Other interest expense, which includes short-term bank borrowings needed to meet operating and interim construction funding, decreased $0.6 million in 2002. The amount borrowed in 2002 was larger because of an increase in capital expenditures. In 2001, other interest increased by $0.1 million because higher borrowings were necessary due to reduced cash flow from operations and increased capital expenditures. Lower interest rates on short-term borrowings in both years offset the interest cost that resulted from higher borrowing levels. There was $36.4 million in short-term borrowings outstanding at December 31, 2002 and $22.0 million at December 31, 2001.

Other Income and Expenses. Other income is derived from management contracts under which the Company operates private and municipally-owned water systems and recycled water systems and provides meter reading, water testing and billing services to various cities; leases of communication antenna sites; sales of surplus property; and interest on short-term investments. Other income, net of expenses, was $5.6 million in 2002, $5.8 million in 2001 and $1.4 million in 2000. During 2002, $3.0 million in pre-tax profits were realized from surplus properties sold as part of the Real Estate Program that is described in more detail in the "LIQUIDITY AND CAPITAL RESOURCES" section of this report. There were $3.9 million of gains from surplus property sales in 2001 and no property sales in 2000.

RATES AND REGULATION

2002 Regulatory Activity. Washington Water filed a GRC application in February 2002. The WUTC issued its decision early in April 2002 granting a $1 million increase in annual revenue to cover higher operating costs and capital expenditures.

In June 2002, the CPUC authorized the Company to increase rates in its Bakersfield district by $796,000 on an annual basis. This decision was based on an advice letter filing to cover approximately $6 million of construction cost incurred to date for a new water treatment plant.

The Company filed a Notice of Intent to file GRC applications for three California districts in July 2002. The Commission's staff accepted the applications in November. Four additional district GRC applications, including the General Office operation, were submitted in January 2003. Combined, these districts represent 17% of the California customers. The Commission staff has indicated that a decision on these filings should be expected in late 2003.

2001 Regulatory Activity. After analyzing 17 Cal Water districts that were eligible for general rate filings in 2001, and based on current earnings levels, projected expense increases, including higher electric power costs, and expected capital expenditures, applications were filed in July 2001 for 15 districts covering about 70% of Cal Water's customers. The applications requested an 11.5% return on equity including 75 basis points to reflect the increased risk associated with the CPUC's changes in recovery of water production expense increases and $21 million in new annual revenue. Under the CPUC's rate case processing schedule, a decision on the district GRC applications was expected by the third quarter of 2002. However, despite the filing of briefs by all parties in May 2002, a Proposed Decision has not been issued. At this time, a final decision is expected in April 2003, about 20 months after filing of the applications. Based on the administrative law judge's Draft of a Proposed Decision (DPD) released in January 2003, the Company would be authorized a $12.8 million increase in annual revenue. Additionally, the DPD recommends a return on equity of 9.7% with an equity percentage of capitalization at 51.5%. While that is positive news, it does not recognize that regulatory delays have resulted in the loss of revenues, which the DPD finds just and reasonable.

The DPD also recommends an allocation method for sharing expenses between regulated and non-regulated activities that is inconsistent with a prior Commission decision that was issued following a Commission rulemaking investigation. Furthermore, the DPD proposes changing the rate-setting practice regarding the treatment of gain on the sale for surplus property. The existing rules are based on legislation adopted in 1995 by the California legislature, which requires that gains realized on the sale of surplus property be reinvested in new utility plant and that the Company be allowed to earn a reasonable rate of return on the reinvestment. As proposed in the DPD, the Company would be required to treat the reinvestment of gains on the sale of surplus property as contributed plant and it would not be allowed to earn a return on its reinvestment. The Company, along with other California water utilities, opposes these rate-setting changes and will aggressively defend the legislation administratively and, if necessary, pursue legislative remedies. If these proposals were adopted by the Commission, they would have a detrimental impact on the Company's non-