansen, C.P.A.

Mrs. Marsha R. Gardner
August 30, 1984
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the 17.00% return on equity requested by HL&P.
REVENUE REQUIREMENT

HL&P requested additional revenues of \$288,490,000 based on a March 31, 1984, test year end. Through a review of the rate increase filing and subsequent information requested from HL&P, additional revenues of \$126,617,000 are recommended.

OPERATING EXPENSES

In its application, HL&P requested \$69,250,000 in additional operation and maintenance expenses, \$311,008,000 for increased fuel expenses, a \$21,167,000 decrease in purchased power expenses, \$5,385,000 for increases in depreciation and amortization expenses, and \$17,297,000 in additional taxes other than income taxes.

Operation and Maintenance Expenses

Operations and maintenance expenses should be decreased \$15,400,000 from the amount requested. The following summarize the adjustments to the requested expenses:

To reduce salaries \$ 5,367,000
By applying the wage increase terms of the new union contract, and deleting the effects of additional employees projected by the Company beyond the test year end, salaries have been reduced from the amount requested.

To reduce employee benefits \$ 732,000
As a result of the decrease in salaries, the related employee benefits are decreased.

To increase the amortization of storm damages \$ 318,000
The increase in "storm damages" is recommended in order to amortize the uninsured amount of damages due to Hurricane Alicia and tornadoes which occurred during the test year. This adjustment is made to amortize total storm damages on a gross-tax basis rather than the net-of-tax basis as requested by HL&P. This adjustment is offset by a corresponding reduction to Federal income tax expense which has an overall effect of reducing revenue requirement.

To reduce self-insurance \$ 485,000
HL&P's self-insurance reserve was depleted due to storm damages during the test year. As recommended, the reserve will be accrued over a ten year period instead of the seven years requested by HL&P.

To reduce rate case expenses \$ 349,000
Since HL&P has not filed a rate application for two years, the expenses associated with HL&P's last rate case have been fully recovered through rates.

James P. Jansen, CPA

Mrs. Marsha R. Gardner
August 30, 1984
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To eliminate EEI dues \$ 318,000
Consistent with prior Public Utility Commission orders, these dues were removed.

To reduce wheeling cost \$ 592,000
This cost was reduced to reflect the cost associated with new wheeling contracts.

To reduce uncollectibles \$ 1,898,000
To reduce franchise taxes \$ 4,566,000
These expenses are revenue-related and are therefore reduced when the revenue requirement is reduced.

Fuel Expenses and Purchased Power

To reduce fuel expense \$ 59,196,000
To reduce purchased power and affiliated fuel
costs recovered through base rates \$ 4,535,000
These changes are the result of using the June 1984 rates for fuel and purchased power, and include the expected 1984 cost of \$101 million for the new Diamond Shamrock cogeneration contract.

Other Taxes

To reduce payroll taxes \$ 854,000
This adjustment is again made as a result of the recommended decrease in salaries.

To reduce ad valorem taxes \$ 303,000
The recommended reduction in ad valorem taxes is related to the reduction in plant held for future use.

To reduce state franchise taxes \$ 299,000
The recommended state franchise tax was based on the actual 1983 state franchise taxes paid in June 1984.

To increase state unemployment taxes \$ 120,000
The increase in the recommended tax was computed based on the end of test period level of employees.

To reduce PUC assessment \$ 355,000
To reduce gross receipts taxes \$ 2,294,000
These taxes are reduced as a result of the lower recommended revenue requirement.

James P. Jansen, C.P.A.

Mrs. Marsha R. Gardner
August 30, 1984
Page 4 of 8

FEDERAL INCOME TAXES

To reduce Federal income taxes \$ 58,527,000
This reduction results from normalized Federal income taxes being applied to the lower recommended return.

RETURN

To reduce return \$ 81,108,000
The recommended reduction in return is caused by the lower rate of return on equity and reductions to the rate base.

RATE BASE

In the Company's application, the rate base requested was the adjusted rate base at March 31, 1984. In reviewing the requested rate base the following adjustments are recommended:

To increase accumulated depreciation \$ 4,045,000
The increase in depreciation expense must be reflected in the accumulated depreciation account.

To reduce CWIP \$298,239,000
To reduce nuclear fuel \$ 48,880,000
CWIP and NFIP were reduced to reflect 50% of the balance in these accounts at test year end. This level of CWIP and NFIP is recommended to maintain the financial integrity of HL&P.

To reduce future use property \$ 22,602,000
This adjustment is made to exclude all property not expected to be in service in the next ten years.

To reduce fuel oil inventory \$ 12,498,000
This adjustment reduces fuel oil inventory to a level adequate to insure service reliability.

To reduce storm loss \$ 17,420,000
The Company requested the unamortized balance of storm losses to be included in the rate base. Consistent with the PUC's accounting treatment of extraordinary losses, this adjustment has been reversed.

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To reduce prepayments \$ 12,677,000
Prepayments are adjusted to reflect the proper balance of sales tax payments.

To increase the insurance reserve \$ 1,211,000
Consistent with the recommendation to fund the property insurance reserve, the rate base must be reduced to reflect this cost free capital to the company.

To increase deferred Federal income taxes \$ 60,056,000
This adjustment reduces the rate base for tax benefits realized by HL&P.

RATE OF RETURN

An overall rate of return on invested capital for HL&P of 12.42% is appropriate. The Company proposed a rate of return of 12.88%. The difference in the rates is the return on equity. In its application, HL&P requested a return on equity of 17.00%, while the proper rate has been found to be 16.00%.

FINANCIAL STATISTICS

The most important factor in the determination of the adequacy of the recommended revenue requirement to maintain the financial integrity of the utility is cash flow. The recommended revenues are expected to generate 36.27% of next year's construction budget from internal sources. This level is sufficient to maintain the financial integrity of the utility.

RATE DESIGN

The residential class of customers as a whole will receive a 4.1% increase in rates. It is recommended that the design of the residential rates be revised because of deficiencies in the current design. The Company addresses the shortcomings in its application, but some refinements are needed. Presently, the first 750 kilowatt-hours are priced at a discount. However, the discount disappears after the 750th kilowatt-hour, causing the bill to jump \$12.44 for the 751st kilowatt-hour. This creates a confused price signal. Furthermore, 750 kilowatt-hours exceeds the usage level of that group of customers whose monthly usage is relatively low. From "cluster analyses" studies, the minimum usage level appears to be 400 kilowatt-hours per month. Therefore, a rate block has been established at this level to recognize the high load factor or constant usage level of this group, allowing the utility to utilize its power production facilities more efficiently. Unlike the current rate structure, the billing for the first 400 kilowatt-hours would be at this lower rate regardless of the amount consumed. The next block, for consumption over 400 kilowatt-hours, recognizes the peak demand placed on the system and is structured so that as consumption increases, the average cost per kilowatt-hour increases during the on-peak summer season. It is also recommended that the minimum bill

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increase slightly from \$7.00 to \$7.25, and that a lower rate for winter heating consumption above 1000 kilowatt-hours be included to recognize the base load usage characteristics of these customers.

The present and proposed rate structures are as follows:

Present Rate Structure

Summer:

Customer Charge of \$7.00 per month, which includes 30 kwh
31-750 kwh at 6.5¢ per kwh
over 750 kwh: all kwh at 8.3¢ per kwh

Winter:

Customer Charge of \$7.00 per month, which includes 30 kwh
over 30 kwh: at 6.5¢ per kwh

Houston Lighting & Power Company Proposed Rate Structure

Summer:

Customer Charge of \$9.00 per month, which includes 250 kwh
over 250 kwh at 9.6¢ per kwh

Winter:

Customer Charge of \$9.00 per month, which includes 250 kwh
251-1,000 kwh at 9.6¢ per kwh
over 1,000 kwh at 6.2¢ per kwh

Public Service Department Recommended Rate Structure

Summer:

Customer Charge of \$7.25 per month, which includes 30 kwh
31-400 kwh at 6.2¢ per kwh
over 400 kwh at 9.1¢ per kwh

Winter:

Customer Charge of \$7.25 per month, which includes 30 kwh
31-400 kwh at 6.2¢ per kwh
401-1,000 kwh at 9.1¢ per kwh
over 1,000 kwh at 6.3¢ per kwh

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Because of the change in the basic design of the rate, the percent increase varies with usage. However, on an annualized basis, the four different types of residential customers will typically experience the following average increases:

| | |
|---|--------|
| (a) Small user (400 kwh winter and 900 kwh summer) | -0.74% |
| (b) Strong summer peaking (4000 kwh peak month) | +7.80% |
| (c) Moderate summer peaking (2300 kwh peak month) | +6.03% |
| (d) Summer/Winter peaking (2300 and 2800 kwh peaks) | +5.55% |

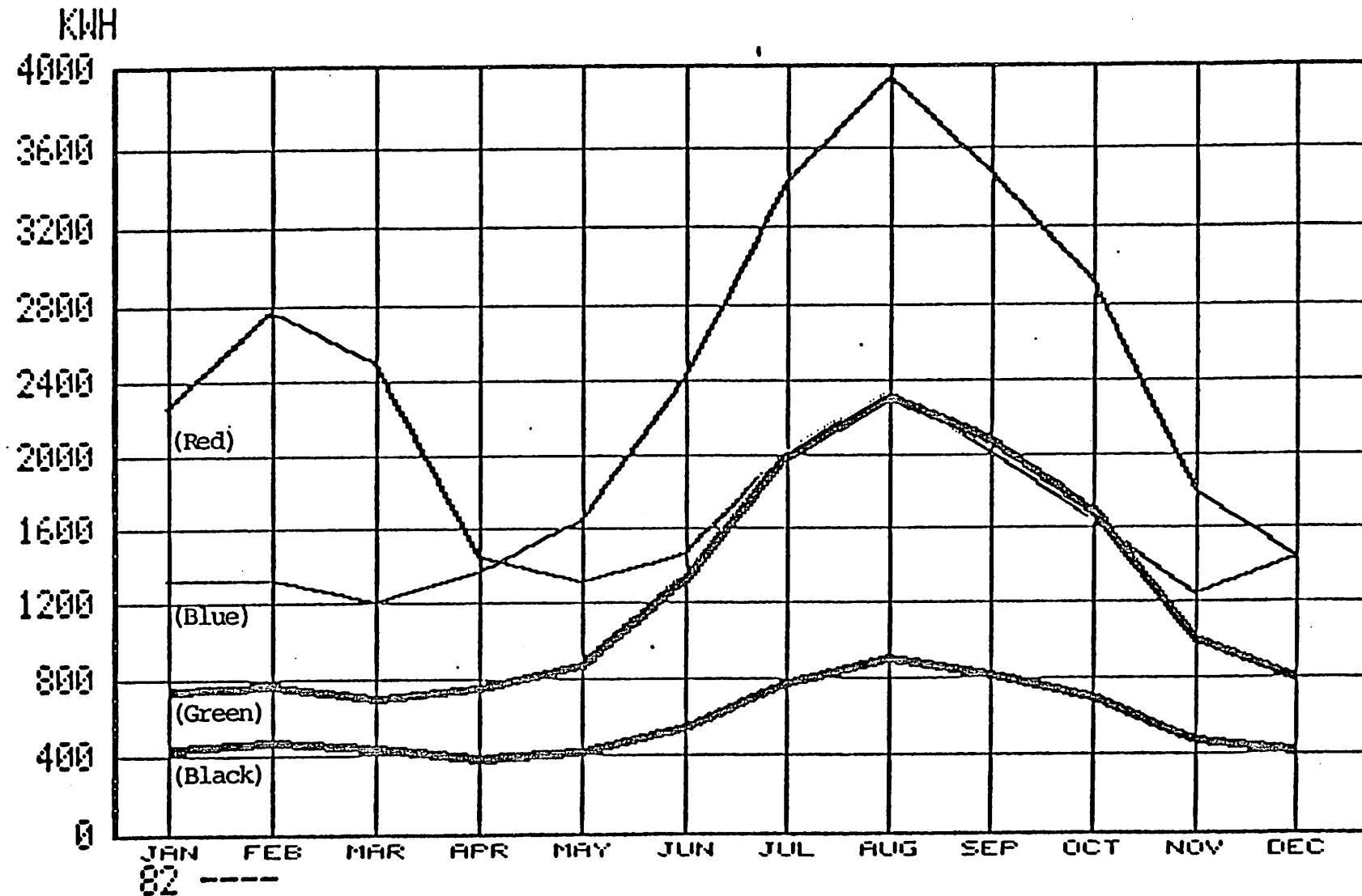
The Company should add an optional time-of-use feature to the small commercial rate to recognize off peak usage. Time-of-use rates are available to most other rate classes, but not for the MGS customers. The City in particular will benefit from such a rate through proper recognition of the off-peak use by freeway lighting and parks. It is recommended that the new time-of-use rate be initially experimental in nature by limiting its application to 500 MGS customers.

SOUTH TEXAS NUCLEAR PROJECT

Pursuant to §16(h) of the Public Utility Regulatory Act, the Utility Evaluation Division of the PUC has enlisted a firm to perform a management audit of HL&P. Arthur Young is currently in the process of completing such an audit. In addition, the Engineering Division of the PUC is evaluating the cost and benefits of continuing or cancelling one or both units of the STNP. Further, the participants of STNP (the City of Austin, the City Public Service Board of San Antonio, Central Power & Light Company, and HL&P), are conducting a study to determine the feasibility of converting the nuclear units to coal units.

Concern over the expenditures on the South Texas Nuclear Project continue to grow, yet the immensity and complexity of the project make it extremely difficult to make rational and educated decisions regarding rate treatment. For this reason, it is recommended the City of Houston review ongoing studies intended to evaluate the Company's performance in managing the construction of STNP, and if necessary, conduct its own study to determine whether STNP is the most economic and reliable source of electric power to meet the needs of the Houston area. Such a study should likely be conducted outside the context of a general rate case.

CYCLE 6 1924 OBS



| | | | | | | | |
|---------|--|-------|---------------|---------|--|-------|---------------|
| Red : | | 3.2% | PK/AVG 1.2458 | Blue : | | 4.5% | PK/AVG 1.7963 |
| Green : | | 42.0% | PK/AVG 1.8562 | Black : | | 48.6% | PK/AVG 1.6100 |

Red: Summer and Winter Peaking

Blue: Strong Summer Peaking

Green: Moderate Summer Peaking

Black: Small User


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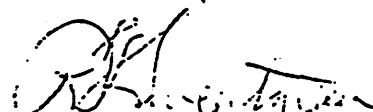
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RATE NEGOTIATIONS FOR THE CITY OF HOUSTON

The consultant is assisting in negotiating changes in contracts for various City of Houston electric service accounts, which will enable many of the City installations to be more properly classified on more favorable rates. It is estimated that the resulting savings to the City will exceed \$250,000 per year.

Very truly yours,


James P. Jansen, CPA


R. T. Sweatman, P.E.

JPJ:mmd

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