DIRECT TESTIMONY OF

R. L. CAMPBELL

for

HOUSTON LIGHTING & POWER COMPANY

July 1981

TESTIMONY OF RICK CAMPBELL

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION WITH HOUSTON LIGHTING & POWER COMPANY.

A. My name is Rick L. Campbell and my address is 611 Walker Avenue, Houston, Texas. I am Manager of the Accounting Services Department.

Q. WOULD YOU PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND, BUSINESS EXPERIENCE AND PROFESSIONAL QUALIFICATIONS?

A. I received a B.B.A. in Accounting from Texas Tech University and joined HL&P as an internal auditor soon thereafter. I later served as senior auditor specializing in EDP auditing before being promoted to a supervisor in the Treasury Department over taxes and external reporting. In May of 1977, I became a manager in the Accounting Department and now report to the Vice President and Comptroller of the Company. I am responsible for HL&P's financial reporting to the Public Utility Commission of Texas, the Federal Energy Regulatory Commission, the Securities and Exchange Commission, and the various security holders. My responsibilities with the Company also encompass financial forecasting, departmental budgeting and district accounting operations. I am a Certified Public Accountant and a member of the American Institute of Certified Public Accountants and the Texas Society of Certified Public Accountants.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE PUBLIC UTILITY COMMISSION?

A. Yes, as a rebuttal witness for the Company in Docket No. 2001.

Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY IN THIS PROCEEDING?

A. My testimony will address the following areas:

1. The financial and accounting data contained in the Rate Filing Package, namely, the overall cost of service and related adjustments as summarized in Schedule A and the rate base as presented in Schedule B.
2. The amount of construction work in progress in rate base in order to achieve the return specified in the testimony of Mr. R. S. Letbetter.
3. The current cost of plant adjusted for age and condition.

Q. HAS HL&P's RATE FILING PACKAGE BEEN PREPARED IN ACCORDANCE WITH THE REQUIREMENTS OF THE PUBLIC UTILITY COMMISSION?

A. Yes. On January 13, 1981 the Commission transmitted to all Class A and B electric utilities new instructions for electric rate filing packages. All schedules have been prepared pursuant to the Commission's new instructions.

Q. WHO WITHIN THE COMPANY WAS RESPONSIBLE FOR PREPARING THE VARIOUS SCHEDULES?

A. All of the schedules setting forth the cost of providing electric service were prepared under my supervision. Per books entries on all schedules, including those used in cost allocation and rate design, were supplied by various accounting personnel of the Company under the supervision of R. S. Letbetter, Vice President and Comptroller. The cost allocation and rate design schedules were prepared under the supervision of R. E. Doan, Vice President.

Q. WHAT DOES THE DESIGNATION "PER BOOKS" INDICATE ON EACH SCHEDULE?

A. All "per books" information refers to entries taken from the accounting records of the Company, which have been reviewed by an outside accounting firm. Included in the rate filing package is a letter from Deloitte Haskins and Sells reflecting their review of the Company's books and records and various rate filing schedules.

I. COST OF SERVICE

Q. WHAT IS MEANT BY COST OF SERVICE?

A. The Commission's Substantive Rule 052.02.03.032(a) defines cost of service as that "amount of revenue required to (1) cover all reasonable and necessary expenses properly incurred by the utility in rendering service to the public and (2) provide a fair and reasonable return on the adjusted value of invested capital used and useful in rendering such service". Schedule A reflects the overall cost of service

for Houston Lighting & Power Company for the test year ended March 31, 1981.

Q. WOULD YOU PLEASE DESCRIBE SCHEDULE A?

A. The items detailed in Schedule A present revenue and expense amounts as recorded on the books of the Company (column b), the effect of the adjustments to actual costs to bring them to the levels experienced at the end of the test year and the effect of adjustments for known and measurable changes (column d), and the effect on the test year of the proposed new rates (column g). Each of the adjustments is referenced to a supporting schedule in the Rate Filing Package which provides underlying detail regarding the nature and calculation of the adjustment. As shown on page 1, we have determined our overall cost of service to be approximately $2.8 billion for the test year ended March 31, 1981 with a resultant requested rate increase of $248 million over the adjusted test year revenues.

Q. WHY HAS THE TEST YEAR COST OF SERVICE BEEN ADJUSTED?

A. The Company has adjusted historical test year data in order to arrive at more representative data from which future revenue requirements can be determined.

Rates are set for the future, not the past. If the test period reflects the relative level of revenues, operation and maintenance expenses, depreciation, taxes, and capital costs that will exist when the new rates are in

effect, then the new rates can be set to recover these costs and both the Company and our customers will be equitably treated. In an effort to approximate these results, we have used an historic test year as the basis for our test period and have made adjustments for changes which will be applicable when the new rates become effective. The principal shortcoming of this approach, of course, is that it might not completely reflect the level of operations that will exist when these new rates become effective in 1982.

Q. WHAT IS THE GENERAL NATURE OF THE SCHEDULE A ADJUSTMENTS UNDER COLUMN C, LABELED "CURRENT RATES"?

A. These adjustments annualize the book figures to more closely reflect the level of Company operations at test year end, normalize book amounts to compensate for unusual conditions, and make allowance for known and measurable or reasonably probable changes.

Q. WOULD YOU PLEASE EXPLAIN THE ADJUSTMENTS MADE TO RECOVERABLE FUEL AND PURCHASED POWER EXPENSE?

A. In general the amount per books has been adjusted to reflect 1) changes in test year kilowatt hour sales resulting from adjustments for weather, year end customers and usage per customer that were provided by Mr. J. M. Edwards, 2) changes in fuel mix, and 3) the recoverable portion of purchased power expenses. Kilowatt hour sales were adjusted to generation levels to recognize

line losses and then converted to units of energy consumed using appropriate heat rates and the availability of fuel when the proposed rates become effective. Gas volumes are either fixed contract amounts or amounts anticipated to be under contract in 1982. The quantity of coal is based upon an average capacity factor of 65.8% for W. A. Parish units 5, 6 and 7. The costs used for gas were either the prices as of the test year end or contractual prices effective January 1, 1982, and the price of coal reflects the March 1981 invoice price less nonrecoverable amounts because of the limitations imposed by Docket 3320. The cost used for anticipated purchased power was the price as of the test year end for fuel costs and operation, maintenance and start-up cost portions of economy purchases.

Q. DOES THIS ADJUSTMENT TO RECOVERABLE FUEL AND PURCHASED POWER EXPENSE REFLECT ANY CHANGES THE COMPANY IS PROPOSING IN THE FUEL COST ADJUSTMENT?

A. Yes. The Fuel Cost Adjustment as defined in the approved tariff in our last rate case, Docket 3320, will generally be maintained; however, as discussed by Mr. Doan and Mr. Letbetter there are minor modifications proposed.

Q. PLEASE EXPLAIN THE LINE ENTITLED "RECOVERABLE CITY FRANCHISE REQUIREMENTS".

A. Pursuant to Docket 2676, city franchise requirements are being recovered through a surcharge much like the fuel cost

adjustment for recoverable fuel. The amount under current rates represents 4% of the appropriate fuel and base revenues collectible within municipalities. As discussed later in my testimony, the Company proposes to charge 4% of revenues including the surcharge itself since a number of municipalities are assessing HL&P on that basis.

Q. PLEASE EXPLAIN THE ADJUSTMENTS MADE TO OPERATION AND MAINTENANCE.

A. There were a number of adjustments made to the book amount and these are summarized on page 5 of Schedule A. The first adjustment is to purchased power and wheeling costs. The per books amount for purchased power consists of a capacity charge to the City of Austin and the operation, maintenance and start-up cost of non-economy purchases that were scheduled from the City of Austin. Economy energy purchases, power brokerage, fuel costs related to all purchased power, and operation, maintenance and start-up costs of economy purchases are included with recoverable fuel expense as shown on Schedule A, page 2.

Included in our adjusted cost of service for purchased power is the cost of 800 MW of power under contract from the City of Austin. The original agreement between HL&P and the City of Austin provided for the purchase of 500 MW of power. An amended agreement became effective January 1, 1981 which, among other things, increased the available

generating capacity to 800 MW for the years 1981 through 1987. Also included in the adjusted cost of service for purchased power is the cost of 500 MW of power under contract from City Public Service of San Antonio. This agreement was entered into in June 1980 and is to begin in January, 1982.

An adjustment is also being made for operation, maintenance and start-up costs related to non-economy purchases, since these costs are not currently recoverable through the fuel clause. A rate per KWH for operation, maintenance and start-up costs was developed from the test year end billings and was reduced by the amount relating to recoverable economy purchases. The resulting non-recoverable rate was applied to the purchased power KWH's that are shown on Schedule A, page 2.

In conjunction with our purchase power agreements, HL&P has entered into an agreement with the Lower Colorado River Authority (LCRA) whereby LCRA has agreed to transmit the power purchased from the City of Austin through LCRA transmission lines to HL&P. The test year amount for wheeling expense is adjusted to reflect their annual charge.

Q. WOULD YOU PLEASE EXPLAIN YOUR ADJUSTMENT TO WAGE AND SALARY EXPENSE?

A. The wage and salary expense adjustment is based on personnel requirements to serve year-end level of customers and has five components:

1. An adjustment to reflect the number of employees and wage levels effective at March 31, 1981;
2. An adjustment to reflect known salary changes for union supervisory personnel;
3. An adjustment to reflect the known union wage increase;
4. An adjustment for wage and salary increases applicable to existing non-union personnel; and
5. An adjustment for additional personnel for which there were outstanding personnel requisitions at March 31, 1981.

Q. WHY ARE ADJUSTMENTS TO WAGE EXPENSE NECESSARY?

A. If the test period reflects the level of wage expense that will exist when the new rates are in effect, then the new rates can be set to recover these expenses and both the Company and our customers will be equitably treated. Accordingly, adjustments to actual wage expense were made in order to bring these expenses to levels experienced at the end of the test year and to adjust them for known and measurable changes which will occur before the proposed rates are in effect.

Q. WOULD YOU PLEASE EXPLAIN YOUR ADJUSTMENT TO EMPLOYEE BENEFITS EXPENSE?

A. Each of the major components of employee benefits expense was adjusted separately. Workmen's compensation insurance

was adjusted based on the test year end adjusted number of employees. Retirement plan expense per books was increased to the minimum contribution level provided by our actuary based on plan benefits, participants, and payroll levels effective January 1, 1981. Test year savings plan costs were adjusted based on test year end adjusted number of employees and the newly approved matching contribution percentage. Hospitalization insurance was adjusted based on increased medical costs at test year end as measured by the Houston Consumer Price Index for medical care. Life insurance was restated to the current expense level based on the premium paid for the month of March 1981. All of these test year adjustments for employee benefits expense were then reduced by the percentage to be capitalized so that the Company's cost of service reflects only current period expenses.

Q. WHY HAVE YOU MADE AN ADJUSTMENT TO THE PROVISION FOR PROPERTY INSURANCE?

A. In Docket 2676 the Commission denied the Company any further accruals to the property insurance reserve on the basis that the balance in the reserve at March 31, 1979 of $8,525,000 was adequate. We still maintain that this level is inadequate based on our increasing investment in transmission and distribution facilities; however, we have merely adjusted property insurance expense in order to reinstate the reserve to the $8,525,000 level.

Q. WOULD YOU PLEASE EXPLAIN YOUR OTHER ADJUSTMENTS TO OPERATION AND MAINTENANCE EXPENSE?

A. The next three adjustments were made in compliance with Substantive Rule 052.02.03.032 (a)(6). The adjustments to legislative advocacy and social dues remove from the cost of service all expenditures for these items. The adjustments to advertising, contributions, and donations reflect application of limits stated in the above rule as well as the reclassification of contributions and donations charged to Account 426 - Other Income Deductions as an allowable cost of service item.

We are requesting recovery of the Company's additional rate case expenses incurred in connection with Docket Nos. 2001 and 2676 and billed subsequent to our last rate case and the estimated Company expenses for this application. Rate case expenses associated with Docket No. 3320 have been fully recovered to date. We anticipate the need to apply for additional rate relief in 1982, and therefore are requesting one-year amortization of our rate case expenses.

Uncollectible accounts expense is a revenue-related expense and has therefore been adjusted for revenue changes under current rates.

Q. PLEASE EXPLAIN THE ADJUSTMENT FOR THE RESIDENTIAL CONSERVATION SERVICE (RCS) PROGRAM.

A. The adjustment for the RCS program represents estimated expenses related to the Company's program for energy conservation by customers and is designed to meet the requirements of the Public Utility Regulatory Policies Act of 1978. This program obligates the Company to notify each one of its residential customers of the availability of energy audits that may be performed by the Company. Based upon this audit, the Company's representative will advise the customer of estimated energy savings which could result if the customer implements certain conservation measures.

Q. WOULD YOU PLEASE EXPLAIN THE ADJUSTMENT MADE FOR EPRI RESEARCH AND DEVELOPMENT SUPPORT?

A. This adjustment to the book amount reflects a known increase of $1,084,000 in our EPRI research and development commitment. The amount is based upon the actual revenue and the kilowatt hour sales which produced this revenue in the year 1979 and the adjustment is necessary to reflect the actual amount due in the coming year. By committing to the EPRI research and development program, the Company is able to spread its research and development dollars over a much broader base of activity; instead of the companies in the industry duplicating each other's efforts, such a program allows the companies to pool their knowledge and resources to eliminate unnecessary expenditures. By supporting this program, the Company and its customers receive the benefits

of information being gathered from scores of projects including, among many others, solar and wind power research, equipment utilization testing and environmental studies.

Q. WOULD YOU EXPLAIN THE ADJUSTMENT TO OTHER OPERATION AND MAINTENANCE EXPENSE?

A. The majority of total operation and maintenance expense for the test year, excluding recoverable fuel, has been adjusted to year end levels through the specific adjustments I have just described. The remainder, however, represents other operation and maintenance expenses which have not been individually adjusted. Included in this category are expenditures for distribution expenses, customer account expenses, customer services expenses, sales expenses and administrative and general expenses. Since the amounts in these accounts are proportional to our number of customers, the cost for the test year end level of customers was determined. Reducing the test year end amount by the per books amount results in an adjustment of $2,227,000. No adjustment is being made for amounts charged to generation and transmission accounts. These accounts are indirectly related to customers and more closely tied to the number and type of plants in operation. It can generally be expected, however, that these costs will increase due to the Company's reliance on more complicated coal-fired generating units.

Q. WOULD YOU EXPLAIN THE ADJUSTMENT TO DEPRECIATION EXPENSE?

A. Depreciation and amortization have been adjusted to the test year end level of adjusted depreciable plant. Using the existing functional depreciation rates at March 31, 1981, the calculated composite depreciation rate is 3.640%.

Q. ARE YOU PROPOSING ANY CHANGES IN THE FUNCTIONAL DEPRECIATION RATES?

A. No, not at this time.

Q. WOULD YOU PLEASE EXPLAIN THE ADJUSTMENTS MADE TO FEDERAL INCOME TAXES AND FEDERAL INVESTMENT TAX CREDITS?

A. An adjustment was made to these items to reflect the effect of known changes under current rates.

The computation of the adjustment to federal income taxes under current rates recognizes all applicable adjustments for revenues, operation and maintenance expenses, taxes other than federal income taxes, interest expense on long term debt, amortization amounts, and interest on customer deposits as shown on Schedule A under current rates. Depreciation and amortization for the purpose of computing federal income taxes was determined by multiplying the tax basis property, including amounts on which deferred taxes were previously provided, by the proposed composite book depreciation rate. The difference between tax basis depreciation and the book basis depreciation is principally a result of permanent basis differences and book basis costs which were previously

deducted for tax purposes and for which deferred taxes were not provided.

The amortization of investment tax credits was recomputed using the proposed composite depreciation rate of 3.64% at March 31, 1981.

Q. SEVERAL ADJUSTMENTS HAVE BEEN MADE TO TAXES OTHER THAN FEDERAL INCOME TAXES. WOULD YOU DESCRIBE EACH OF THESE ADJUSTMENTS?

A. Social Security taxes have been adjusted for the increase in wage and salary expense, using the 1982 tax rate. Federal and state unemployment taxes have both been adjusted for the increase in test year end number of employees. Ad valorem or property taxes were adjusted to reflect taxes based on electric plant in service at March 31, 1981, and the effective tax rate for 1980 based on actual taxes assessed for that year. The gross receipts tax and the Public Utility Commission fee are revenue-related taxes and have both been adjusted for revenue changes under current rates. The state franchise tax adjustment has been computed using the taxable capital of the Company at the end of the test year, including the Accumulated Deferred Investment Tax Credits.

Q. PLEASE EXPLAIN THE ADJUSTMENT TO THE LINE ENTITLED "AMORTIZATION OF ALLENS CREEK CANCELLATION CHARGES, FREESTONE PROJECT AND OTHER DEFERRED DEBITS".

A. As a result of the final order in Docket 2676, the Commission authorized the amortization over 5 years of the Allens Creek Unit No. 2 cancellation charges, as well as amortization of fees paid to United Research Company for a manpower study for coal-fired generating units, Telesurvey of Texas for an appliance saturation survey and expenses associated with a co-generation study. In Docket 3320, the Commission also authorized the amortization over 5 years of the Freestone Project. Amortization of each of these investments is then increased to allow for recovery of the debt portion of the carrying cost of the remaining unrecovered investments. The Company is not asking for rate base treatment of the unamortized portions, only recovery of the cost of capital associated with our debt obligations. Although the Company incurred these costs in the reasonable and normal conduct of its business operations, it is not at this time asking that the shareholders earn a return on their portion of the unrecovered investments.

Q. PLEASE EXPLAIN THE LINE ENTITLED "AMORTIZATION OF STATE FRANCHISE TAX ASSESSMENT".

A. As a result of the final order in Docket 3320, the Commission authorized the amortization over one year of additional state franchise taxes and interest assessed for the years 1975 through 1978. The adjustment to amortization of state franchise tax assessment eliminates the amount

amortized from rates since the Company has already received recovery of the additional state franchise assessment.

Q. WHY HAVE YOU INCLUDED INTEREST EXPENSE ON CUSTOMER DEPOSITS IN THE COST OF SERVICE?

A. It is appropriate to include interest expense on customer deposits in the cost of service because customer deposits have been removed from the rate base in Schedule B. Our adjustment reflects the annual interest on active customer deposits outstanding at test year end.

Q. ARE THERE OTHER ITEMS INCLUDED ON SCHEDULE A UNDER CURRENT RATES?

A. Yes. One other item is an adjustment to revenue under current rates of approximately $364 million, provided to me by Mr. Edwards. This adjustment reflects the level of KWH sales and revenues which would have occurred had the number of customers at year end been served for the entire test year. It also takes into consideration adjustments for weather, income level, price of electricity and price of competing fuels. The result of these adjustments is to more accurately reflect test period revenues, as Mr. Edwards describes in detail in his written testimony.

Q. WOULD YOU PLEASE EXPLAIN THE ADJUSTMENTS UNDER PROPOSED RATES?

A. Except for the price of coal, which reflects no limitations on the amount that can be recovered, the fuel expense

adjustment at proposed rates was calculated using the same approach that was used in calculating the fuel expense adjustment at current rates. Also, the level of kilowatt hour sales have decreased in response to the higher rates charged to customers as discussed by Mr. Edwards.

The recoverable city franchise requirement adjustment under proposed rates represents 4.167% of the appropriate fuel and base revenues collectible within municipalities, and permits the Company to recover the amount claimed by certain cities under their franchises. HL&P is contesting municipal claims that the franchise fee must be paid on revenues arising from the franchise fee surcharge itself. Should it be successful in resisting these claims, any collections above the amount actually paid to the municipalities would be refunded with interest to the ratepayers.

The adjustment to operation and maintenance is for uncollectible accounts expense. This revenue-related expense has been adjusted for revenue changes under proposed rates.

An adjustment was also made to federal income taxes to take into account the effect of the proposed rate increase as shown on Schedules I-7.6 and I-7.8.

Taxes other than federal income taxes has been adjusted for the increased gross receipts tax and the increased

Public Utility Commission fee that will be due under proposed rates.

The adjustment for the return on invested capital represents the difference between the return as shown on Schedules B and H, and the return as shown on Schedule A at current rates.

This adjustment generates the proposed return of approximately $431 million included in the proposed cost of service of approximately $2.8 billion.

Q. HOW DID YOU DETERMINE THE AMOUNT OF THE PROPOSED RETURN?

A. Mr. Letbetter indicated in his testimony that the Company's weighted average cost of capital at March 31, 1981, is 12.32% as shown on Schedule H, page 1. This rate was applied to the original cost rate base at March 31, 1981 which, as will be explained in detail in my testimony that follows, contains $990 million of construction work in progress and nuclear fuel in process. The $431 million resulting return is equivalent to a 10.43% return on the adjusted value rate base as shown on Schedule H, page 3.

II. RATE BASE

Q. WHAT IS THE PURPOSE OF SCHEDULE B?

A. Schedule B enumerates the Company's rate base. This rate base represents dollars of investment that HL&P has made to serve its customers and upon which it should earn a reasonable return. As stated in the Public Utility

Regulatory Act, Article VI, Section 41, utility rates shall be "based upon the adjusted value of property used by and useful to the public utility in providing service including, where necessary to the financial integrity of the utility construction work in progress at cost as recorded on the books of the utility".

Q. WOULD YOU PLEASE EXPLAIN PAGE 1 OF SCHEDULE B?

A. This page is a summary of the components of the original cost rate base of the Company as of March 31, 1981. It consists of plant and other assets, including facilities that are currently in service as well as facilities that, although are not currently in service, must be included in rate base if the Company is to have an opportunity to meet certain financial goals. Each of the components of the $3.5 billion original cost rate base is discussed below.

Q. WERE ANY ADJUSTMENTS MADE TO THE ORIGINAL COST OF PLANT?

A. A number of adjustments have been made to original cost of plant. The accounts adjusted and the amount of the adjustments are summarized on Schedule C-1.

Q. WOULD YOU PLEASE EXPLAIN THE ADJUSTMENT MADE TO ACCOUNT 106, COMPLETED CONSTRUCTION NOT CLASSIFIED - ELECTRIC?

A. This adjustment consists of two components, as shown on page 2 of Schedule C-1. First, the balance in the account per books at March 31, 1981 was adjusted to include projects that were in service at March 31, but, due to a delay in

paper work, were still recorded on the books as construction work in progress. The second adjustment reflects the reclassification from construction work in progress of delayed credits applicable to depreciable plant in service.

Q. WHY HAVE YOU INCLUDED ELECTRIC PLANT HELD FOR FUTURE USE IN THE RATE BASE?

A. Electric Plant Held For Future Use consists primarily of land and land rights for which the Company has a definite plan, such as future generating facilities, substations and transmission lines. These purchases were made in order to provide for the energy needs of our customers, similar to purchases for a materials and supplies inventory. Had these acquisitions not been made well in advance of construction activity, the cost would have been much higher or the property might not have been available, resulting in delays for the completion of needed facilities. Since the account represents capital investments necessary to continue providing reliable service to the benefit of our customers we are requesting recovery of the cost of capital relating to these committed funds.

Q. IN THE PAST, THE COMMISSION HAS EXCLUDED FROM THE COMPANY'S RATE BASE CERTAIN PROPERTIES FOR WHICH A SPECIFIC IN-SERVICE DATE HAD NOT BEEN DETERMINED. HAVE YOU FOLLOWED THIS PROCEDURE IN THIS FILING?

A. No, I have not. Once again, the Company has a definite plan for such properties although a specific date for service has not been set. Considering the uncertain economic environment and double-digit inflation, we maintain it is in the customers best interests for the Company to purchase these properties in advance of construction activity.

Q. WHAT IS INCLUDED IN THE LINE ENTITLED "ACCUMULATED DEPRECIATION"?

A. The accumulated provision for depreciation consists of the adjusted book balance as of March 31, 1981.

Q. WHY HAVE YOU NOT INCREASED THE ACCUMULATED PROVISION FOR DEPRECIATION FOR THE INCREASED DEPRECIATION EXPENSE INCLUDED IN THE COST OF SERVICE?

A. Consistent with prior rate filings, the Company is not increasing the Accumulated Provision for Depreciation for the increased depreciation expense included in the cost of service. This is also in accordance with Docket 3320 in that no adjustments were recommended by the PUC staff.

Q. PLEASE EXPLAIN THE LINE ENTITLED "EXCLUDED PORTION OF CONSTRUCTION WORK IN PROGRESS".

A. The $367 million is the difference between the adjusted construction work in progress less land included in CWIP and the amount of CWIP in rate base. The book cost of land is excluded since it is not used in the calculation of

allowance for funds used during construction and accordingly is treated as if it was included in Account 105 - Electric Plant Held for Future Use. The $367 million represents the difference between total original cost of plant and the required amount of investment in plant included in rate base in order to enable the Company to achieve the return set forth by Mr. Letbetter. I would point out that the inclusion of CWIP in rate base does not cause our customers to pay for facilities for which they receive no current benefit. The Company's rates will not be set to recover the actual cost of a new generating unit or transmission line until these facilities are actually in service to the customer. CWIP in rate base simply offsets some of the cost of financing the construction. By asking the ratepayers to join with the Company in bearing some of the burdens of the financing costs of new construction, we will have an opportunity to place into service, on a timely basis, generating facilities needed by our customers.

Q. HOW DID YOU ARRIVE AT THE $990 MILLION FOR CONSTRUCTION WORK IN PROGRESS AND NUCLEAR FUEL IN PROCESS IN RATE BASE?

A. On Mr. Letbetter's request, several cases were run with the level of CWIP and NFIP in rate base ranging from 50% to 100% and it was determined that 73% of CWIP and NFIP was the appropriate level to achieve the return needed to produce the required base revenues in the year the new rates would be in effect.

Q. WOULD YOU PLEASE EXPLAIN YOUR COMPUTATION OF WORKING CAPITAL SHOWN IN SCHEDULE B?

A. We have computed working capital in accordance with Substantive Rule 052.02.03.031 (a)(3), and have presented the details of the computation in Schedule G. The allowances for materials and supplies and prepayments are thirteen-month averages. The allowance for fuel stock is the test year end balance, which is more appropriate than an average since the cost of oil has increased during the test year. The Company also anticipates purchasing additional barrels of fuel oil throughout the remainder of 1981 in order to support its expected usage of oil as a boiler fuel in 1982 during peak periods and whenever any of the coal units are temporarily out of service. The allowance for cash working capital represents one-eighth of adjusted operation and maintenance expenses less recoverable fuel, and the materials and supplies issues, and prepayments charged to expense during the test year.

Q. WOULD YOU PLEASE EXPLAIN WHAT IS INCLUDED IN THE RATE BASE ITEM ENTITLED "ADVANCE FOR LIGNITE LEASES"?

A. In August 1979, HL&P exercised an option for the right to acquire certain lignite leases in the Texas counties of Limestone, Leon and Freestone. As a result of this agreement the Company was required to make an advance of $18 million to the owner of the leases. It is intended that

these leases supply a substantial portion of HL&P's fuel requirements for its Limestone Electric Generating Station expected to be ready for commercial operation by 1987.

Q. PLEASE EXPLAIN THE JUSTIFICATION FOR INCLUDING THIS ADVANCE IN RATE BASE.

A. HL&P is not currently contemplating the transfer of the lignite leases to Utility Fuels, Inc. (UFI). A transfer at this point in time will not be made since it is not practical for a company the size of UFI to carry an investment of this magnitude without the corresponding ability to earn a return on the investment. In addition, financing this investment will limit UFI's financing flexibility in the future. UFI will not be able to recover any cost until lignite is actually sold to HL&P in the future. HL&P will carry the investment until mining of the lignite leases starts at which time the leases will probably be transferred to UFI.

A long term fuel supply contract is essential for the operation of a power plant such as the Limestone Electric Generating Station and has to be negotiated well in advance of the expected in-service date of the project. Since the lignite leases ensure a reliable fuel source for the life of the plant and enable the Company to continue to provide reliable service to its customers, HL&P should be allowed a reasonable return on its prudent capital investment.

Q. WHY HAVE YOU EXCLUDED THE REMAINING ITEMS SHOWN ON SCHEDULE B FROM THE RATE BASE?

A. We have deducted these items from the rate base in accordance with Substantive Rule 052.02.03.031(a)(4).

Q. WOULD YOU PLEASE EXPLAIN PAGE 2 OF SCHEDULE B?

A. This page is a summary of the components of the adjusted value rate base of the Company prepared according to the guidelines specified in the Public Utility Regulatory Act, Section 41 (a) and Substantive Rule 052.02.03.031.

Q. WHAT WEIGHTINGS WERE ASSIGNED TO CURRENT COST AND ORIGINAL COST IN CALCULATING THIS ADJUSTED VALUE RATE BASE?

A. Section 41 of the Public Utility Regulatory Act provides that the adjusted value rate must reflect a balance of between 60 and 75 percent original cost less depreciation and between 40 and 25 percent current cost less an adjustment for age and condition. In determining the proper weighting of current and original costs of property, we have considered the effects of inflation on our construction program, the growth of our service area, the quality of service currently being provided to our customers, and our need to attract new capital to finance our construction costs. Inflation will especially affect our construction program due to the length of time required for completion of major construction projects. Because of these factors, we have determined that a mix of 40% net current cost and 60%

net original cost is necessary and appropriate to accurately reflect the adjusted value of utility property used by and useful to our customers.

Q. PLEASE EXPLAIN HOW THE CURRENT COST OF THE COMPANY'S FACILITIES WAS DETERMINED?

A. The current cost of the Company's facilities was determined with the assistance of Whitman, Requardt and Associates. Estimating the current cost of the property in any plant account requires a suitable index and the vintaged surviving investment. Handy-Whitman construction cost indexes and other published indexes were used.

Utility plant can be divided into two classes of property: located property and mass property. Located property is property which is classified by location and installation date. In the case of generating plants, interim additions and retirements are debited or credited to the specific units and when a unit is retired, its cost is deducted from the original vintage at the original cost. Vintaged surviving balances are maintained by account and the application of trend factors is a straight-forward process.

Mass property accounts are composed of hundreds of identical retirement units. Additions are recorded in terms of total units and total dollars. Retirements are normally recorded as subtractions from the whole. Since the original

cost and age of a retired unit cannot be determined, the Company applies the rolling average cost.

Q. WHAT IS A ROLLING AVERAGE COST?

A. The rolling average unit cost of a particular retirement unit is the total investment in that unit divided by the total number of units. Theoretically, the cost changes each time a unit is capitalized. As a practical matter, the rolling average unit cost for retirements is computed annually.

The property records do not show any dispersion of survivors. This situation is not true to real life because units are retired at all ages for a variety of reasons. Therefore, the surviving investment in the mass accounts must be distributed by vintage.

Q. HOW WAS THAT DONE?

A. Using the depreciation study developed in Docket 3320, suvivor curves typical of each of the mass accounts was developed. The dollars were then distributed by vintage in accordance with these curves as shown on Schedule E-1. These vintaged dollars were then trended with the appropriate index for each account. The supporting computations are shown as part of the development of the trended future accruals in Schedule F-1.

Q. HOW WAS THE ADJUSTMENT FOR AGE AND CONDITION SHOWN IN SCHEDULE F CALCULATED?

A. The adjustment for age and condition was determined by using a trending method. The surviving investment by year placed in service was first determined for each primary account, that is, the original cost of the plant placed in service during that year less the cost of any such plant that has since been retired. This is also commonly known as "vintage survivors". Future accruals are then computed for each vintage based on the remaining life for each vintage. The balance and the future accruals were then trended to current cost. The theoretical reserve was calculated by subtracting the trended future accruals from the trended balance in each vintage and summing results for all vintages in each account.

Q. HOW DOES NET CURRENT COST RELATE TO THE COMPANY'S HISTORICAL COST?

A. Since utility plant was purchased, two things have occurred. First, plant has depreciated in value, and second, inflation has eroded the value of a dollar. Net current cost reflects both depreciation and the impact of inflation on the construction of the Company's facilities over the years. A return of 10.43% on our current cost investment would provide the return that we're requesting in this application.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.

THE STATE OF TEXAS §

COUNTY OF HARRIS §

Before me, the undersigned authority, on this day personally appeared Rick L. Campbell, having been duly sworn, upon oath says:

"My name is Rick L. Campbell, I am of legal age and a resident of the State of Texas. The foregoing testimony, and exhibits, offered by me on behalf of Houston Lighting & Power Company, are true and correct, and the opinions stated therein are, in my judgment and based upon my professional experience, true and correct."

Rick L. Campbell

Rick L. Campbell

Subscribed and sworn to before me by the said Rick L. Campbell this 15TH day of JUNE, 1981.

John P. Sterner

Notary Public in and for

Harris County, Texas

NOTARY PUBLIC STATE OF TEXAS

JOHN P. STERNER
Notary Public, State of Texas
My Commission Expires MAR 31 1985