Purchased power is required to operate wells and pumps. Prior to 2001, the Company had not been subjected to significant electric power cost increases. However, California energy costs rose significantly in 2001. In January 2001, the CPUC approved an energy surcharge that increased the Company's cost of purchased electricity by 10%. A second, more significant 38% increase in electric costs became effective in May 2001, bringing the total increase to 48%. When the CPUC proposed electric cost increases, the Company believed the higher costs were recoverable from consumers on a pass-through basis under established CPUC procedures regarding expense-balancing accounts. However, the CPUC subsequently revised its rules regarding recovery of the higher costs, resulting in delays in recovering the higher costs. While no new power rate increases are proposed or known at this time, the Company continues to purchase electricity from suppliers at rates greater than it is recovering from its water customers in 20 California districts.

Purchased power increased $1.8 million in 2002, $6.0 million in 2001 and $0.7 million in 2000. The 2002 cost increase was caused by higher electric rates paid through May 2002 as compared to 2001's electric rates and a 5% increase in well production. The purchased power cost increase in 2000 was due mainly to a 3% increase in water production.

Employee payroll and benefits charged to operations and maintenance was $50.3 million in 2002, $47.8 million for 2001, and $44.5 million for 2000. The increases in payroll and related benefits are attributable to general wage increases effective at the start of each year and additional hours worked. At year-end 2002, there were 802 employees, including 12 employees added in New Mexico with the acquisition of Rio Grande Utility Corporation. At the end of 2001 and 2000, there were 783 and 797 employees, respectively. Most non-supervisory employees are represented by the Utility Workers Union of America, AFL-CIO, with the exception of certain engineering and laboratory employees who are represented by the International Federation of Professional and Technical Engineers, AFL-CIO. In December 2002, the Company successfully negotiated new three-year agreements with both unions covering 2003 through 2005. Wage increases under the new agreements will be 1% in 2003, 1.5% in 2004 and 2% in 2005. Improvements in employee benefit plans were also negotiated.

During 2000, a curtailment of the Dominguez pension plan was recorded resulting in a non-taxable gain of $1.2 million that was offset against operating expenses. The curtailment occurred because the Dominguez pension plan was frozen at the merger date and its participants became participants in the Company's pension plan. Previous amounts expensed by Dominguez but not funded to the plan comprise the curtailment amount. This amount is included in the $44.5 million reported for payroll and benefits charged to operations and maintenance expense.

Income tax expense was $12.6 million in 2002, $9.7 million in 2001 and $11.6 million in 2000. The changes in taxes are generally due to variations in taxable income.

Long-term debt interest expense increased $1.4 million compared to 2001. Series E, 7.11% $20 million senior notes were issued in May 2002 and Series F, 5.90% $20 million senior notes were issued in August 2002. Proceeds from the issues were used to repay short-term bank borrowings and to fund the Company's construction program.

As part of a program to refinance certain high interest rate first mortgage bonds, Series G and Series H, 5.29% senior notes were issued in November and December 2002, each for $20 million. With the proceeds from these two issues, three series of first mortgage bonds totaling $33 million were redeemed. The remaining proceeds were used to repay short-term bank borrowings.

The issuance of the new senior notes caused long-term interest expense to increase because of the higher principal amount outstanding. In 2001, interest on long-term debt increased $1.3 million over 2000. The issuance of $20 million of Series D senior notes in September 2001 and $20 million of Series C senior notes in October 2000, net of sinking fund payments on first mortgage bonds, resulted in a larger principal amount of long-term debt outstanding and thus increased interest expense. In 2002, 2001 and 2000, interest capitalized on construction projects was $1.5 million, $0.9 million, and $0.7 million, respectively. The increase in the amount capitalized in 2002 is attributable to an increase in the Company's construction expenditures, particularly those associated with construction of a water treatment plant in the Bakersfield district. Interest coverage of long-term debt before income taxes was 2.7 times in 2002, 2.6 times in 2001 and 3.3 times in 2000. The reduction in interest coverage for 2002 and 2001 compared to 2000 resulted from lower earnings and the new senior note issues outstanding. The interest coverage is expected to improve once GRC decisions are authorized by the CPUC and as a result of the lower interest costs realized by refinancing certain first mortgage bond issues.