

CALIFORNIA WATER SERVICE GROUP

Form 10-Q

November 05, 2010

**Table of Contents**

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

**(Mark One)**

☐ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2010**

**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 1-13883  
CALIFORNIA WATER SERVICE GROUP**

(Exact name of registrant as specified in its charter)

Delaware

77-0448994

(State or other jurisdiction  
of incorporation or organization)

(I.R.S. Employer identification No.)

1720 North First Street, San Jose, CA.

95112

(Address of principal executive offices)

(Zip Code)

408-367-8200

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has 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 registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☐ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated  
filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting  
company ☐

(Do not check if a Smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act) Yes ☐ No ☐

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Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding as of November 2, 2010 20,830,303

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TABLE OF CONTENTS

|                                                                                                                          | <b>Page</b> |
|--------------------------------------------------------------------------------------------------------------------------|-------------|
| <u>PART I Financial Information</u>                                                                                      | 3           |
| <u>Item 1 Financial Statements</u>                                                                                       | 3           |
| <u>Condensed Consolidated Balance Sheets (unaudited) as of September 30, 2010 and December 31, 2009</u>                  | 3           |
| <u>Condensed Consolidated Statements of Income (unaudited) For the Three Months Ended September 30, 2010 and 2009</u>    | 4           |
| <u>Condensed Consolidated Statements of Income (unaudited) For the Nine months ended September 30, 2010 and 2009</u>     | 5           |
| <u>Condensed Consolidated Statements of Cash Flows (unaudited) For the Nine months ended September 30, 2010 and 2009</u> | 6           |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>                                                    | 7           |
| <u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                      | 21          |
| <u>Item 3 Quantitative and Qualitative Disclosure about Market Risk</u>                                                  | 32          |
| <u>Item 4 Controls and Procedures</u>                                                                                    | 32          |
| <u>PART II Other Information</u>                                                                                         | 33          |
| <u>Item 1 Legal Proceedings</u>                                                                                          | 33          |
| <u>Item 6 Exhibits</u>                                                                                                   | 34          |
| <u>Signatures</u>                                                                                                        | 35          |
| <u>Index to Exhibits</u>                                                                                                 | 36          |
| <u>EX-10.1</u>                                                                                                           |             |
| <u>EX-10.2</u>                                                                                                           |             |
| <u>EX-31.1</u>                                                                                                           |             |
| <u>EX-31.2</u>                                                                                                           |             |
| <u>EX-32</u>                                                                                                             |             |
| <u>EX-101 INSTANCE DOCUMENT</u>                                                                                          |             |
| <u>EX-101 SCHEMA DOCUMENT</u>                                                                                            |             |
| <u>EX-101 CALCULATION LINKBASE DOCUMENT</u>                                                                              |             |
| <u>EX-101 LABELS LINKBASE DOCUMENT</u>                                                                                   |             |
| <u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>                                                                             |             |

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS**

The condensed consolidated financial statements presented in this filing on Form 10-Q have been prepared by management and are unaudited.

**CALIFORNIA WATER SERVICE GROUP****CONDENSED CONSOLIDATED BALANCE SHEETS**

Unaudited

(In thousands, except per share data)

|                                                 | <b>September<br/>30,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|-------------------------------------------------|-----------------------------------|----------------------------------|
| <b>ASSETS</b>                                   |                                   |                                  |
| <b>Utility plant:</b>                           |                                   |                                  |
| Utility plant                                   | \$ 1,819,330                      | \$ 1,709,062                     |
| Less accumulated depreciation and amortization  | (538,919)                         | (510,985)                        |
| Net utility plant                               | 1,280,411                         | 1,198,077                        |
| <b>Current assets:</b>                          |                                   |                                  |
| Cash and cash equivalents                       | 9,738                             | 9,866                            |
| Receivables:                                    |                                   |                                  |
| Customers                                       | 33,606                            | 25,567                           |
| Regulatory balancing accounts                   | 6,898                             | 10,513                           |
| Other                                           | 5,699                             | 9,043                            |
| Unbilled revenue                                | 21,602                            | 13,417                           |
| Materials and supplies at weighted average cost | 5,925                             | 5,530                            |
| Taxes, prepaid expenses and other assets        | 8,260                             | 18,305                           |
| Total current assets                            | 91,728                            | 92,241                           |
| <b>Other assets:</b>                            |                                   |                                  |
| Regulatory assets                               | 223,724                           | 204,104                          |
| Goodwill                                        | 2,615                             | 2,615                            |
| Other assets                                    | 33,462                            | 28,544                           |
| Total other assets                              | 259,801                           | 235,263                          |
|                                                 | \$ 1,631,940                      | \$ 1,525,581                     |
| <b>CAPITALIZATION AND LIABILITIES</b>           |                                   |                                  |
| <b>Capitalization:</b>                          |                                   |                                  |
| Common stock, \$.01 par value                   | \$ 208                            | \$ 208                           |
| Additional paid-in capital                      | 217,147                           | 215,528                          |
| Retained earnings                               | 219,127                           | 204,898                          |
| Total common stockholders' equity               | 436,482                           | 420,634                          |
| Long-term debt, less current maturities         | 380,285                           | 374,269                          |

|                                                                |              |              |
|----------------------------------------------------------------|--------------|--------------|
| Total capitalization                                           | 816,767      | 794,903      |
| <b>Current liabilities:</b>                                    |              |              |
| Current maturities of long-term debt                           | 2,374        | 12,953       |
| Short-term borrowings                                          | 56,250       | 12,000       |
| Accounts payable                                               | 47,827       | 43,689       |
| Regulatory balancing accounts                                  | 586          | 2,430        |
| Accrued interest                                               | 8,991        | 4,258        |
| Accrued expenses and other liabilities                         | 39,511       | 35,028       |
| Total current liabilities                                      | 155,539      | 110,358      |
| <b>Unamortized investment tax credits</b>                      | 2,318        | 2,318        |
| <b>Deferred income taxes, net</b>                              | 103,866      | 91,851       |
| <b>Pension and postretirement benefits other than pensions</b> | 143,619      | 137,127      |
| <b>Regulatory and other liabilities</b>                        | 88,839       | 85,780       |
| <b>Advances for construction</b>                               | 187,646      | 185,027      |
| <b>Contributions in aid of construction</b>                    | 133,346      | 118,217      |
|                                                                | \$ 1,631,940 | \$ 1,525,581 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

Unaudited

(In thousands, except per share data)

|                                                     | <b>Three Months Ended September 30,</b> |             |
|-----------------------------------------------------|-----------------------------------------|-------------|
|                                                     | <b>2010</b>                             | <b>2009</b> |
| <b>Operating revenue</b>                            | \$ 146,349                              | \$ 139,167  |
| <b>Operating expenses:</b>                          |                                         |             |
| Operations:                                         |                                         |             |
| Water production costs                              | 54,634                                  | 48,898      |
| Administrative and general                          | 17,794                                  | 19,084      |
| Other operations                                    | 14,889                                  | 14,639      |
| Maintenance                                         | 4,853                                   | 4,405       |
| Depreciation and amortization                       | 10,934                                  | 10,259      |
| Income taxes                                        | 12,825                                  | 13,417      |
| Property and other taxes                            | 4,555                                   | 4,371       |
| Total operating expenses                            | 120,484                                 | 115,073     |
| Net operating income                                | 25,865                                  | 24,094      |
| <b>Other income and expenses:</b>                   |                                         |             |
| Non-regulated revenue                               | 3,850                                   | 5,194       |
| Non-regulated expenses, net                         | (2,214)                                 | (3,464)     |
| Gain on sale of non-utility property                | 33                                      |             |
| Income taxes (expense) on other income and expenses | (674)                                   | (702)       |
| Net other income and expenses                       | 995                                     | 1,028       |
| <b>Interest expense:</b>                            |                                         |             |
| Interest expense                                    | 6,958                                   | 6,480       |
| Less: capitalized interest                          | (484)                                   | (950)       |
| Net interest expense                                | 6,474                                   | 5,530       |
| <b>Net income</b>                                   | \$ 20,386                               | \$ 19,592   |
| <b>Earnings per share</b>                           |                                         |             |
| Basic                                               | \$ 0.98                                 | \$ 0.94     |
| Diluted                                             | \$ 0.98                                 | \$ 0.94     |
| <b>Weighted average shares outstanding</b>          |                                         |             |
| Basic                                               | 20,811                                  | 20,745      |
| Diluted                                             | 20,824                                  | 20,767      |

|                                                     |    |        |    |        |
|-----------------------------------------------------|----|--------|----|--------|
| <b>Dividends declared per share of common stock</b> | \$ | 0.2975 | \$ | 0.2950 |
|-----------------------------------------------------|----|--------|----|--------|

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

4

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**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME**

Unaudited

(In thousands, except per share data)

|                                                     | <b>Nine Months Ended September<br/>30,</b> |             |
|-----------------------------------------------------|--------------------------------------------|-------------|
|                                                     | <b>2010</b>                                | <b>2009</b> |
| <b>Operating revenue</b>                            | \$ 354,942                                 | \$ 342,447  |
| <b>Operating expenses:</b>                          |                                            |             |
| Operations:                                         |                                            |             |
| Water production costs                              | 126,923                                    | 119,468     |
| Administrative and general                          | 53,718                                     | 57,331      |
| Other operations                                    | 43,204                                     | 41,425      |
| Maintenance                                         | 14,962                                     | 13,352      |
| Depreciation and amortization                       | 32,364                                     | 30,739      |
| Income taxes                                        | 21,324                                     | 21,438      |
| Property and other taxes                            | 12,545                                     | 12,371      |
| Total operating expenses                            | 305,040                                    | 296,124     |
| Net operating income                                | 49,902                                     | 46,323      |
| <b>Other income and expenses:</b>                   |                                            |             |
| Non-regulated revenue                               | 10,963                                     | 11,173      |
| Non-regulated expenses, net                         | (9,451)                                    | (6,826)     |
| Gain on sale of non-utility property                | 33                                         | 675         |
| Income taxes (expense) on other income and expenses | (614)                                      | (2,032)     |
| Net other income and expense                        | 931                                        | 2,990       |
| <b>Interest expense:</b>                            |                                            |             |
| Interest expense                                    | 20,386                                     | 17,480      |
| Less: capitalized interest                          | (2,338)                                    | (2,270)     |
| Net interest expense                                | 18,048                                     | 15,210      |
| <b>Net income</b>                                   | \$ 32,785                                  | \$ 34,103   |
| <b>Earnings per share</b>                           |                                            |             |
| Basic                                               | \$ 1.58                                    | \$ 1.64     |
| Diluted                                             | \$ 1.58                                    | \$ 1.64     |
| <b>Weighted average shares outstanding</b>          |                                            |             |
| Basic                                               | 20,798                                     | 20,740      |
| Diluted                                             | 20,812                                     | 20,765      |

|                                                     |    |        |    |        |
|-----------------------------------------------------|----|--------|----|--------|
| <b>Dividends declared per share of common stock</b> | \$ | 0.8925 | \$ | 0.8850 |
|-----------------------------------------------------|----|--------|----|--------|

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

5

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**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

Unaudited

(In thousands)

|                                                                                   | <b>Nine Months Ended September<br/>30,</b> |             |
|-----------------------------------------------------------------------------------|--------------------------------------------|-------------|
|                                                                                   | <b>2010</b>                                | <b>2009</b> |
| <b>Operating activities</b>                                                       |                                            |             |
| Net income                                                                        | \$ 32,785                                  | \$ 34,103   |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                            |             |
| Depreciation and amortization                                                     | 34,588                                     | 32,178      |
| Gain on sale of non-utility property                                              | (33)                                       | (675)       |
| Change in value of life insurance contracts                                       | (1,308)                                    | (3,555)     |
| Other changes in noncurrent assets and liabilities                                | 2,708                                      | 11,975      |
| Changes in operating assets and liabilities:                                      |                                            |             |
| Receivables                                                                       | (9,265)                                    | (31,449)    |
| Accounts payable                                                                  | 4,236                                      | 15,561      |
| Other current assets                                                              | 6,659                                      | 4,572       |
| Other current liabilities                                                         | 9,217                                      | 13,689      |
| Other changes, net                                                                | (2,121)                                    | 764         |
| Net adjustments                                                                   | 44,681                                     | 43,060      |
| Net cash provided by operating activities                                         | 77,466                                     | 77,163      |
| <b>Investing activities:</b>                                                      |                                            |             |
| Utility plant expenditures                                                        | (99,341)                                   | (86,410)    |
| Purchase of life insurance                                                        | (1,798)                                    | (1,711)     |
| Proceeds on sale of non-utility property                                          | 33                                         | 750         |
| Restricted cash decrease                                                          | 2,991                                      |             |
| Net cash used in investing activities                                             | (98,115)                                   | (87,371)    |
| <b>Financing activities:</b>                                                      |                                            |             |
| Short-term borrowings                                                             | 71,250                                     | 20,000      |
| Repayment of short-term borrowing                                                 | (27,000)                                   | (48,000)    |
| Advances and contributions in aid of construction                                 | 3,258                                      | 3,642       |
| Refunds of advances for construction                                              | (4,687)                                    | (4,354)     |
| Dividends paid                                                                    | (18,556)                                   | (18,353)    |
| Proceeds from long-term debt, net of issuance cost                                | 7,969                                      | 96,706      |
| Repayment of long-term debt                                                       | (12,532)                                   | (5,751)     |
| Issuance of common stock                                                          | 819                                        | 30          |
| Net cash provided by financing activities                                         | 20,521                                     | 43,920      |
| Change in cash and cash equivalents                                               | (128)                                      | 33,712      |

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|                                                  |          |           |
|--------------------------------------------------|----------|-----------|
| Cash and cash equivalents at beginning of period | 9,866    | 13,869    |
| Cash and cash equivalents at end of period       | \$ 9,738 | \$ 47,581 |

**Supplemental information**

|                                                     |           |          |
|-----------------------------------------------------|-----------|----------|
| Cash paid for interest, net of interest capitalized | \$ 11,287 | \$ 8,717 |
| Cash paid for income taxes                          | \$ 68     | \$ 717   |

**Supplemental disclosure of non-cash activities:**

|                                                   |           |           |
|---------------------------------------------------|-----------|-----------|
| Accrued payables for investments in utility plant | \$ 7,756  | \$ 8,013  |
| Utility plant contribution by developers          | \$ 26,045 | \$ 13,940 |

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

**Table of Contents**

**CALIFORNIA WATER SERVICE GROUP**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**September 30, 2010**

(Amounts in thousands, except share and per share amounts)

**Note 1. Organization and Operations and Basis of Presentation**

California Water Service Group (the Company) is a holding company that provides water utility and other related services in California, Washington, New Mexico and Hawaii through its wholly-owned subsidiaries. California Water Service Company (Cal Water), Washington Water Service Company (Washington Water), New Mexico Water Service Company (New Mexico Water), and Hawaii Water Service Company, Inc. (Hawaii Water) provide regulated utility services under the rules and regulations of their respective state's regulatory commissions (jointly referred to herein as the Commissions). CWS Utility Services and HWS Utility Services LLC provide non-regulated water utility and utility-related services.

**Basis of Presentation**

The unaudited interim financial information has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC) and therefore do not contain all of the information and footnotes required by GAAP and the SEC for annual financial statements. The condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2009, included in its annual report on Form 10-K as filed with the SEC on March 1, 2010.

The preparation of the Company's condensed consolidated financial statements in accordance with GAAP 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 balance sheet dates and the reported amounts of revenues and expenses for the periods presented. Actual results could differ from these estimates.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments that are necessary to provide a fair presentation of the results for the periods covered. The results for interim periods are not necessarily indicative of the results for any future period.

Due to the seasonal nature of the water business, the results for interim periods are not indicative of the results for a twelve-month period. Revenue and income are generally higher in the warm, summer months and lower in the cooler winter months.

The Company operates in one reportable segment providing water and related utility services.

The Company evaluated its operations through the time these financial statements were issued and determined there were no subsequent events requiring additional adjustments or disclosures as of the time these financial statements were issued.

**Note 2. Summary of Significant Accounting Policies**

**Revenue**

Revenue includes monthly cycle customer billings for regulated water and wastewater services at rates authorized by regulatory commissions and billings to certain non-regulated customers. Revenue from metered customers includes billings to customers based on monthly meter readings plus an estimate for water used between the customer's last meter reading and the end of the accounting period. Flat rate customers are billed in advance at the beginning of the service period. The revenue is prorated so that the portion of revenue applicable to the current accounting period is included in that period's revenue, with the balance recorded as unearned revenue on the balance sheet and recognized as revenue when earned in the subsequent accounting period. In addition, effective July 1, 2008 with the adoption of the Water Revenue Adjustment Mechanism (WRAM) and the Modified Cost Balancing Account (MCBA), Cal Water records the difference between what is billed to its regulated customers and that which is authorized by the California Public Utilities Commission (CPUC).

## **Table of Contents**

Under the WRAM, Cal Water records the adopted level of volumetric revenues as authorized by the CPUC for metered accounts (adopted volumetric revenues). In addition to volumetric-based revenues, the revenue requirements approved by the CPUC include service charges, flat rate charges, and other items that are not subject to the WRAM. The adopted volumetric revenue considers the seasonality of consumption of water based upon historical averages. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as a component of revenue with an offsetting entry to a current or long-term asset or liability balancing account (tracked individually for each Cal Water district). The variance amount may be positive or negative and represents amounts that will be billed or refunded to customers in the future.

Under the MCBA, Cal Water tracks adopted expense levels for water production costs (purchased water, purchased power, and pump taxes), as established by the CPUC. Variances (which include the effects of changes in both rate and volume) between adopted and actual purchased water, purchased power, and pump tax expenses are recorded as a component of revenue, as the amount of such variances will be recovered from or refunded to the Company's customers at a later date. This is reflected with an offsetting entry to a current or long-term asset or liability regulatory balancing account (tracked individually for each Cal Water district).

The balances in the WRAM and MCBA assets and liabilities accounts fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of the WRAM is netted against the MCBA over- or under-recovery for the corresponding district and is interest bearing at the current ninety day commercial paper rate. When the net amount for any district achieves a pre-determined level at the end of any calendar year (i.e., at least 2.5% over- or under-recovery of the approved revenue requirement), Cal Water will file with the CPUC to refund or collect the balance in the accounts. Account balances less than those levels may be refunded or collected in Cal Water's general rate case proceedings or aggregated with future calendar year balances for comparison with the recovery level. As of September 30, 2010 included in the net regulatory balancing accounts, current and long-term assets were \$6.8 million and \$23.7 million, respectively, and the net regulatory balancing accounts current and long-term liabilities were \$0.6 million and \$2.5 million, respectively. As of December 31, 2009, included in the net regulatory balancing accounts, current and long-term assets were \$10.5 million and \$5.1 million, respectively, and the net regulatory balancing accounts current and long-term liabilities were \$2.4 million and \$0.9 million, respectively.

### **Note 3. Stock-based Compensation**

#### **Long-Term Incentive Plan**

On April 27, 2005, the stockholders approved an equity incentive plan, which replaced the Company's previous Long-Term Incentive Plan. The Long-Term Incentive Plan allowed granting of nonqualified stock options, some of which are currently outstanding. There will be no future grants made under the Long-Term Incentive Plan. The Company had accounted for options using the intrinsic value method. Options were granted at an exercise price that was not less than the per share common stock market price on the date of grant. The options vested over four years at a rate of 25% per year on the anniversary date of the date of grant and are exercisable over a ten-year period. At September 30, 2010, options are fully vested and exercisable at a weighted average price of \$25.22. No options were granted and 27,250 shares were exercised during the nine-month period ended September 30, 2010. All options will expire in 2012.

#### **Equity Incentive Plan**

The Company's Equity Incentive Plan, which was approved by shareholders on April 27, 2005, is authorized to issue up to 1,000,000 shares of common stock. As of September 30, 2010 and 2009, the Company granted Restricted Stock Awards (RSAs) of 38,286 and 21,000 shares, respectively, of common stock both to officers and to directors of the Company. Employee options vest ratably over forty-eight months, while director options become fully vested at the end of twelve months. In the third quarters of 2010 and 2009, the shares were valued at \$35.48 and \$38.38 per share, respectively, based upon the fair market value of the Company's common stock on the date of grant.

During the first nine months of 2009, the Company granted Stock Appreciation Rights (SARs) to officers of 71,500 shares, which vest ratably over forty-eight months and expire at the end of ten years. The Company has not granted any SARs in 2010.

The Company has recorded compensation costs for the RSAs and SARs in Operating Expense in the amount of \$0.8 million for each of the nine months ended September 30, 2010 and September 30, 2009.



**Table of Contents****Note 4. Earnings Per Share Calculations**

The computations of basic and diluted earnings per share are noted below. RSAs are included in the weighted stock outstanding as the shares have all the same voting and dividend rights as issued and unrestricted common stock.

Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

The SARs outstanding of 180,210 were anti-dilutive for the third quarter of 2010 and 2009. All options are dilutive and the dilutive effect is shown in the table below.

(In thousands, except per share data)

|                                                 | <b>Three Months Ended September<br/>30</b> |             |
|-------------------------------------------------|--------------------------------------------|-------------|
|                                                 | <b>2010</b>                                | <b>2009</b> |
| Net income available to common stockholders     | \$ 20,386                                  | \$ 19,592   |
| Weighted average common shares, basic           | 20,811                                     | 20,745      |
| Dilutive common stock options (treasury method) | 13                                         | 22          |
| Shares used for dilutive computation            | 20,824                                     | 20,767      |
| Net income per share basic                      | \$ 0.98                                    | \$ 0.94     |
| Net income per share diluted                    | \$ 0.98                                    | \$ 0.94     |

|                                                 | <b>Nine months ended September<br/>30</b> |             |
|-------------------------------------------------|-------------------------------------------|-------------|
|                                                 | <b>2010</b>                               | <b>2009</b> |
| Net income available to common stockholders     | \$ 32,785                                 | \$ 34,103   |
| Weighted average common shares, basic           | 20,798                                    | 20,740      |
| Dilutive common stock options (treasury method) | 14                                        | 25          |
| Shares used for dilutive computation            | 20,812                                    | 20,765      |
| Net income per share basic                      | \$ 1.58                                   | \$ 1.64     |
| Net income per share diluted                    | \$ 1.58                                   | \$ 1.64     |

**Note 5. Pension Plan and Other Postretirement Benefits**

The Company provides a qualified, defined-benefit, non-contributory pension plan for substantially all employees.

The Company makes annual contributions to fund the amounts accrued for the qualified pension plan. The Company also maintains an unfunded, non-qualified, supplemental executive retirement plan. The costs of the plans are charged to expense or are capitalized in utility plant as appropriate.

The Company offers medical, dental, vision, and life insurance benefits for retirees and their spouses and dependents. Participants are required to pay a premium, which offsets a portion of the cost.

Cash payments by the Company related to pension plans and other postretirement benefits were \$13.2 million for the nine months ended September 30, 2010. The estimated cash contribution to the pension plans during 2010 is \$24.3 million. The estimated contribution to the other benefits plan during 2010 is \$5.6 million.



**Table of Contents**

The following table lists components of the pension plans and other postretirement benefits. The data listed under pension plan includes the qualified pension plan and the non-qualified supplemental executive retirement plan. The data listed under other benefits is for all other postretirement benefits.

|                                    | Three Months Ended September 30 |          |                |          | Nine Months Ended September 30 |           |                |          |
|------------------------------------|---------------------------------|----------|----------------|----------|--------------------------------|-----------|----------------|----------|
|                                    | Pension Plan                    |          | Other Benefits |          | Pension Plan                   |           | Other Benefits |          |
|                                    | 2010                            | 2009     | 2010           | 2009     | 2010                           | 2009      | 2010           | 2009     |
| Service cost                       | \$ 2,654                        | \$ 2,279 | \$ 813         | \$ 728   | \$ 7,557                       | \$ 6,839  | \$ 2,399       | \$ 2,186 |
| Interest cost                      | 3,612                           | 3,088    | 739            | 703      | 10,276                         | 9,264     | 2,305          | 2,111    |
| Expected return on plan assets     | (2,068)                         | (1,788)  | (278)          | (196)    | (6,171)                        | (5,366)   | (836)          | (589)    |
| Recognized net initial APBO (1)    | N/A                             | N/A      | 69             | 69       | N/A                            | N/A       | 207            | 207      |
| Amortization of prior service cost | 1,649                           | 1,533    | 29             | 29       | 4,947                          | 4,599     | 87             | 87       |
| Recognized net actuarial loss      | 922                             | 482      | 332            | 406      | 1,971                          | 1,448     | 1,117          | 1,217    |
| Net periodic benefit cost          | \$ 6,769                        | \$ 5,594 | \$ 1,704       | \$ 1,739 | \$ 18,580                      | \$ 16,784 | \$ 5,279       | \$ 5,219 |

## (1) APBO

Accumulated  
postretirement  
benefit  
obligation

## Note 6. Short-term and Long-term Borrowings

California Water Service Group and subsidiaries which it designates may borrow up to \$50 million under the Company's short-term credit facility. Cal Water may borrow up to \$250 million under its separate credit facility; however, all borrowings need to be repaid within twelve months unless otherwise authorized by the CPUC.

The short-term unsecured credit agreement applicable to each credit facility contains affirmative and negative covenants and events of default customary for credit facilities of this type including, among other things, limitations and prohibitions relating to additional indebtedness, liens, mergers, and asset sales. Also, each unsecured credit agreement contains financial covenants governing the Company and its subsidiaries' consolidated total capitalization ratio and interest coverage ratio. As of September 30, 2010, the Company had met all borrowing covenants for both credit agreements.

As of September 30, 2010 and 2009, the outstanding borrowings on the Company lines of credit were \$22.3 million and \$12 million, respectively, and outstanding borrowings on the Cal Water lines of credit were \$34.0 million and none, respectively.

During the nine months ended September 30, 2010, we added new long-term debt of \$8.0 million to fund Cal Water and Washington Water capital projects and repaid debt of \$12.5 million.

## Note 7. Commitment and Contingencies

Commitments

The Company has significant commitments to lease certain office spaces and water systems, and for the purchase of water from water wholesalers. These commitments are described in footnote 15 of the current report on Form 10-K.

ContingenciesGroundwater Contamination

The Company has been and is involved in litigation against third parties to recover past and future costs related to ground water contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. Any settlement in excess of the cost to litigate is accounted for on a case by case basis, dependent upon the nature of the settlement.

## **Table of Contents**

The Company is involved in a lawsuit against major oil refineries regarding the contamination of the ground water as a result of the gas additive Methyl *tert*-butyl ether (MTBE). The Company entered into a partial settlement with the defendants in April of 2008 that represent approximately 70% of the responsible parties (as determined by the Superior Court). On October 22, 2008, the Company received \$34.2 million after deducting attorneys' fees and litigation expenses. The Company is aggressively pursuing legal action against the remaining responsible parties. On July 8, 2009, Cal Water filed an application requesting the CPUC adopt ratemaking treatment of proceeds from its partial settlement of MTBE contamination litigation. Cal Water requested that all of the proceeds be reinvested in infrastructure to treat or replace MTBE-contaminated facilities. In addition, Cal Water requested that 50% of the reinvestment be included in rate base upon which Cal Water could earn its authorized fair and reasonable rate of return. The remaining 50% of the settlement proceeds would be included in rate base as contributions in aid of construction which does not earn a return. Cal Water also requested specific regulatory treatment of future settlement or litigation proceeds that may occur in the consolidated MTBE cases. As an interim step, Cal Water and the CPUC's Division of Ratepayer Advocates agreed to track all proceeds and remediation costs in a memorandum account for future disposition. This treatment removes from rate base certain capital projects which were constructed to replace or treat for MTBE and records them in a memorandum account as of the effective date of the 2009 General Rate Case. On October 14, 2010, in a separate industry-wide proceeding, the CPUC issued an interim decision in its review of general policies for accounting treatment of contamination proceeds. The interim decision would require all proceeds to be used first to pay transactional expenses, then to make ratepayers whole for costs to ensure the water system complies with the Commission's water quality standards. The interim decision allows for a risk-based consideration of proceeds which exceed the costs of the remediation described above and may result in some sharing of excess, or net proceeds. The interim decision also allows the utility to track litigation and settlement proceeds, along with transactional costs and remediation costs, in a memorandum account. It directs the utility to include a request for disposition of its memorandum account in a general rate case. When an agreement is reached with the Commission regarding the regulatory treatment, the Company will adjust the accounting of the settlement, accordingly. The Company has recorded the proceeds to replace the infrastructure damaged or lost due to the MTBE contamination in accordance with Section 1033 of the Internal Revenue Code. This treatment will reduce the tax basis of the replacement property and therefore defer any taxable gain.

As previously reported, the Company has jointly filed with the City of Bakersfield a lawsuit in the Superior Court of California, that names potentially responsible parties that manufactured and distributed products containing 1,2,3 trichloropropane (TCP) in California. TCP has been detected in the ground water. The lawsuit seeks to recover treatment costs necessary to remove TCP. The Court has now coordinated our action with other water purveyor cases (TCP Cases JCCP 4435) in San Bernardino County. No trial date has yet been set. The Company has entered into a settlement with one of the distributor defendants, FMC Corporation. The Company will record the proceeds in a memorandum account until the Commission approves an allocation between ratepayers and shareholders.

The Company has filed in San Mateo County Superior Court a complaint (*California Water Service Company v. The Dow Chemical Company, et al.* CIV 473093) against potentially responsible parties that manufactured and distributed products in California containing perchloroethylene, also known as tetrachloroethylene (PCE) for recovery of past, present, and future treatment costs. The case has not been consolidated with other PCE cases. Discovery is underway and no trial date has yet been set.

### **Other Legal Matters**

From time to time, the Company has been named as a co-defendant in several asbestos related lawsuits. Several of these cases against the Company have been dismissed without prejudice. In other cases the Company's contractors and insurance policy carriers have settled the cases with no effect on the Company's financial statements. As such the Company does not currently believe there is any potential loss probable of occurring related to these matters and therefore no accrual or contingency has been recorded.

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. The status of each significant matter is reviewed and assessed for potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount of the range of loss can be estimated, a liability is accrued for the estimated loss in accordance with the accounting standards for contingencies.

Legal proceedings are subject to uncertainties, and

**Table of Contents**

the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the time. While the outcome of these disputes and litigation matters cannot be predicted with any certainty, management does not believe that when taking into account existing reserves the ultimate resolution of these matters will materially affect the Company's financial position, results of operations, or cash flows.

**Note 8. Fair Value of Financial Instruments**

For those financial instruments for which it is practicable to estimate a fair value, the following methods and assumptions were used. For cash equivalents, accounts receivable and accounts payable, the carrying amounts approximated the fair value because of the short-term maturity of the instruments. The fair value of the Company's long-term debt was estimated at \$397.1 million and \$366.9 million as of September 30, 2010 and December 31, 2009, respectively, using the published quoted market price, if available, or otherwise a discounted cash flow analysis, based on the current rates available to the Company for debt of similar maturities and credit risk. The book value of the long-term debt was \$380.3 million and \$373.5 million as of September 30, 2010 and December 31, 2009, respectively. The fair value of advances for construction contracts was estimated at \$76.1 million as of September 30, 2010 and \$73.8 million as of December 31, 2009, based on broker quotes.

**Note 9. Condensed Consolidating Financial Statements**

The following tables present the condensed consolidating statements of income of California Water Service Group (Guarantor and Parent), Cal Water (issuer and wholly-owned consolidated subsidiary of California Water Service Group) and other wholly-owned subsidiaries of the Company for the nine-month periods ended September 30, 2010 and 2009, the condensed consolidating statements of cash flows for the nine months ended September 30, 2010 and 2009 and the condensed consolidating balance sheets as of September 30, 2010 and December 31, 2009. The information is presented utilizing the equity method of accounting for investments in consolidating subsidiaries.

**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING BALANCE SHEET****As of September 30, 2010****(In thousands)**

|                                                | <b>Parent<br/>Company</b> | <b>All<br/>Cal Water Subsidiaries</b> | <b>Other<br/>Adjustment</b> | <b>Consolidating<br/>Consolidated</b> |
|------------------------------------------------|---------------------------|---------------------------------------|-----------------------------|---------------------------------------|
| <b>ASSETS</b>                                  |                           |                                       |                             |                                       |
| <b>Utility plant:</b>                          |                           |                                       |                             |                                       |
| Utility plant                                  | \$                        | \$ 1,688,711                          | \$ 137,818                  | \$ (7,199) \$ 1,819,330               |
| Less accumulated depreciation and amortization |                           | (513,346)                             | (26,801)                    | 1,228 (538,919)                       |
| Net utility plant                              |                           | 1,175,365                             | 111,017                     | (5,971) 1,280,411                     |
| <b>Current assets:</b>                         |                           |                                       |                             |                                       |
| Cash and cash equivalents                      |                           | 6,342                                 | 3,396                       | 9,738                                 |
| Receivables and unbilled revenue               | 51                        | 63,509                                | 4,245                       | 67,805                                |
| Receivables from affiliates                    | 26,316                    | 10,998                                | 3,144                       | (40,458)                              |
| Other current assets                           | 55                        | 13,062                                | 1,068                       | 14,185                                |
| Total current assets                           | 26,422                    | 93,911                                | 11,853                      | (40,458) 91,728                       |
| <b>Other assets:</b>                           |                           |                                       |                             |                                       |
| Regulatory assets                              |                           | 221,731                               | 1,993                       | 223,724                               |
| Investments in affiliates                      | 435,583                   |                                       |                             | (435,583)                             |
| Long-term affiliate notes receivable           | 9,311                     |                                       |                             | (9,311)                               |
| Other assets                                   | 605                       | 28,458                                | 7,218                       | (204) 36,077                          |
| Total other assets                             | 445,499                   | 250,189                               | 9,211                       | (445,098) 259,801                     |
|                                                | \$ 471,921                | \$ 1,519,465                          | \$ 132,081                  | \$ (491,527) \$ 1,631,940             |
| <b>CAPITALIZATION AND LIABILITIES</b>          |                           |                                       |                             |                                       |
| <b>Capitalization:</b>                         |                           |                                       |                             |                                       |
| Common stockholders' equity                    | \$ 436,483                | \$ 403,658                            | \$ 37,668                   | \$ (441,327) \$ 436,482               |
| Affiliate long-term debt                       |                           |                                       | 9,311                       | (9,311)                               |
| Long-term debt, less current maturities        |                           | 376,028                               | 4,257                       | 380,285                               |
| Total capitalization                           | 436,483                   | 779,686                               | 51,236                      | (450,638) 816,767                     |
| <b>Current liabilities:</b>                    |                           |                                       |                             |                                       |
| Current maturities of long-term debt           |                           | 1,709                                 | 665                         | 2,374                                 |
| Short-term borrowings                          | 22,250                    | 34,000                                |                             | 56,250                                |
| Payables to affiliates                         | 11,643                    | 272                                   | 28,543                      | (40,458)                              |
| Accounts payable                               |                           | 44,010                                | 4,403                       | 48,413                                |
| Accrued expenses and other liabilities         | 1,545                     | 41,661                                | 5,244                       | 52 48,502                             |
| Total current liabilities                      | 35,438                    | 121,652                               | 38,855                      | (40,406) 155,539                      |

|                                                                |            |              |            |                           |
|----------------------------------------------------------------|------------|--------------|------------|---------------------------|
| <b>Unamortized investment tax credits</b>                      | 2,318      |              |            | 2,318                     |
| <b>Deferred income taxes, net</b>                              | 102,009    | 2,340        | (483)      | 103,866                   |
| <b>Pension and postretirement benefits other than pensions</b> | 143,619    |              |            | 143,619                   |
| <b>Regulatory and other liabilities</b>                        | 77,676     | 11,163       |            | 88,839                    |
| <b>Advances for construction</b>                               | 186,106    | 1,540        |            | 187,646                   |
| <b>Contributions in aid of construction</b>                    | 106,399    | 26,947       |            | 133,346                   |
|                                                                | \$ 471,921 | \$ 1,519,465 | \$ 132,081 | \$ (491,527) \$ 1,631,940 |

**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING BALANCE SHEET****As of December 31, 2009****(In thousands)**

|                                                | Parent<br>Company | Cal Water    | All<br>Other Subsidiaries | Consolidating<br>Adjustment | Consolidated |
|------------------------------------------------|-------------------|--------------|---------------------------|-----------------------------|--------------|
| <b>ASSETS</b>                                  |                   |              |                           |                             |              |
| <b>Utility plant:</b>                          |                   |              |                           |                             |              |
| Utility plant                                  | \$                | \$ 1,604,680 | \$ 111,581                | \$ (7,199)                  | \$ 1,709,062 |
| Less accumulated depreciation and amortization |                   | (488,577)    | (23,538)                  | 1,130                       | (510,985)    |
| Net utility plant                              |                   | 1,116,103    | 88,043                    | (6,069)                     | 1,198,077    |
| <b>Current assets:</b>                         |                   |              |                           |                             |              |
| Cash and cash equivalents                      | 532               | 6,000        | 3,334                     |                             | 9,866        |
| Receivables                                    | 28                | 54,117       | 4,395                     |                             | 58,540       |
| Receivables from affiliates                    | 11,026            | 12,827       | 2,140                     | (25,993)                    |              |
| Other current assets                           |                   | 23,025       | 810                       |                             | 23,835       |
| Total current assets                           | 11,586            | 95,969       | 10,679                    | (25,993)                    | 92,241       |
| <b>Other assets:</b>                           |                   |              |                           |                             |              |
| Regulatory assets                              |                   | 202,268      | 1,836                     |                             | 204,104      |
| Investments in affiliates                      | 422,287           |              |                           | (422,287)                   |              |
| Long-term affiliate notes receivable           | 11,155            |              |                           | (11,155)                    |              |
| Other assets                                   |                   | 24,026       | 7,337                     | (204)                       | 31,159       |
| Total other assets                             | 433,442           | 226,294      | 9,173                     | (433,646)                   | 235,263      |
|                                                | \$ 445,028        | \$ 1,438,366 | \$ 107,895                | \$ (465,708)                | \$ 1,525,581 |
| <b>CAPITALIZATION AND LIABILITIES</b>          |                   |              |                           |                             |              |
| <b>Capitalization:</b>                         |                   |              |                           |                             |              |
| Common stockholders' equity                    | \$ 420,634        | \$ 389,127   | \$ 39,592                 | \$ (428,719)                | \$ 420,634   |
| Affiliate long-term debt                       |                   |              | 11,155                    | (11,155)                    |              |
| Long-term debt, less current maturities        |                   | 370,900      | 3,369                     |                             | 374,269      |
| Total capitalization                           | 420,634           | 760,027      | 54,116                    | (439,874)                   | 794,903      |
| <b>Current liabilities:</b>                    |                   |              |                           |                             |              |
| Current maturities of long-term debt           |                   | 12,246       | 707                       |                             | 12,953       |
| Short-term borrowings                          | 12,000            |              |                           |                             | 12,000       |
| Payables to affiliates                         | 11,983            | 12           | 13,998                    | (25,993)                    |              |
| Accounts payable                               | 86                | 41,405       | 4,628                     |                             | 46,119       |
| Accrued expenses and other liabilities         | 325               | 34,580       | 4,369                     | 12                          | 39,286       |
| Total current liabilities                      | 24,394            | 88,243       | 23,702                    | (25,981)                    | 110,358      |

|                                                                |            |              |            |                           |
|----------------------------------------------------------------|------------|--------------|------------|---------------------------|
| <b>Unamortized investment tax credits</b>                      | 2,318      |              |            | 2,318                     |
| <b>Deferred income taxes, net</b>                              | 90,330     | 1,374        | 147        | 91,851                    |
| <b>Pension and postretirement benefits other than pensions</b> | 137,127    |              |            | 137,127                   |
| <b>Regulatory and other liabilities</b>                        | 74,956     | 10,824       |            | 85,780                    |
| <b>Advances for construction</b>                               | 183,555    | 1,472        |            | 185,027                   |
| <b>Contributions in aid of construction</b>                    | 101,810    | 16,407       |            | 118,217                   |
|                                                                | \$ 445,028 | \$ 1,438,366 | \$ 107,895 | \$ (465,708) \$ 1,525,581 |

Table of Contents

**CALIFORNIA WATER SERVICE GROUP**  
**CONDENSED CONSOLIDATING STATEMENT OF INCOME**  
**For the three months ended September 30, 2010**  
**(In thousands)**

|                                                  | Parent    | Cal        | All Other    | Consolidating |              |
|--------------------------------------------------|-----------|------------|--------------|---------------|--------------|
|                                                  | Company   | Water      | Subsidiaries | Adjustments   | Consolidated |
| <b>Operating revenue</b>                         | \$        | \$ 137,410 | \$ 8,939     | \$            | \$ 146,349   |
| <b>Operating expenses:</b>                       |           |            |              |               |              |
| Operations:                                      |           |            |              |               |              |
| Water production costs                           |           | 52,288     | 2,346        |               | 54,634       |
| Administrative and general                       | 37        | 15,976     | 1,781        |               | 17,794       |
| Other operations                                 |           | 13,158     | 1,985        | (254)         | 14,889       |
| Maintenance                                      |           | 4,673      | 180          |               | 4,853        |
| Depreciation and amortization                    |           | 10,141     | 858          | (65)          | 10,934       |
| Income taxes (benefit)                           | (662)     | 13,288     | (210)        | 409           | 12,825       |
| Property and other taxes                         |           | 3,941      | 614          |               | 4,555        |
| <b>Total operating expenses</b>                  | (625)     | 113,465    | 7,554        | 90            | 120,484      |
| <b>Net operating income</b>                      | 625       | 23,945     | 1,385        | (90)          | 25,865       |
| <b>Other Income and Expenses:</b>                |           |            |              |               |              |
| Non-regulated revenue                            | 588       | 2,638      | 1,395        | (771)         | 3,850        |
| Non-regulated expense, net                       |           | (1,007)    | (1,207)      |               | (2,214)      |
| Gain on sale on non-utility property             |           | 33         |              |               | 33           |
| Income tax (expense) on other income and expense | (240)     | (678)      | (137)        | 381           | (674)        |
| <b>Net other income and expense</b>              | 348       | 986        | 51           | (390)         | 995          |
| <b>Interest:</b>                                 |           |            |              |               |              |
| Interest expense                                 | 215       | 6,693      | 695          | (645)         | 6,958        |
| Less: capitalized interest                       |           | (752)      | 268          |               | (484)        |
| <b>Net interest expense</b>                      | 215       | 5,941      | 963          | (645)         | 6,474        |
| <b>Gross income</b>                              | 758       | 18,990     | 473          | 165           | 20,386       |
| <b>Equity earnings of subsidiaries</b>           | 19,628    |            |              | (19,628)      |              |
| <b>Net income</b>                                | \$ 20,386 | \$ 18,990  | \$ 473       | \$ (19,463)   | \$ 20,386    |

Table of Contents**CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF INCOME****For the nine months ended September 30, 2010****(In thousands)**

|                                                  | <b>Parent</b>  | <b>Cal</b>   | <b>All Other</b>    | <b>Consolidating</b> |                     |
|--------------------------------------------------|----------------|--------------|---------------------|----------------------|---------------------|
|                                                  | <b>Company</b> | <b>Water</b> | <b>Subsidiaries</b> | <b>Adjustments</b>   | <b>Consolidated</b> |
| <b>Operating revenue</b>                         | \$             | \$ 332,399   | \$ 22,543           | \$                   | \$ 354,942          |
| <b>Operating expenses:</b>                       |                |              |                     |                      |                     |
| Operations:                                      |                |              |                     |                      |                     |
| Water production costs                           |                | 120,311      | 6,612               |                      | 126,923             |
| Administrative and general                       | 37             | 47,997       | 5,684               |                      | 53,718              |
| Other operations                                 |                | 37,885       | 5,698               | (379)                | 43,204              |
| Maintenance                                      |                | 14,429       | 533                 |                      | 14,962              |
| Depreciation and amortization                    |                | 30,421       | 2,041               | (98)                 | 32,364              |
| Income taxes (benefit)                           | (757)          | 21,910       | (2)                 | 173                  | 21,324              |
| Property and other taxes                         |                | 10,889       | 1,656               |                      | 12,545              |
| <b>Total operating expenses</b>                  | (720)          | 283,842      | 22,222              | (304)                | 305,040             |
| <b>Net operating income</b>                      | 720            | 48,557       | 321                 | 304                  | 49,902              |
| <b>Other Income and Expenses:</b>                |                |              |                     |                      |                     |
| Non-regulated revenue                            | 1,118          | 7,410        | 4,109               | (1,674)              | 10,963              |
| Non-regulated expense, net                       |                | (6,182)      | (3,269)             |                      | (9,451)             |
| Gain on sale on non-utility property             |                | 33           |                     |                      | 33                  |
| Income tax (expense) on other income and expense | (456)          | (514)        | (407)               | 763                  | (614)               |
| <b>Net other income and expense</b>              | 662            | 747          | 433                 | (911)                | 931                 |
| <b>Interest:</b>                                 |                |              |                     |                      |                     |
| Interest expense                                 | 449            | 19,792       | 1,440               | (1,295)              | 20,386              |
| Less: capitalized interest                       |                | (2,012)      | (326)               |                      | (2,338)             |
| <b>Net interest expense</b>                      | 449            | 17,780       | 1,114               | (1,295)              | 18,048              |
| <b>Gross income</b>                              | 933            | 31,524       | (360)               | 688                  | 32,785              |
| <b>Equity earnings of subsidiaries</b>           | 31,852         |              |                     | (31,852)             |                     |
| <b>Net income</b>                                | \$ 32,785      | \$ 31,524    | \$ (360)            | \$ (31,164)          | \$ 32,785           |

Table of Contents**CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF INCOME****For the three months ended September 30, 2009****(In thousands)**

|                                                  | <b>Parent</b>  | <b>Cal</b>   | <b>All Other</b>    | <b>Consolidating</b> |                     |
|--------------------------------------------------|----------------|--------------|---------------------|----------------------|---------------------|
|                                                  | <b>Company</b> | <b>Water</b> | <b>Subsidiaries</b> | <b>Adjustments</b>   | <b>Consolidated</b> |
| <b>Operating revenue</b>                         | \$             | \$ 130,659   | \$ 8,508            | \$                   | \$ 139,167          |
| <b>Operating expenses:</b>                       |                |              |                     |                      |                     |
| Operations:                                      |                |              |                     |                      |                     |
| Water production costs                           |                | 46,626       | 2,272               |                      | 48,898              |
| Administrative and general                       |                | 17,231       | 1,853               |                      | 19,084              |
| Other operations                                 |                | 12,815       | 1,939               | (115)                | 14,639              |
| Maintenance                                      |                | 4,269        | 136                 |                      | 4,405               |
| Depreciation and amortization                    |                | 9,856        | 437                 | (34)                 | 10,259              |
| Income taxes (benefit)                           | (64)           | 12,824       | 480                 | 177                  | 13,417              |
| Property and other taxes                         |                | 3,893        | 478                 |                      | 4,371               |
| <b>Total operating expenses</b>                  | (64)           | 107,514      | 7,595               | 28                   | 115,073             |
| <b>Net operating income</b>                      | 64             | 23,145       | 913                 | (28)                 | 24,094              |
| <b>Other Income and Expenses:</b>                |                |              |                     |                      |                     |
| Non-regulated revenue                            | 233            | 4,231        | 1,140               | (410)                | 5,194               |
| Non-regulated expense, net                       |                | (2,432)      | (1,032)             |                      | (3,464)             |
| Gain on sale on non-utility property             |                |              |                     |                      |                     |
| Income tax (expense) on other income and expense | (94)           | (734)        | (37)                | 163                  | (702)               |
| <b>Net other income and expense</b>              | 139            | 1,065        | 71                  | (247)                | 1,028               |
| <b>Interest:</b>                                 |                |              |                     |                      |                     |
| Interest expense                                 | 118            | 6,294        | 363                 | (295)                | 6,480               |
| Less: capitalized interest                       |                | (728)        | (222)               |                      | (950)               |
| <b>Net interest expense</b>                      | 118            | 5,566        | 141                 | (295)                | 5,530               |
| <b>Gross income</b>                              | 85             | 18,644       | 843                 | 20                   | 19,592              |
| <b>Equity earnings of subsidiaries</b>           | 19,507         |              |                     | (19,507)             |                     |
| <b>Net income</b>                                | \$ 19,592      | \$ 18,644    | \$ 843              | \$ (19,487)          | \$ 19,592           |

Table of Contents**CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF INCOME****For the nine months ended September 30, 2009****(In thousands)**

|                                                  | <b>Parent</b>  | <b>Cal</b>   | <b>All Other</b>    | <b>Consolidating</b> |                     |
|--------------------------------------------------|----------------|--------------|---------------------|----------------------|---------------------|
|                                                  | <b>Company</b> | <b>Water</b> | <b>Subsidiaries</b> | <b>Adjustments</b>   | <b>Consolidated</b> |
| <b>Operating revenue</b>                         | \$             | \$ 320,732   | \$ 21,715           | \$                   | \$ 342,447          |
| <b>Operating expenses:</b>                       |                |              |                     |                      |                     |
| Operations:                                      |                |              |                     |                      |                     |
| Water production costs                           |                | 113,685      | 5,783               |                      | 119,468             |
| Administrative and general                       |                | 51,773       | 5,558               |                      | 57,331              |
| Other operations                                 |                | 36,232       | 5,536               | (343)                | 41,425              |
| Maintenance                                      |                | 12,843       | 509                 |                      | 13,352              |
| Depreciation and amortization                    |                | 28,739       | 2,103               | (103)                | 30,739              |
| Income taxes (benefit)                           | (129)          | 20,956       | 121                 | 490                  | 21,438              |
| Property and other taxes                         |                | 10,846       | 1,525               |                      | 12,371              |
| <b>Total operating expenses</b>                  | (129)          | 275,074      | 21,135              | 44                   | 296,124             |
| <b>Net operating income</b>                      | 129            | 45,658       | 580                 | (44)                 | 46,323              |
| <b>Other Income and Expenses:</b>                |                |              |                     |                      |                     |
| Non-regulated revenue                            | 585            | 8,175        | 3,436               | (1,023)              | 11,173              |
| Non-regulated expense, net                       |                | (4,087)      | (2,739)             |                      | (6,826)             |
| Gain on sale on non-utility property             |                | 675          |                     |                      | 675                 |
| Income tax (expense) on other income and expense | (238)          | (1,941)      | (301)               | 448                  | (2,032)             |
| <b>Net other income and expense</b>              | 347            | 2,822        | 396                 | (575)                | 2,990               |
| <b>Interest:</b>                                 |                |              |                     |                      |                     |
| Interest expense                                 | 277            | 17,022       | 861                 | (680)                | 17,480              |
| Less: capitalized interest                       |                | (1,778)      | (492)               |                      | (2,270)             |
| <b>Net interest expense</b>                      | 277            | 15,244       | 369                 | (680)                | 15,210              |
| <b>Gross income</b>                              | 199            | 33,236       | 607                 | 61                   | 34,103              |
| <b>Equity earnings of subsidiaries</b>           | 33,904         |              |                     | (33,904)             |                     |
| <b>Net income</b>                                | \$ 34,103      | \$ 33,236    | \$ 607              | \$ (33,843)          | \$ 34,103           |

**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****For the nine months ended September 30, 2010****(In thousands)**

|                                                                                             | <b>Parent</b>  | <b>Cal</b>   | <b>All Other</b>    | <b>Consolidating</b> |                     |
|---------------------------------------------------------------------------------------------|----------------|--------------|---------------------|----------------------|---------------------|
|                                                                                             | <b>Company</b> | <b>Water</b> | <b>Subsidiaries</b> | <b>Adjustments</b>   | <b>Consolidated</b> |
| <b>Operating activities:</b>                                                                |                |              |                     |                      |                     |
| Net income                                                                                  | \$ 32,785      | \$ 31,524    | \$ (360)            | \$ (31,164)          | \$ 32,785           |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                |              |                     |                      |                     |
| Equity earnings of subsidiaries                                                             | (31,852)       |              |                     | 31,852               |                     |
| Dividends received from affiliates                                                          | 18,556         |              |                     | (18,556)             |                     |
| Depreciation and amortization                                                               |                | 32,420       | 2,266               | (98)                 | 34,588              |
| Gain on sale of non-utility property                                                        |                | (33)         |                     |                      | (33)                |
| Change in value of life insurance contracts                                                 |                | (1,308)      |                     |                      | (1,308)             |
| Other changes in noncurrent assets and liabilities                                          |                | 2,169        | 1,169               | (630)                | 2,708               |
| Changes in operating assets and liabilities:                                                |                |              |                     |                      |                     |
| Net increase (decrease) in advances to affiliates                                           | (15,522)       | 2,089        | 13,433              |                      |                     |
| Other changes, net                                                                          | 1,252          | 6,554        | 880                 | 40                   | 8,726               |
| Net adjustments                                                                             | (27,566)       | 41,891       | 17,748              | 12,608               | 44,681              |
| Net cash provided by (used in) operating activities                                         | 5,219          | 73,415       | 17,388              | (18,556)             | 77,466              |
| <b>Investing activities:</b>                                                                |                |              |                     |                      |                     |
| Utility plant expenditures                                                                  |                | (84,418)     | (14,923)            |                      | (99,341)            |
| Sale of non-utility property                                                                |                | 33           |                     |                      | 33                  |
| Proceeds from affiliates long-term debt                                                     | 1,736          |              |                     | (1,736)              |                     |
| Purchase of life insurance                                                                  |                | (1,798)      |                     |                      | (1,798)             |
| Restricted cash decrease                                                                    |                | 2,991        |                     |                      | 2,991               |
| Net cash provided by (used in) investing activities                                         | 1,736          | (83,192)     | (14,923)            | (1,736)              | (98,115)            |
| <b>Financing Activities:</b>                                                                |                |              |                     |                      |                     |
| Short-term borrowings                                                                       | 12,250         | 59,000       |                     |                      | 71,250              |
| Repayment of short-term borrowings                                                          | (2,000)        | (25,000)     |                     |                      | (27,000)            |
|                                                                                             |                |              | (1,736)             | 1,736                |                     |

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|                                                     |          |          |          |        |          |
|-----------------------------------------------------|----------|----------|----------|--------|----------|
| Reduction of affiliate notes receivable             |          |          |          |        |          |
| Proceeds from long-term debt                        |          | 5,805    | 2,164    |        | 7,969    |
| Repayment of long-term debt                         |          | (11,214) | (1,318)  |        | (12,532) |
| Advances and contributions in aid for construction  |          | 3,190    | 68       |        | 3,258    |
| Refunds of advances for construction                |          | (4,669)  | (18)     |        | (4,687)  |
| Dividends paid to non-affiliates                    | (18,556) |          |          |        | (18,556) |
| Dividends paid to affiliates                        |          | (16,993) | (1,563)  | 18,556 |          |
| Issuance of common stock                            | 819      |          |          |        | 819      |
| Net cash provided by (used in) financing activities | (7,487)  | 10,119   | (2,403)  | 20,292 | 20,521   |
| Change in cash and cash equivalents                 | (532)    | 342      | 62       |        | (128)    |
| Cash and cash equivalents at beginning of period    | 532      | 6,000    | 3,334    |        | 9,866    |
| Cash and cash equivalents at end of period          | \$       | \$ 6,342 | \$ 3,396 | \$     | \$ 9,738 |

**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****For the nine months ended September 30, 2009****(In thousands)**

|                                                                                             | <b>Parent</b>  | <b>Cal</b>   | <b>All Other</b>    | <b>Consolidating</b> |                     |
|---------------------------------------------------------------------------------------------|----------------|--------------|---------------------|----------------------|---------------------|
|                                                                                             | <b>Company</b> | <b>Water</b> | <b>Subsidiaries</b> | <b>Adjustments</b>   | <b>Consolidated</b> |
| <b>Operating activities:</b>                                                                |                |              |                     |                      |                     |
| Net income                                                                                  | \$ 34,103      | \$ 33,236    | \$ 607              | \$ (33,843)          | \$ 34,103           |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                |              |                     |                      |                     |
| Equity earnings of subsidiaries                                                             | (33,904)       |              |                     | 33,904               |                     |
| Dividends received from affiliates                                                          | 18,353         |              |                     | (18,353)             |                     |
| Depreciation and amortization                                                               |                | 30,043       | 2,238               | (103)                | 32,178              |
| Gain on sale of non-utility property                                                        |                | (675)        |                     |                      | (675)               |
| Change in value of life insurance contracts                                                 |                | (3,555)      |                     |                      | (3,555)             |
| Other changes in noncurrent assets and liabilities                                          | (1,490)        | 12,564       | 896                 | 5                    | 11,975              |
| Changes in operating assets and liabilities:                                                |                |              |                     |                      |                     |
| Net increase (decrease) in advances to affiliates                                           | 1,193          | 138          | (1,331)             |                      |                     |
| Other changes, net                                                                          | 117            | 2,673        | 310                 | 37                   | 3,137               |
| Net adjustments                                                                             | (15,731)       | 41,188       | 2,113               | 15,490               | 43,060              |
| Net cash provided by (used in) operating activities                                         | 18,372         | 74,424       | 2,720               | (18,353)             | 77,163              |
| <b>Investing activities:</b>                                                                |                |              |                     |                      |                     |
| Utility plant expenditures                                                                  |                | (78,850)     | (7,560)             |                      | (86,410)            |
| Sale of non-utility property                                                                |                | 750          |                     |                      | 750                 |
| Purchase of life insurance                                                                  |                | (1,711)      |                     |                      | (1,711)             |
| Reduction of loans to affiliates                                                            | 415            |              |                     | (415)                |                     |
| Net cash provided by (used in) investing activities                                         | 415            | (79,811)     | (7,560)             | (415)                | (87,371)            |
| <b>Financing Activities:</b>                                                                |                |              |                     |                      |                     |
| Short-term borrowings                                                                       |                | 20,000       |                     |                      | 20,000              |
| Repayment of short-term borrowings                                                          |                | (48,000)     |                     |                      | (48,000)            |
| Reduction of affiliate notes receivable                                                     |                |              | (415)               | 415                  |                     |
|                                                                                             |                | 96,610       | 96                  |                      | 96,706              |

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|                                                               |          |           |          |        |           |
|---------------------------------------------------------------|----------|-----------|----------|--------|-----------|
| Proceeds from long-term debt, net of issuance cost of \$3,390 |          |           |          |        |           |
| Repayment of long-term debt                                   |          | (5,116)   | (635)    |        | (5,751)   |
| Advances and contributions in aid for construction            |          | 3,347     | 295      |        | 3,642     |
| Refunds of advances for construction                          |          | (4,263)   | (91)     |        | (4,354)   |
| Dividends paid to non-affiliates                              | (18,353) |           |          |        | (18,353)  |
| Dividends paid to affiliates                                  |          | (16,874)  | (1,479)  | 18,353 |           |
| Issuance of common stock                                      | 30       |           |          |        | 30        |
| Net cash provided by (used in) financing activities           | (18,323) | 45,704    | (2,229)  | 18,768 | 43,920    |
| Change in cash and cash equivalents                           | 464      | 40,317    | (7,069)  |        | 33,712    |
| Cash and cash equivalents at beginning of period              | 427      | 3,025     | 10,417   |        | 13,869    |
| Cash and cash equivalents at end of period                    | \$ 891   | \$ 43,342 | \$ 3,348 | \$     | \$ 47,581 |

**Table of Contents**

Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollar amounts in thousands, except where otherwise noted and per share amounts)

FORWARD LOOKING STATEMENTS

This quarterly report, including all documents incorporated by reference, contains forward-looking statements within the meaning established by the Private Securities Litigation Reform Act of 1995 (Act). Forward-looking statements in this quarterly report are based on currently available information, expectations, estimates, assumptions and projections, and our management's beliefs, assumptions, judgments and expectations about us, the water utility industry and general economic conditions. These statements are not statements of historical fact. When used in our documents, statements that are not historical in nature, including words like expects, intends, plans, believes, may, estimates, assumes, anticipates, projects, predicts, forecasts, should, seeks, or variations of these words and expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. They are based on numerous assumptions that we believe are reasonable, but they are open to a wide range of uncertainties and business risks. Consequently, actual results may vary materially from what is contained in a forward-looking statement.

Factors which may cause actual results to be different than those expected or anticipated include, but are not limited to:

- governmental and regulatory commissions' decisions, including decisions on proper disposition of property;

- changes in regulatory commissions' policies and procedures;

- the timeliness of regulatory commissions' actions concerning rate relief;

- changes in the capital markets and access to sufficient capital on satisfactory terms;

- new legislation;

- changes in accounting valuations and estimates;

- changes in accounting treatment for regulated companies, including adoption of International Financial Reporting Standards, if required;

- electric power interruptions;

- increases in suppliers' prices and the availability of supplies including water and power;

- fluctuations in interest rates;

- changes in environmental compliance and water quality requirements;

- acquisitions and the ability to successfully integrate acquired companies;

- the ability to successfully implement business plans;

- civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type;

- the involvement of the United States in war or other hostilities;

our ability to attract and retain qualified employees;

labor relations matters as we negotiate with the unions;

federal health care law changes could result in increases to Company health care costs and additional income tax expenses in future years;

**Table of Contents**

implementation of new information technology systems;

changes in operations that result in an impairment to acquisition goodwill;

restrictive covenants in or changes to the credit ratings on current or future debt that could increase financing costs or affect the ability to borrow, make payments on debt, or pay dividends;

general economic conditions, including changes in customer growth patterns and our ability to collect billed revenue from customers;

changes in customer water use patterns and the effects of conservation;

the impact of weather on water sales and operating results;

the ability to satisfy requirements related to the Sarbanes-Oxley Act and other regulations on internal controls; and

the risks set forth in **Risk Factors** included elsewhere in this quarterly report.

In light of these risks, uncertainties and assumptions, investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this quarterly report or as of the date of any document incorporated by reference in this report, as applicable. When considering forward-looking statements, investors should keep in mind the cautionary statements in this quarterly report and the documents incorporated by reference. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

**CRITICAL ACCOUNTING POLICIES**

We maintain our accounting records in accordance with accounting principles generally accepted in the United States of America (GAAP) and as directed by the regulatory commissions to which we are subject. The process of preparing financial statements in accordance with GAAP requires the use of estimates and assumptions on the part of management. The estimates and assumptions used by management are based on historical experience and our understanding of current facts and circumstances. Management believes that the following accounting policies are critical because they involve a higher degree of complexity and judgment, and can have a material impact on our results of operations and financial condition. These policies and their key characteristics are discussed in detail in the Company's annual report on Form 10-K for the year ended December 31, 2009. They include:

revenue recognition and the water revenue adjustment mechanism;

expense balancing and memorandum accounts;

modified cost balancing accounts;

regulatory utility accounting;

income taxes;

pension benefits;

workers' compensation and other claims;

goodwill accounting and evaluation for impairment; and

contingencies

For the three and nine-month periods ended September 30, 2010, there were no changes in the methodology for computing critical accounting estimates, no additional accounting estimates met the standards for critical accounting policies, and there were no material changes to the important assumptions underlying the critical accounting estimates.

**Table of Contents****RESULTS OF THIRD QUARTER 2010 OPERATIONS COMPARED TO  
THIRD QUARTER 2009 OPERATIONS**

Amounts in thousands except share data

**Overview**

Third quarter of 2010 net income was \$20.4 million or \$0.98 per diluted common share compared to net income of \$19.6 million or \$0.94 per diluted common share in the third quarter of 2009. The increase in net income is primarily attributable to rate increases and lower administrative and general expenses during the third quarter of 2010 compared to the prior year.

**Operating Revenue**

Operating revenue increased \$7.2 million or 5.2% to \$146.3 million in the third quarter of 2010, primarily due to increases in rates.

The factors that impacted the operating revenue for the third quarter of 2010 compared to 2009 are presented in the following table:

|                                                                   |          |
|-------------------------------------------------------------------|----------|
| Rate increases                                                    | \$ 9,071 |
| Usage by new customers                                            | 472      |
| Net change due to actual versus adopted results, usage, and other | (2,361)  |
| Net operating revenue increase                                    | \$ 7,182 |

The net change due to actual versus adopted results, usage, and other in the above table refers to the revenue impact year over year of the change in revenue recognized by the Water Revenue Adjustment Mechanism (WRAM) and Modified Cost Balancing Account (MCBA). The WRAM is impacted by changes in consumption patterns from our historical trends as well as an increase in conservation efforts. The MCBA, which records the differences in production costs from the adopted costs, is recorded as an element of revenue as it represents pass through costs which are billed to customers. The MCBA is impacted by changes in total production quantities, the production mix of the source of water, the price paid for purchased water and power, and the amount of pump taxes paid.

The components of the rate increases are listed in the following table:

|                                         |          |
|-----------------------------------------|----------|
| Purchased water offset increases        | \$ 7,603 |
| Step-rate increases                     | 1,330    |
| Balancing account adjustments and other | 138      |
| Total rate increases                    | \$ 9,071 |

In California, general rate case (GRC) rate increases are for a forward looking three year period with annual step rate increases for the three-year GRC cycle. Step rate changes can increase or decrease net income. Purchased water offset rate changes are for purchased water supplier rate changes that were not included in customer GRC and/or step water rates. Purchased water offset changes do not affect net operating income and are collectible from customers (or refunded to customers) in future rates designed to offset cost changes from suppliers. Balancing account adjustments and other rate changes are mostly for purchased power supplier rate changes, pump tax usage fee changes, and other operating cost changes that were not included in customer GRC and/or step water rates. These rate changes can increase or decrease net income and are collectible from customers (or refunded to customers) in future rates designed to offset cost changes from suppliers.

**Total Operating Expenses**

Total operating expenses were \$120.5 million for the third quarter of 2010, versus \$115.1 million for the same period in 2009, a 4.7% increase.

Water production expense consists of purchased water, purchased power, and pump taxes. It represents the largest component of total operating expenses, accounting for approximately 45% of total operating expenses in the third quarter of 2010. Water production expenses increased 5% compared to the same period last year due to increased

cost of purchased water and purchased

23

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**Table of Contents**

power. Our wholly-owned operating subsidiaries, Washington Water, New Mexico Water and Hawaii Water, obtain all of their water supply from wells.

Sources of water as a percent of total water production are listed in the following table:

|                 | <b>Three Months Ended September 30</b> |             |
|-----------------|----------------------------------------|-------------|
|                 | <b>2010</b>                            | <b>2009</b> |
| Well production | 51%                                    | 51%         |
| Purchased       | 43%                                    | 46%         |
| Surface         | 6%                                     | 3%          |
| Total           | 100%                                   | 100%        |

The components of water production costs are shown in the table below:

|                 | <b>Three Months Ended September 30</b> |             |               |
|-----------------|----------------------------------------|-------------|---------------|
|                 | <b>2010</b>                            | <b>2009</b> | <b>Change</b> |
| Purchased water | \$ 40,514                              | \$ 35,326   | \$ 5,188      |
| Purchased power | 10,832                                 | 10,089      | 743           |
| Pump taxes      | 3,288                                  | 3,483       | (195)         |
| Total           | \$ 54,634                              | \$ 48,898   | \$ 5,736      |

Purchased water costs increased due to price increases from water wholesalers and an increase in customer usage. Total water production, measured in acre feet, increased by 2% during the third quarter of 2010 as compared with the third quarter of 2009. Purchased power costs increased due to higher prices from electric utilities.

Administrative, general expense, and other operations expense were \$32.7 million for the third quarter of 2010 compared to \$33.7 million for the third quarter of 2009. Pension costs, employee benefit costs, and payroll cost increases were offset by an increase in the proportion of labor and benefit costs included in capital projects and a reduction in legal costs and outside service costs during the third quarter of 2010 compared to the third quarter of 2009. On January 1, 2010, wage increases became effective and there was an increase in the number of employees. There were 1,041 and 976 employees at September 30, 2010 and at September 30, 2009, respectively.

Maintenance expenses increased by 10% to \$4.9 million in the third quarter of 2010 compared to \$4.4 million in the third quarter of 2009, due to an increase in main and service repairs. Depreciation and amortization expense increased \$0.7 million, or 7%, because of 2009 capital additions.

Federal and state income taxes charged to operating expenses and other income and expenses decreased \$0.6 million, from a provision of \$14.1 million in the third quarter of 2009 to \$13.5 million in the third quarter of 2010. The decrease is due to a change in pretax income and in the effective tax rate recognized in the third quarter of 2010 compared to the third quarter of 2009 due to revised permanent differences.

**Other Income and Expense**

Other income and expense, net of income taxes, was a gain of \$1.0 million for the three months ended September 30, 2010 and September 30, 2009, respectively. Overall, revenues and expenses decreased during the current year due to a decline in our construction activity or that of developers.

**Interest Expense**

Net interest expense increased \$0.9 million to \$6.5 million for the three-month period ended September 30, 2010 compared to the three-month period ended September 30, 2009. This increase was attributable to interest on short-term borrowings of \$56.3 million on the unsecured revolving lines of credit and a reduction to capitalized interest due to construction projects placed into service during the third quarter of 2010.



**Table of Contents****RESULTS OF THE NINE MONTHS ENDED SEPTEMBER 2010 COMPARED TO  
THE NINE MONTHS ENDED SEPTEMBER 2009 OPERATIONS**

Amounts in thousands except per share data

**Overview**

Net income for the nine-month period ended September 30, 2010, was \$32.8 million, or \$1.58 per diluted common share compared to net income of \$34.1 million or \$1.64 per diluted common share for the nine months ended September 30, 2009. The decrease in net income is primarily attributable to the decrease in non-regulated income due to lower unrealized gains on benefit plans life insurance policy investments and an increase of interest expense attributable to borrowings on the unsecured revolving lines of credit in 2010.

**Operating Revenue**

Operating revenue increased \$12.5 million, or 3.6%, to \$354.9 million in the nine-month period ended September 30, 2010, as compared to the same period in the prior year. As disclosed in the following table, the increase was primarily due to increases in rates and usage by new customers.

The factors that affected the operating revenue for the nine-month period ended September 30, 2010 compared to the nine-month period ended September 30, 2009 are presented in the following table:

|                                                                   |           |
|-------------------------------------------------------------------|-----------|
| Rate increases                                                    | \$ 21,450 |
| Increase in usage by new customers                                | 1,657     |
| Net change due to actual verses adopted results, usage, and other | (10,612)  |
| Net changes in operating revenue                                  | \$ 12,495 |

The net change due to actual versus adopted results, usage, and other in the above table refers to the revenue impact year over year of the change in revenue recognized by the WRAM and MCBA. The WRAM is impacted by changes in consumption patterns from our historical trends as well as an increase in conservation efforts. The MCBA, which records the differences in production costs from the adopted costs, is recorded as an element of revenue as it is a pass through cost. The MCBA is impacted by changes in total production quantities, the production mix of the source of water, the price paid for purchased water and power, and the amount of pump taxes paid.

The components of the rate increases are listed in the following table:

|                                         |           |
|-----------------------------------------|-----------|
| Purchased water offset increase         | \$ 14,033 |
| General Rate Case (GRC) increase        | 5,388     |
| Step rate increase                      | 1,330     |
| Balancing account adjustments and other | 699       |
| Total rate increases                    | \$ 21,450 |

GRC rate increases recover operating costs and capital requirements filed on a forward looking basis in California, a combination of a forward-looking and historical cost basis in Hawaii, and a historical cost basis in Washington and New Mexico. GRC decisions typically authorize immediate rate increases. In California, GRC rate increases are for a forward looking three year period with annual step rate increases for the three-year GRC cycle. In Hawaii, Washington, and New Mexico, GRC rate increases can be filed each year if needed. These rate changes can increase or decrease net income. Purchased water offset rate changes are for purchased water supplier rate changes that were not included in customer GRC and/or step water rates. Purchased water offset changes do not affect net income and are collectible from customers (or refunded to customers) in future rates designed to offset cost changes from suppliers. Balancing account adjustments and other rate changes are mostly for purchased power supplier rate changes, pump tax usage fee changes, and other operating cost changes that were not included in customer GRC and/or step water rates. These rate changes can increase or decrease net income and are collectible from customers (or refunded to customers) in future rates designed to offset cost changes from suppliers.



**Table of Contents****Total Operating Expenses**

Total operating expenses were \$305.0 million for the nine months ended September 30, 2010, versus \$296.1 million for the same period in 2009, a 5% increase.

Water production expense consists of purchased water, purchased power and pump taxes. Water production expense represents the largest component of total operating expenses, accounting for approximately 42% of total operating expenses. Water production expenses increased \$7.5 million in the nine months ended September 30, 2010, or 6%, compared to the same period last year due to increased cost of purchased water and purchased power. Our wholly-owned operating subsidiaries, Washington Water, New Mexico Water and Hawaii Water, obtain all of their water supply from wells.

Sources of water production as a percent of total water production are listed on the following table:

|                 | <b>Nine months ended September 30</b> |             |
|-----------------|---------------------------------------|-------------|
|                 | <b>2010</b>                           | <b>2009</b> |
| Well production | 49%                                   | 49%         |
| Purchased       | 45%                                   | 48%         |
| Surface         | 6%                                    | 3%          |
| Total           | 100%                                  | 100%        |

The components of water production costs are shown in the table below:

|                 | <b>Nine months ended September 30</b> |             |               |
|-----------------|---------------------------------------|-------------|---------------|
|                 | <b>2010</b>                           | <b>2009</b> | <b>Change</b> |
| Purchased water | \$ 96,786                             | \$ 89,920   | \$ 6,866      |
| Purchased power | 23,416                                | 22,216      | 1,199         |
| Pump taxes      | 6,721                                 | 7,332       | (610)         |
| Total           | \$ 126,923                            | \$ 119,468  | \$ 7,455      |

Purchased water cost increased due to higher prices from wholesalers. Total water production, measured in acre feet, decreased 5% for the first nine months of 2010 compared to the same period last year due to lower customer usage primarily attributable to voluntary conservation and cooler weather. Purchased power costs increased due to higher prices from electric utilities.

Administration and general and other operations expenses were \$96.9 million, decreasing \$1.8 million, or 2%, for the nine months ended September 30, 2010, as compared to the same period in the prior year. The decrease was primarily attributable to an increase in the proportion of labor and benefit costs included in capital projects, lower outside service costs and lower legal fees. These decreases were partially offset by higher employee costs due to wage increases and an increase in the number of employees. At September 30, 2010, there were 1,041 employees and at September 30, 2009, there were 976 employees.

Maintenance expense increased \$1.6 million, or 12%, for the nine months ended September 30, 2010, as compared to the same period in the prior year, to \$15.0 million due to an increase in repairs of mains, water treatment facilities, and wells. Depreciation and amortization expense increased \$1.6 million as compared to the same period in the prior year, or 5%, because of 2009 capital additions.

Federal and state income taxes decreased \$1.5 million, or 7%, for the nine months ended September 30, 2010, compared to the prior years, due to the decline in pretax income and a change in the effective tax rate due to permanent differences. We expect the effective tax rate to be between 40% and 40.5% for 2010.

**Other Income and Expense**

Other income and expense, net of income taxes, was income of \$0.9 million for the nine months ended September 30, 2010, compared to income of \$3.0 million in the same period last year, which was a decrease of

\$2.1 million. The decrease was primarily attributable to an unrealized gain of \$1.3 million due to an increase in the cash surrender value of life insurance contracts associated with our benefit plans during the first nine months of 2010 compared to an unrealized gain of \$3.6 million during the

## **Table of Contents**

first nine months of 2009. In addition, there was a non-recurring property sale of \$0.7 million during the first nine months of 2009 and a non-recurring \$0.6 million increase in new business costs incurred during the first nine months of 2010 to evaluate potential acquisitions.

### **Interest Expense**

Net interest expense increased \$2.8 million to \$18.1 million for the nine-month period ended September 30, 2010 compared to the nine-month period ended September 30, 2009. This increase was attributable to borrowings of \$56.3 million on the unsecured revolving lines of during the nine months ended September 30, 2010.

## **REGULATORY MATTERS**

### **Rates and Regulations**

The state regulatory commissions have plenary powers setting rates and operating standards. As such, state commission decisions significantly impact our revenues, earnings, and cash flows. The amounts discussed herein are generally annual amounts, unless specifically stated, and the financial impact to recorded revenue is expected to occur over a twelve-month period from the effective date of the decision. In California, water utilities are required to make several different types of filings. Most filings result in rate changes that remain in place until the next General Rate Case (GRC). As explained below, surcharges and surcredits to recover balancing and memorandum accounts as well as interim rate true-ups are temporary rate changes, which have specific time frames for recovery. GRCs, escalation rate increase filings, and offset filings change rates to amounts that will remain in effect until the next GRC. The CPUC follows a rate case plan, which requires Cal Water to file a GRC for each of its twenty-four regulated operating districts every three years. In a GRC proceeding, the CPUC not only considers the utility's rate setting requests, but may also consider other issues that affect the utility's rates and operations. Effective in 2004, Cal Water's GRC schedule was shifted from a calendar year to a fiscal year with test years commencing on July 1st of each year. Effective in 2011, Cal Water will shift back to a calendar year, with test years commencing on January 1st of each year. The CPUC is generally required to issue its GRC decision prior to the first day of the test year or authorize interim rates. Effective with the 2009 GRC, the processing time is scheduled for eighteen months with rates to be effective on January 1, 2011.

Between GRC filings utilities may file escalation rate increases, which allow the utility to recover cost increases, primarily from inflation and incremental investment, during the second and third years of the rate case cycle. However, escalation rate increases are subject to a weather-normalized earnings test. Under the earnings test, the CPUC may reduce the escalation rate increase to prevent the utility from earning in excess of the authorized rate of return for that district.

In addition, utilities are entitled to file offset filings. Offset filings may be filed to adjust revenues for construction projects authorized in GRCs when the plant is placed in service or for rate changes charged to the Company for purchased water, purchased power, and pump taxes (referred to as "offsettable expenses"). Such rate changes approved in offset filings remain in effect until a GRC is approved. Additional information on the Company's regulatory process is described in its annual report on Form 10-K for the year ended December 31, 2009.

### **Remaining Unrecorded Balances from Previously Authorized Balancing Accounts Recoveries/Refunds**

The total of unrecorded, under-collected memorandum and balancing accounts was approximately \$1.5 million as of September 30, 2010, which includes amounts from districts that are pending further action when balances become large enough to warrant action of either recovery or refund.

### **2009 California General Rate Case Filing**

On July 2, 2009, Cal Water filed its required application for a general review of rates for all operating districts and general operations. The application, A.09-07-001, requests an annual increase in rates of \$70.6 million on January 1, 2011, \$24.8 million on January 1, 2012, and \$24.8 million on January 1, 2013. The filing marks the beginning of an eighteen month review process. On June 28, 2010, Cal Water filed a settlement of most issues in the proceeding with the Commission's Division of Ratepayer

## **Table of Contents**

Advocates and several other parties. On October 27, 2010, the CPUC issued a proposed decision on Cal Water's 2009 GRC. The proposed decision approves the original settlement agreement announced by the Company on June 28, 2010, and the total gross revenue recommended in the settlement. In addition, in the third quarter, and since the original settlement filing, the Company received \$9.8 million in offset and other rate increases, meaning the proposed decision would increase rates on January 1, 2011 by an additional \$25.4 million. On January 1, 2012, the Company anticipates an attrition increase of \$9.6 million. On January 1, 2013, the Company anticipates an additional attrition increase of \$9.0 million. These attrition increases are estimated and may change if inflation rates change significantly. These increases are also subject to the results of an earnings test requirement. The proposed decision also adopts the previously announced ratemaking authorizations which would allow the Company to obtain up to another \$7 million in gross revenue after certain capital projects are completed. The proposed decision cannot be approved by the Commission until completion of a 30-day comment period. The Commission may approve the proposed decision as written or may modify it based upon comments received. The Company cannot predict the timing of final Commission approval or whether any changes will be made before adoption.

### **Request for MTBE regulatory treatment**

On July 8, 2009, Cal Water filed an application requesting that the CPUC adopt ratemaking treatment of proceeds from its partial settlement of MTBE contamination litigation. Cal Water requested that all of the proceeds be reinvested in infrastructure to treat or replace MTBE-contaminated facilities. In addition, Cal Water requested that 50% of the reinvestment be included in rate base upon which Cal Water could earn its authorized fair and reasonable rate of return. The remaining 50% of the settlement proceeds would be included in rate base as contributions in aid of construction, which does not earn a return. Cal Water also requested specific regulatory treatment of future settlement or litigation proceeds that may occur in the consolidated MTBE cases. As an interim step, Cal Water and the CPUC's Division of Ratepayer Advocates agreed to track all proceeds and remediation costs in a memorandum account for future disposition. This treatment removes from rate base certain capital projects which were constructed to replace or treat for MTBE and records them in a memorandum account as of the effective date of the 2009 GRC.

On October 14, 2010, in a separate industry-wide proceeding, the CPUC issued an interim decision in its review of general policies for accounting treatment of contamination proceeds. The interim decision would require all proceeds to be used first to pay transactional expenses, then to make ratepayers whole for costs to ensure the water system complies with the Commission's water quality standards. The interim decision allows for a risk-based consideration of proceeds which exceed the costs of the remediation described above and may result in some sharing of excess, or net proceeds. The interim decision also allows the utility to track litigation and settlement proceeds, along with transactional costs and remediation costs, in a memorandum account and directs the utility to include a request for disposition of its memorandum account in a general rate case.

Because treatment or replacement of Cal Water's MTBE contaminated wells will occur over a number of years, and because litigation continues with remaining defendants, a final disposition of Cal Water's memorandum account will occur at an unknown future date.

### **2010 Regulatory Activity to Date**

In February, March, and April 2010, Cal Water filed advice letters to offset increased purchased water and pump tax rates in seven of its regulated districts totaling \$17.1 million in annual revenue. Under CPUC advice letter processing rules, Cal Water charges the rates in expense offset advice letters to its customers upon filing. These rates were approved during the months of March, April, and May 2010, respectively. However, expense offsets are dollar-for-dollar increases in revenue to match increased expenses and interact with the WRAM and MCBA mechanisms so that net operating income is not affected by an offset increase.

On January 7, 2010, Cal Water filed an application for additional financing authority with the CPUC. This request was approved on September 23, 2010 and the CPUC's decision authorizes Cal Water to issue \$350 million of debt and common stock to finance capital projects and operations.

On January 12, 2010, Cal Water filed an advice letter to collect the balance of the Dominguez Synergies memorandum account by surcharge for twelve months. This was approved in February 2010 and adds monthly fixed charges to bills for eight districts, totaling \$0.8 million over the recovery period.

In April and May, 2010, Cal Water filed advice letters for nineteen districts to recoup the net balance of the WRAM and MCBA from 2008 and 2009. The total amount requested was \$11.4 million. The recovery period requested was between twelve and eighteen months, consistent with past practice, from the date of advice letter approval. Advice letters for thirteen of the districts were approved as filed. The Commission staff required Cal Water to lengthen the recovery period for balances in six of the

## **Table of Contents**

districts. While preliminarily implementing the longer recovery periods, Cal Water has appealed the Commission's ruling by filing an application, in conjunction with other investor-owned water companies, and with the advice of the CPUC's Division of Ratepayer Advocates, to modify the language of the decision authorizing the WRAM and MCBA regulatory accounting mechanisms to ensure that past and future balances are recovered within 24 months of the end of the accounting period. Cal Water cannot determine the timing or outcome of this application at this time.

In May 2010, as allowed in the Commission's 2007 Rate Case Plan, Cal Water filed advice letters to establish interim rates for eight districts. The effective date for these interim rates was July 1, 2010. These advice letters do not immediately impact revenues. The interim rate changes will be adjusted once the Commission has issued a determination in Cal Water's 2009 GRC, expected in the fourth quarter of 2010.

In May 2010, Cal Water filed for escalation rate increases effective in July for seven districts totaling \$4.2 million in annual revenues. These rate changes were effective as filed.

During the quarter, Cal Water filed an advice letter to request an increase in its surcharge of the Low Income Ratepayer Assistance (LIRA) program. The LIRA program is a pass-through transfer of surcharge revenue from most customers to fund bill credits for low-income customers. Cal Water records the balancing account, consistent with Commission practice, as a regulatory asset. The request for an increased surcharge was originally denied by the CPUC staff, but Cal Water expects to resolve staff concerns which will allow the requested relief. Cal Water cannot determine the timing of this regulatory approval at this time.

During the quarter, Cal Water filed advice letters to offset increased purchased water and pump tax rates in eight of its regulated districts totaling \$7.0 million in annual revenue. Under CPUC advice letter processing rules, Cal Water charges the rates in expense offset advice letters to its customers upon filing. These rates were approved in August 2010. However, expense offsets are dollar-for-dollar increases in revenue to match increased expenses and interact with the WRAM and MCBA mechanisms so that net operating income is not affected by an offset increase. Throughout the calendar year, Cal Water plans to file advice letters to offset expected increases in purchased water and pump tax charges in some districts. Cal Water cannot predict the exact timing or dollar amount of the changes. However, expense offsets are dollar-for-dollar increases in revenue to match increased expenses and interact with the WRAM and MCBA mechanisms so that net operating revenue is not affected by an offset increase.

During the calendar year, Hawaii Water plans to file general rate increase applications with the Hawaii Public Utilities Commission (HPUC) for certain service areas. Hawaii Water expects the HPUC to rule in 2011 on its requests. However, these applications have not been filed at this time and therefore Hawaii Water cannot determine the final amount of rate relief these filings will generate.

## **LIQUIDITY**

### **Cash flows from Operations**

Cash flows from operations were \$77.5 million for the nine months ended September 30, 2010. Cash flows from operations is primarily generated by net income and changes in our operating assets and liabilities. Cash generated by operations varies during the year due to the timing of customer billings, contributions to our benefit plans, and vendor payments.

During the nine months ended September 30, 2010, we made contributions to our pension and retiree health care plan of \$13.2 million compared to \$23.7 million paid during the nine months ended September 30, 2009. As approved in the 2007 General Rate Case, we increased the funding level of our pension and retiree health care plan from \$27.5 million during 2009 to \$29.1 million during 2010.

Bond principal and other long-term debt payments were \$12.5 million during the nine months ended September 30, 2010, compared to \$5.8 million during the same period last year.

## **Table of Contents**

The water business is seasonal. Revenue is lower in the cooler winter months and higher in the warm summer months. This seasonality results in the possible need for short-term borrowings under the bank lines of credit in the event cash is not available during the cooler winter months. The increase in cash flows during the summer months allows short-term borrowings to be paid down. Short-term borrowings are used to finance capital expenditures until long-term financing is arranged.

## **Investing Activities**

During the nine months ended September 30, 2010, we had company and developer-funded capital expenditures of \$99.3 million. For 2010, our capital budget is approximately \$120 to \$140 million.

## **Financing Activities**

During the first nine months ended September 30, 2010, there were no equity offerings; however, we increased borrowings on our bank lines of credit to \$56.3 million, added new long-term debt of \$8.0 million, and repaid \$12.5 million of long-term debt. Cal Water received CPUC approval of its financing application to issue up to \$350 million of debt and equity to fund our capital needs and fund operations. We intend to fund our capital needs in future periods through a relatively balanced approach between long-term debt and equity. Advances and contributions in aid of construction were \$3.3 million during the nine months ended September 30, 2010, which was offset by refunds to developers of \$4.7 million during the nine months ended September 30, 2010. Dividend payments were higher than the prior year due to an increased dividend rate paid in the current year.

## **Short-Term and Long-Term Debt**

Short-term liquidity is provided by bank lines of credit funds extended to us and certain of our subsidiaries and by internally generated funds. Long-term financing is accomplished through the use of both debt and equity. As of September 30, 2010, there were short-term borrowings of \$56.3 million outstanding on the line of credit as compared to short-term bank borrowings of \$12.0 million at December 31, 2009.

We made principal payments on our First Mortgage Bonds and other long-term debt payments of \$12.5 million during the nine months ended September 30, 2010. First Mortgage Bond Series K, in the amount of \$10 million, was paid during the first nine months of 2010. We issued \$100 million of First Mortgage Bonds in 2009. In connection with this issuance, Cal Water's outstanding senior notes in the aggregate principal amount of \$260 million were exchanged for First Mortgage Bonds with the same interest rate and maturities as the previously outstanding senior notes for which they were exchanged.

Long-term financing, which includes First Mortgage Bonds and other debt securities, and common stock, has typically been used to replace short-term borrowings and fund capital expenditures. Internally generated funds, after making dividend payments, provide positive cash flow, but have not been at a level to meet the needs of our capital expenditure requirements. Management expects this trend to continue given our capital expenditures plan for the next 5 years. Some capital expenditures are funded by payments received from developers for contributions in aid of construction or advances for construction. Funds received for contributions in aid of construction are non-refundable, whereas funds classified as advances in construction are refundable. Management believes long-term financing is available to meet our cash flow needs through issuances in both debt and equity instruments.

## **Dividends, Book Value and Shareholders**

The third quarter common stock dividend of \$0.2975 per share was paid on August 20, 2010, compared to a quarterly dividend in the third quarter of 2009 of \$0.2950. This was Cal Water's 262<sup>nd</sup> consecutive quarterly dividend. On an annualized basis, the 2010 dividend rate is \$1.19 per common share, compared to \$1.18 in 2009. For the full year 2009, the payout ratio was 61% of net income. On a long-term basis, our goal is to achieve a dividend payout ratio of 60% of net income accomplished through future earnings growth.

At its October 27, 2010 meeting, the Board declared the fourth quarter dividend of \$0.2975 per share payable on November 19, 2010, to stockholders of record on November 8, 2010. This will be our 263<sup>rd</sup> consecutive quarterly dividend.

## **Table of Contents**

### **2010 Financing Plan**

Cal Water is currently reviewing its financing needs for the balance of 2010 and 2011. We intend to fund our capital needs in future periods through a relatively balanced approach between long-term debt and equity. The Company and Cal Water have a three-year syndicated unsecured revolving line of credit of \$50 million and \$250 million, respectively for short-term borrowings. As of September 30, 2010, the amount of borrowings available to the Company on these unsecured revolving lines of credit was \$243.7 million. Cal Water received CPUC approval of its financing application to issue up to \$350 million of debt and equity to finance capital projects and operations.

### **Book Value and Stockholders of Record**

Book value per common share was \$20.95 at September 30, 2010 compared to \$20.26 at December 31, 2009. There are approximately 2,542 (not in thousands) stockholders of record for our common stock, as of October 28, 2010.

### **Utility Plant Expenditures**

During the nine months ended September 30, 2010, capital expenditures totaled \$99.3 million for company-funded and developer-funded projects. The planned 2010 company-funded capital expenditure budget is approximately \$120 to \$140 million. The actual amount may vary from the budget number due to timing of actual payments related to current year projects and prior year projects. We do not control third-party-funded capital expenditures and therefore are unable to estimate the amount of such projects for 2010.

At September 30, 2010, construction work in progress was \$141.0 million compared to \$126.3 million at September 30, 2009. Work in progress includes projects that are under construction but not yet complete and placed in service.

## **WATER SUPPLY**

Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of their supply from wholesale suppliers; and other districts obtain supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. To the best of management's knowledge, we are meeting water quality, environmental, and other regulatory standards for all company-owned systems. California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington Water service areas receive precipitation in all seasons, with the heaviest amounts during the winter. New Mexico Water's rainfall is heaviest in the summer monsoon season. Hawaii Water receives precipitation throughout the year, with the largest amounts in the winter months. Water usage in all service areas is highest during the warm and dry summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water aquifers and fill reservoirs, providing the water supply for future delivery to customers. To date, snowpack water content and rainfall accumulation during the 2009-2010 water year is 107% of normal (as of October 1, 2010 per the California Department of Water Resources). Precipitation in the prior year was below average. Management believes that supply pumped from underground aquifers and purchased from wholesale suppliers will be adequate to meet customer demand during 2010 and beyond. However, water rationing may be required if declared by the state or local jurisdictions. Long-term water supply plans are developed for each of our districts to help assure an adequate water supply under various operating and supply conditions. Some districts have unique challenges in meeting water quality standards, but management believes that supplies will meet current standards using current treatment processes.

## **CONTRACTUAL OBLIGATIONS**

During the nine months ended September 30, 2010, there were no material changes in contractual obligations outside the normal course of business.

**Table of Contents**

**Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK**

We do not hold, trade in or issue derivative financial instruments and therefore are not exposed to risks these instruments present. Our market risk to interest rate exposure is limited because the cost of long-term financing and short-term bank borrowings, including interest costs, is covered in consumer water rates as approved by the Commissions. We do not have foreign operations; therefore, we do not have a foreign currency exchange risk. Our business is sensitive to commodity prices and is most affected by changes in purchased water and purchased power costs.

Historically, the CPUC's balancing account or offsetable expense procedures allowed for increases in purchased water and purchased power costs to be passed on to consumers. Traditionally, a significant percentage of our net income and cash flows comes from California regulated operations; therefore, the CPUC's actions have a significant impact on our business. See Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies -Expense Balancing and Memorandum Accounts and Regulatory Matters .

**Item 4. CONTROLS AND PROCEDURES**

**(a) Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(c) under the Exchange Act) that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow for timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Accordingly, our disclosure controls and procedures have been designed to provide reasonable assurance of achieving their objectives.

Our management, with the participation of our CEO and our CFO, evaluated the effectiveness of our disclosure controls and procedures for the period ended September 30, 2010. Based on that evaluation, we concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

**(b) Changes to Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting that occurred during the last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **Table of Contents**

### **PART II OTHER INFORMATION**

#### **Item 1.**

#### **LEGAL PROCEEDINGS**

##### **Groundwater Contamination**

The Company has been and is involved in litigation against third parties to recover past and future costs related to ground water contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. Any settlement in excess of the cost to litigate is accounted for on a case by case basis, depending upon the nature of the settlement.

The Company is involved in a lawsuit against major oil refineries regarding the contamination of the ground water as a result of the gas additive Methyl *tert*-butyl ether (MTBE). The Company entered into a partial settlement with certain of the defendants in April of 2008 that represent approximately 70% of the responsible parties (as determined by the Superior Court). On October 22, 2008, the Company received \$34.2 million after deducting attorneys' fees and litigation expenses. The Company is aggressively pursuing legal action against the remaining responsible parties. The Company has filed with the Commission to determine the appropriate regulatory treatment of the proceeds. It anticipates that the proceeds will be used on MTBE qualified capital investments. When an agreement is reached with the Commission regarding the regulatory treatment, the Company will adjust the accounting of the settlement, accordingly.

The Company has recorded the proceeds to replace the infrastructure damaged or lost due to the MTBE contamination in accordance with Section 1033 of the Internal Revenue Code. This treatment will reduce the tax basis of the replacement property and therefore defer any taxable gain.

As previously reported, the Company has jointly filed with the City of Bakersfield a lawsuit in the Superior Court of California that names potentially responsible parties that manufactured and distributed products containing 1,2,3 trichloropropane (TCP) in California. TCP has been detected in the ground water. The lawsuit seeks to recover treatment costs necessary to remove TCP. The Court has now coordinated our action with other water purveyor cases (TCP Cases JCCP 4435) in San Bernardino County. No trial date has yet been set. The Company has entered into a settlement with one of the distributor defendants, FMC Corporation. The Company will record the proceeds in a memorandum account until the Commission approves an allocation between ratepayers and shareholders.

The Company has filed in San Mateo County Superior Court a complaint (*California Water Service Company v. The Dow Chemical Company, et al.* CIV 473093) against potentially responsible parties that manufactured and distributed products in California containing perchloroethylene, also known as tetrachloroethylene (PCE) for recovery of past, present, and future treatment costs. The case has not been consolidated with other PCE cases. Discovery is underway and no trial date has yet been set.

##### **Other Legal Matters**

From time to time, the Company has been named as a co-defendant in several asbestos related lawsuits. Several of these cases against the Company have been dismissed without prejudice. In other cases the Company's contractors and insurance policy carriers have settled the cases with no effect on the Company's financial statements. As such, the Company does not currently believe there is any potential loss that is more likely than not to occur related to these matters and therefore no accrual or contingency has been recorded.

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. The status of each significant matter is reviewed and assessed for potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount of the range of loss can be estimated, a liability is accrued for the estimated loss in accordance with the accounting standards for contingencies. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the

**Table of Contents**

time. While the outcome of these disputes and litigation matters cannot be predicted with any certainty, management does not believe when taking into account existing reserves the ultimate resolution of these matters will materially affect the Company's financial position, results of operations, or cash flows.

Item 4. (Removed and Reserved)

Item 6. EXHIBITS

| <b>Exhibit</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|----------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1           | Unsecured Credit Agreement dated as of October 27, 2009 among California Water Service Group and certain of its subsidiaries from time to time, as borrowers, Bank of America, N.A., as administrative agent, swing line lender and letter of credit issuer, Banc of America Securities LLC, as sole lead arranger and sole book manager, CoBank, ACB and Bank of China, Los Angeles Branch, as co-syndication agents, Compass Bank and U.S. Bank National Association, as co-documentation agents, and the other lender parties thereto. |
| 10.2           | Unsecured Credit Agreement dated as of October 27, 2009 among California Water Service Company, as borrower, Bank of America, N.A., as administrative agent, swing line lender and letter of credit issuer, Banc of America Securities LLC, as sole lead arranger and sole book manager, CoBank, ACB and Bank of China, Los Angeles Branch, as co-syndication agents, Compass Bank and U.S. Bank National Association, as co-documentation agents, and the other lender parties thereto                                                   |
| 31.1           | Chief Executive Officer certification of financial statements pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                                                                                   |
| 31.2           | Chief Financial Officer certification of financial statements pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                                                                                   |
| 32             | Chief Executive Officer and Chief Financial Officer Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                                                                                                                |
| 101.INS        | XBRL Instance Document                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 101.SCH        | XBRL Taxonomy Extension Schema                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| 101.LAB        | XBRL Taxonomy Extension Label Linkbase                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |

The financial  
information  
contained in  
these XBRL  
documents is

unaudited and is  
furnished, not  
filed with the  
Commission.

**Table of Contents**

SIGNATURES

Pursuant to the requirement 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.

CALIFORNIA WATER SERVICE GROUP  
Registrant

November 5, 2010

By: /s/ Martin A. Kropelnicki  
Martin A. Kropelnicki  
Vice President, Chief Financial Officer  
and Treasurer

35

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**Table of Contents**

Exhibit Index

| <b>Exhibit</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
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The financial information contained in these XBRL documents is unaudited and is furnished, not filed with the

Commission.