CALIFORNIA WATER SERVICE GROUP
Form 10-Q
November 09, 2009

Table of Contents

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

(Mark One)

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

For the quarterly period ended September 30, 2009

OR

o **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 þ No o

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 o No o

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 þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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, 2009 20,744,952

TABLE OF CONTENTS

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)

	September 30, 2009	December 31, 2008
ASSETS		
Utility plant:		
Utility plant	$ 1,676,287	$ 1,583,079
Less accumulated depreciation and amortization	(501,704)	(470,712)
Net utility plant	1,174,583	1,112,367
Current assets:		
Cash and cash equivalents	47,581	13,869
Receivables:		
Customers	31,722	22,786
Regulatory balancing accounts	15,592	4,629
Other	10,752	7,442
Unbilled revenue	21,352	13,112
Materials and supplies at weighted average cost	5,457	5,070
Taxes, prepaid expenses and other assets	7,922	12,890
Total current assets	140,378	79,798
Other assets:		
Regulatory assets	201,442	198,293
Goodwill	2,615	3,906
Other assets	30,456	23,743
Total other assets	234,513	225,942
	$ 1,549,474	$ 1,418,107
CAPITALIZATION AND LIABILITIES		
Capitalization:		
Common stock, $.01 par value	$ 207	$ 207
Additional paid-in capital	214,715	213,922
Retained earnings	204,570	188,820
Total common stockholders equity	419,492	402,949
Long-term debt, less current maturities	373,541	287,498

Total capitalization	793,033	690,447
Current liabilities:		
Current maturities of long-term debt	12,424	2,818
Short-term borrowings	12,000	40,000
Accounts payable:		
Trade and other	46,894	39,187
Regulatory balancing accounts	7,486	2,585
Accrued interest	9,096	3,295
Accrued expenses and other liabilities	42,938	35,311
Total current liabilities	130,838	123,196
Unamortized investment tax credits	2,392	2,392
Deferred income taxes, net	83,512	72,344
Pension and postretirement benefits other than pensions	152,467	152,685
Regulatory and other liabilities	83,357	83,312
Advances for construction	182,763	176,163
Contributions in aid of construction	121,112	117,568
Commitments and contingencies		
	$ 1,549,474	$ 1,418,107

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

3

Table of Contents

CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
Unaudited
(In thousands, except per share data)

For the three months ended	September 30, 2009	September 30, 2008
Operating revenue	$ 139,167	$ 131,702
Operating expenses:		
Operations:		
Water production costs	48,898	46,455
Administrative and general	19,084	14,995
Other operations	14,639	12,935
Maintenance	4,405	3,824
Depreciation and amortization	10,259	9,281
Income taxes	13,417	13,510
Property and other taxes	4,371	3,940
Total operating expenses	115,073	104,940
Net operating income	24,094	26,762
Other income and expenses:		
Non-regulated revenue	5,194	3,805
Non-regulated expenses, net	(3,464)	(4,501)
Income taxes (expense) benefit on other income and expenses	(702)	288
Net other income and expenses	1,028	(408)
Interest expense:		
Interest expense	6,480	5,233
Less: capitalized interest	(950)	(1,065)
Net interest expense	5,530	4,168
Net income	$ 19,592	$ 22,186
Earnings per share		
Basic	$ 0.94	$ 1.06
Diluted	$ 0.94	$ 1.06

Weighted average shares outstanding				
Basic		20,745		20,717
Diluted		20,767		20,740
Dividends declared per share of common stock	$	0.2950	$	0.2925

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)

For the nine months ended	September 30, 2009	September 30, 2008
Operating revenue	$ 342,447	$ 310,204
Operating expenses:		
Operations:		
Water production costs	119,468	112,162
Administrative and general	57,331	42,248
Other operations	41,425	37,766
Maintenance	13,352	12,884
Depreciation and amortization	30,739	27,779
Income taxes	21,438	20,127
Property and other taxes	12,371	11,163
Total operating expenses	296,124	264,129
Net operating income	46,323	46,075
Other income and expenses:		
Non-regulated revenue	11,173	9,452
Non-regulated expenses, net	(6,826)	(9,715)
Gain on sale of non-utility property	675	7
Income taxes (expense) benefit on other income and expenses	(2,032)	118
Net other income and expense	2,990	(138)
Interest expense:		
Interest expense	17,480	15,405
Less: capitalized interest	(2,270)	(1,955)
Net interest expense	15,210	13,450
Net income	$ 34,103	$ 32,487
Earnings per share		
Basic	$ 1.64	$ 1.55

Diluted	$ 1.64	$ 1.55
Weighted average shares outstanding		
Basic	20,740	20,707
Diluted	20,765	20,731
Dividends declared per share of common stock	$ 0.8850	$ 0.8775

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

5

Table of Contents

CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
Unaudited
(In thousands)

For the nine months ended:	September 30, 2009	September 30, 2008
Operating activities		
Net income	$ 34,103	$ 32,487
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	32,178	29,722
Gain on sale of non-utility property	(675)	(7)
Change in value of life insurance contracts	(3,555)	2,198
Other changes in noncurrent assets and liabilities	11,975	1,990
Changes in operating assets and liabilities:		
Receivables	(31,449)	(18,659)
Accounts payable	15,561	6,659
Other current assets	4,572	(647)
Other current liabilities	13,689	26,683
Other changes, net	764	589
Net adjustments	43,060	48,528
Net cash provided by operating activities	77,163	81,015
Investing activities:		
Utility plant expenditures:		
Company funded	(82,862)	(74,603)
Developer funded	(3,548)	(6,020)
Acquisitions		(14,341)
Purchase of life insurance	(1,711)	(1,366)
Proceeds on sale of non-utility property	750	
Net cash used in investing activities	(87,371)	(96,330)
Financing activities:		
Short-term borrowings	20,000	40,000
Repayment of short-term borrowing	(48,000)	
Advances and contributions in aid of construction	3,642	6,548
Refunds of advances for construction	(4,354)	(5,383)
Dividends paid	(18,353)	(18,289)
Proceeds from long-term debt, net of issuance cost of $3,390	96,706	693
Repayment of long-term debt	(5,751)	(1,861)

Issuance of common stock		30		
Redemption of preferred stock				(3,718)
Net cash provided by financing activities		43,920		17,990
Change in cash and cash equivalents		33,712		2,675
Cash and cash equivalents at beginning of period		13,869		6,734
Cash and cash equivalents at end of period	$	47,581	$	9,409
Supplemental information				
Cash paid for interest, net of interest capitalized	$	8,717	$	9,225
Cash paid for income taxes	$	717	$	6,586
Supplemental disclosure of non-cash activities:				
Accrued payables for investments in utility plant	$	8,013	$	10,248
Purchase of intangible assets with company common stock			$	1,300
Utility plant contribution by developers	$	13,940	$	11,519

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, 2009
(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, 2008, included in its current report on Form 8-K as filed with the SEC on April 7, 2009.

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, dry summer months when water usage and sales are greater. Revenue and income are lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

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

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. 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).

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 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.

Table of Contents

Under the MCBA, Cal Water tracks adopted expense levels for 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 asset or liability regulatory balancing account (tracked individually for each Cal Water district).

The balances in the WRAM and MCBA asset and liability 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 90-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 percent 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, 2009 and December 31, 2008, the aggregated asset in regulatory balancing accounts was $15,592 and $4,629, respectively, and the aggregate liability in regulatory balancing accounts was $7,486 and $2,585, respectively.

Recent Accounting Pronouncements Adopted

In December 2007, the Financial Accounting Standards Board (FASB) issued accounting standards for business combinations. The new standards apply prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Among the more significant changes, it expands the definition of a business and a business combination; requires the acquirer to recognize the assets acquired, liabilities assumed and noncontrolling interests (including goodwill), measured at fair value at the acquisition date; requires acquisition-related expenses and restructuring costs to be recognized separately from the business combination and requires assets acquired and liabilities assumed from contractual and non-contractual contingencies to be recognized at their acquisition date fair values with subsequent changes recognized in earnings. Also, it requires that an entity record, generally through income tax expense, adjustments made after the measurement period (and adjustments during the measurement period that relate to facts and circumstances that did not exist as of the acquisition date) to (1) valuation allowances for acquired deferred tax assets and (2) acquired tax uncertainties. The Company adopted the new accounting standards for business combinations effective January 1, 2009.

In December 2007, the FASB issued accounting standards for noncontrolling interests in consolidated financial statements. The new standards establish accounting and reporting standards for the noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. The statement is effective for years beginning after December 15, 2008. The Company adopted the new accounting standards for noncontrolling interests in consolidated financial statements effective January 1, 2009, and it did not have a material impact on the Company s financial position, results of operation, or cash flows.

In May 2008, the FASB issued new standards to compute earnings per share with the assumption that instruments granted in shared-based payment transactions are participating securities. It requires unvested share-based payments that entitle employees to receive nonrefundable dividends to also be considered participating securities. The Company currently grants certain unvested share-based payments awards that include rights to dividends similar to common stockholders. The Company adopted the new standards effective January 1, 2009, and it did not have a material impact to its computation of earnings per share.

In April 2009, the FASB issued new accounting standards for interim disclosures about fair value of financial instruments. It requires interim financial reporting to require disclosures about the fair value of financial instruments for interim reporting periods that were previously only required for annual reporting periods. An entity is required to disclose the fair value of financial assets and liabilities together with the related carrying amount and where the carrying amount is classified in the Condensed Consolidated Balance Sheets. It is effective prospectively for interim reporting periods after June 15, 2009. The Company adopted the new disclosure, interim disclosures about fair value of financial instruments. See Note 9.

In May 2009, the FASB issued new accounting standards for subsequent events. It does not significantly change the prior accounting practice for subsequent events except for the requirement to disclose the date through which an entity has evaluated subsequent events and the basis for that date. The Company adopted the new disclosure requirements for the period ended September 30, 2009, and evaluated subsequent events through the time the financial statements were issued on November 9, 2009. All significant events and transactions that occurred after the balance sheet date and before the issuance of the financial statements are detailed in Note 10.

In June 2009, the FASB issued new accounting standards for the accounting standards codification and the hierarchy of generally accepted accounting principles (codification). The Codification is a reorganization and compilation of all existing authoritative U.S. GAAP recognized by the FASB to be applied to nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities law are also sources of authoritative GAAP for SEC registrants. On the effective date of this statement, the Codification superseded all then-existing non-SEC accounting and reporting standards. This new accounting standard is effective for financial statements issued for interim and annual periods ended after September 15, 2009. The Company adopted the codification effective September 30, 2009.

Accounting Pronouncements Issued But Not Yet Adopted

In December 2008, the FASB issued new accounting standards for employers disclosures about postretirement benefit plan assets. An entity is required to provide qualitative disclosures about how investment allocation decisions are made, the inputs and valuation techniques used to measure the fair value of plan assets, and the concentration of risk within plan assets. Additionally, quantitative disclosures are required showing the fair value of each major category of plan assets, the levels in which each asset is classified within the fair value hierarchy, and a reconciliation for the period of plan assets which are measured using significant unobservable inputs. The new disclosure requirement is effective prospectively for fiscal years ending after December 15, 2009. The Company will include the expanded disclosure requirement in the consolidated financial statements for the annual period ending December 31, 2009.

Note 3. Stock-based Compensation

Long-Term Incentive Plan

The Company had a stockholder-approved Long-Term Incentive Plan (which was replaced on April 27, 2005, by a stockholder-approved Equity Incentive Plan) that allowed granting of non-qualified stock options. The Company had accounted for options using the intrinsic value method. All outstanding options (83,250 shares at September 30, 2009) have an exercise price equal to the market price on the date they were granted. The weighted average price of the options is $24.90. All options granted under the Long-Term Incentive Plan are fully vested. No compensation expense was recorded for the three or nine-month periods ended September 30, 2009 and 2008 related to stock options issued under the Long-Term Incentive Plan.

Equity Incentive Plan

Under the Company s Equity Incentive Plan, which was approved by shareholders in April 2005, the Company is authorized to issue up to 1,000,000 shares of common stock. In the nine-months ended September 30, 2009 and 2008, the Company granted Restricted Stock Awards (RSAs) of 21,000 and 16,630 shares, respectively, of common stock both to officers and to directors of the Company. Employee options vest ratably over 48 months, while director options vest at the end of 12 months. The shares were valued at $38.38 and $37.60 per share, respectively, based upon the fair market value of the Company s common stock on the date of grant.

In addition, in the nine-months ended September 30, 2009 and 2008, Stock Appreciation Rights (SARs) equivalent to 71,500 and 47,070 shares, respectively, were granted to officers, which vest ratably over 48 months and expire at the end of 10 years. The grant-date fair value for SARs was determined using the Black Scholes model, which arrived at a fair value of $10.50 and $6.03 per share, respectively. Upon exercise of a SAR, the appreciation is payable in common shares of the Company.

The assumptions utilized in calculation of the SAR fair value were:

	2009	**2008**
Expected dividend yield	3.06%	3.11%
Expected volatility	36.97%	21.96%
Risk-free interest rate	1.89%	2.63%
Expected holding period in years	6.0	5.2

The Company did not apply a forfeiture rate in the expense computation relating to RSAs and SARs issued to officers as they vest monthly and, as a result, the expense is recorded for actual vesting during the period. For outside directors the Company did not apply a forfeiture rate in the expense computation relating to RSAs, as the Company expects 100% to vest at the end of twelve months.

Table of Contents

The table below reflects SARs activity under the Equity Incentive Plan for the nine-months ended September 30, 2009.

	Shares		Weighted Average Exercise Price
Stock Appreciation Rights:			
Outstanding at December 31, 2008	108,710	$	38.16
Granted	71,500		38.38
Exercised			
Cancelled			
Outstanding at September 30, 2009	180,210	$	38.25
Exercisable at September 30, 2009	75,622	$	38.34

The Company has recorded compensation costs for the RSAs and SARs in Operating Expense in the amount of $263 and $134 for the quarters ended September 30, 2009 and September 30, 2008, respectively, and $768 and $412 for the nine-months ended September 30, 2009 and 2008, respectively.

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 and 108,710 were anti-dilutive for the third quarter and dilutive for the nine-months ended September 30, 2009 and 2008. All options are dilutive and the dilutive effect is shown in the table below.

(In thousands, except per share data)

	Three Months Ended September 30			
		2009		2008
Net income	$	19,592	$	22,186
Less preferred dividends				289
Net income available to common stockholders	$	19,592	$	21,897
Weighted average common shares, basic		20,745		20,717
Dilutive common stock options (treasury method)		22		24
Shares used for dilutive computation		20,767		20,741
Net income per share basic	$	0.94	$	1.06
Net income per share diluted	$	0.94	$	1.06

Nine-months ended September 30

	2009	2008
Net income	$ 34,103	$ 32,487
Less preferred dividends		366
Net income available to common stockholders	$ 34,103	$ 32,121
Weighted average common shares, basic	20,740	20,707
Dilutive common stock options (treasury method)	25	24
Shares used for dilutive computation	20,765	20,731
Net income per share basic	$ 1.64	$ 1.55
Net income per share diluted	$ 1.64	$ 1.55

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.

Table of Contents

Cash payments by the Company related to pension plans and other postretirement benefits were $23,690 for the nine-months ended September 30, 2009. The estimated cash contribution to the pension plans during 2009 is $29,600. The estimated contribution to the other benefits plan during 2009 is $10,020.

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	
	2009	2008	2009	2008	2009	2008	2009	2008
Service cost	$ 2,279	$ 1,862	$ 728	$ 361	$ 6,839	$ 4,533	$ 2,186	$ 1,083
Interest cost	3,088	2,869	703	433	9,264	6,125	2,111	1,298
Expected return on plan assets	(1,788)	(1,436)	(196)	(156)	(5,366)	(4,591)	(589)	(468)
Recognized net initial APBO (1)	N/A	N/A	69	69	N/A	N/A	207	207
Amortization of prior service cost	1,533	1,524	29	29	4,599	2,460	87	87
Recognized net actuarial loss	482	178	406	75	1,448	340	1,217	225
Net periodic benefit cost	$ 5,594	$ 4,997	$ 1,739	$ 811	$ 16,784	$ 8,867	$ 5,219	$ 2,432

(1) APBO Accumulated postretirement benefit obligation

Note 6. Short-term Borrowings

The Company maintained a bank line of credit providing unsecured borrowings of up to $20 million and Cal Water maintained a separate bank line of credit for an additional $55 million. On April 17, 2009, the Company s and Cal Water s loan agreements with Bank of America, N.A. were amended so that the interest rate payable on outstanding borrowings is equal to the bank s prime rate minus 0.75 percentage points or the LIBOR rate plus 1.0 percentage point. Additionally, the Company and Cal Water agreed to a fee of 0.15% based upon any unused commitment. The amendment also changed the expiration date to April 16, 2010. The agreement with the Company requires a debt to capitalization ratio of less than 0.667:1.0 and an interest coverage ratio of at least 2.5:1.0. As of September 30, 2009, the Company and Cal Water were in compliance with the bank covenants in the loan agreements. At September 30, 2009, there were no outstanding borrowings on the Cal Water line of credit and the outstanding borrowings on the Company line of credit was $12 million. On October 27, 2009, the Company and Cal Water entered into unsecured credit agreements that replaced and expanded their lines of credit. See Note 10.

Note 7. Long-Term Debt

On April 17, 2009, Cal Water completed the sale and issuance of $100 million aggregate principal amount of its 5.875% First Mortgage Bonds due 2019, which are fully and unconditionally guaranteed by the Company. Pursuant to the note purchase agreements and supplements thereto under which Cal Water s outstanding unsecured senior notes had been issued, Cal Water was required to issue a new series of First Mortgage Bonds in exchange for each outstanding series of unsecured senior notes with a like aggregate principal amount. The offering triggered this exchange provision. Accordingly, upon the closing of the offering, Cal Water was required to issue an additional series of First Mortgage Bonds under the mortgage indenture with a like aggregate principal amount to the holders of each series of its outstanding unsecured senior notes in exchange for each such series of notes.

In connection with the offering, Cal Water exercised its option to redeem the remaining $3.0 million of 8.86% Series J First Mortgage Bonds due 2023, which Cal Water assumed in connection with its acquisition of Dominguez Water Corporation in 2000. The redemption was effected pursuant to the terms of the indenture and supplemental indentures governing the Series J bonds. The Series J bonds were redeemed at a redemption price equal to 100% of the outstanding principal amount of the Series J bonds plus a make-whole premium of $1.0 million, and accrued and unpaid interest to the date of redemption.

Note 8. Commitments 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 8-K dated April 7, 2009.

Contingencies

Chico Groundwater/Wausau Insurance Matter

In 1995, the State of California s Department of Toxic Substances Control (DTSC) named us as a potential responsible party for cleanup of toxic contamination plumes, which contain perchloroethylene, also know as tetrachloroethylene (PCE) in the Chico groundwater. In December 2002, we were named along with other defendants in two lawsuits filed by DTSC for the cleanup of the plumes. In 2007, we entered into Court approved consent decrees (Consent Decrees). The Consent Decrees conditioned our performance upon many factors, including, but not limited to, water pumped and treated by us must meet regulatory standards so we may distribute to its customers. Pursuant to the terms of the Consent Decrees, we will incur capital costs of $1.5 million and future operating costs with a present value of approximately $2.6 million. In our 2007 general rate case (GRC) settlement negotiations, Division of Ratepayer Advocates have tentatively agreed to track all costs associated with the Consent Decrees, including legal costs to pursue insurance coverage, for potential future recovery in rates.

In connection with these suits, our insurance carrier, Employers Insurance of Wausau (Wausau) filed a separate lawsuit against us for reimbursement of past defense costs which approximate $1.5 million and a declaratory determination of coverage. On January 23, 2008, the Court heard various parties motions and on September 25, 2008 issued its rulings that Wausau had a duty to defend; therefore, the Company will not have to reimburse Wausau for previously incurred defense costs. The Court did not find Wausau s actions were intended to harm the Company, so punitive damages will not be recoverable by the Company. However, the Court also found that the issue of policy coverage would be determined at trial. Trial commenced on June 1, 2009. During trial, the parties entered into a confidential settlement agreement which did not have a significant impact to the Company s results of operations. The confidential settlement was fully executed on June 23, 2009, and the lawsuit was dismissed with prejudice by the court during the month of October 2009.

Other 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 based upon the nature of the settlement. It is anticipated that the majority of the settlement will be reflected as a benefit to the rate payers by offsetting future operating or capital costs.

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 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. The Company has filed with the Commission to determine the appropriate regulatory treatment of the proceeds. It anticipates that the proceeds will be used by the Company on infrastructure improvements. The Company has filed with the Internal Revenue Service a request for a private letter ruling regarding the taxability of the proceeds.

The Company believes the proceeds are non-taxable based upon its intent to reinvest them in qualifying assets. When an agreement is reached with the Commission regarding the regulatory treatment, or when the taxability is determined based upon proceedings with the Internal Revenue Service, the Company will adjust the accounting of the settlement accordingly.

As previously reported, Cal Water has filed with the City of Bakersfield, in the Superior Court of California, a lawsuit that names potentially responsible parties, who 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 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, which contained perchloroethylene, also know as tetrachloroethylene (PCE) in California, to recover the past, present, and future treatment costs. No trial date has yet been set.

12

Table of Contents

Other Legal Matters

On October 14, 2009, Victor Guerrero and Hortencia Guerrero filed a Complaint in Solano County Superior Court: *Victor Guerrero and Hortencia Guerrero v. California Water Service Company*, Case No. FCSo34481. The Complaint for wrongful death seeks damages for negligence for failure to maintain the water system, negligence for failure to warn, negligence and intentional concealment causes of actions. The Company does not believe it has any liability in this matter and tendered the lawsuit to its insurance carrier.

From time to time, the Company has been named as a co-defendant in several asbestos related lawsuits. The Company has been dismissed without prejudice in several of these cases. In other cases our contractors and our insurance policy carriers have settled the cases with no effect on the Company s financial statements. As such the Company does not currently believe that there is any potential loss which is 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. We review the status of each significant matter and assess its 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, the Company accrues a liability for the estimated loss in accordance with general accounting procedures 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 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 that the ultimate resolution of these matters will materially affect our financial position, results of operations, or cash flows.

Note 9. 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 amount approximates the fair value because of the short-term maturity of the instruments. The fair value of the Company s long-term debt is estimated at $396 million and $290 million as of September 30, 2009 and December 31, 2008, respectively, using the published quoted market price, if available, or the 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 is $374 million and $287 million as of September 30, 2009 and December 31, 2008, respectively. The fair value of advances for construction contracts is estimated at $67 million as of September 30, 2009, and $66 million as of December 31, 2008, based on discounted cash flows.

Note 10. Subsequent Event

On October 27, 2009, the Company and Cal Water entered into three-year syndicated unsecured revolving line of credit agreements with sixteen banks to provide an unsecured revolving line of credit of $50 million and $250 million, respectively. The base loan rate can vary from prime plus 50 basis points to prime plus 125 basis points depending on the Company s total capitalization ration. Likewise, the unused commitment fee can vary from 25 basis points to 35 basis points based on the same ratio. Based on the Company s planned capitalization during 2010 and future years, the Company expects its pricing to be prime plus 75 basis points with a 25 basis point unused commitment fee. California Water Service Group and subsidiaries which it designates may borrow under the facilities. Borrowings by California Water Service Company will be repaid within 12 months unless otherwise authorized by the CPUC. Bank of America was selected as lead bank and administrative agent, with CoBank and Bank of China as co-syndication agents.

These unsecured credit agreements contain 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, these unsecured credit agreements contain financial covenants governing the Company and its subsidiaries consolidated total capitalization ratio and interest coverage ratio.

Note 11. Condensed Consolidating Financial Statements

As discussed in Note 7, on April 17, 2009, Cal Water issued $100 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, which are fully and unconditionally guaranteed by California Water Service Group (Parent Company). 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 three-month and nine-month periods ended September 30, 2009 and 2008, the condensed consolidating statements of cash flows for the nine-months ended September 30, 2009 and 2008, and the condensed consolidating balance sheets as of September 30, 2009, and December 31, 2008. 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, 2009
(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	$	$ 1,574,294	$ 109,192	$ (7,199)	$ 1,676,287
Less accumulated depreciation and amortization		(480,330)	(22,470)	1,096	(501,704)
Net utility plant		1,093,964	86,722	(6,103)	1,174,583
Current assets:					
Cash and cash equivalents	891	43,342	3,348		47,581
Receivables and unbilled revenue	37	74,998	4,383		79,418
Receivables from affiliates	9,410	11,645	2,007	(23,062)	
Other current assets	63	12,505	811		13,379
Total current assets	10,401	142,490	10,549	(23,062)	140,378
Other assets:					
Regulatory assets		201,045	397		201,442
Investments in affiliates	422,011			(422,011)	
Long-term affiliate notes receivable	11,560			(11,560)	
Other assets		25,931	7,345	(205)	33,071
Total other assets	433,571	226,976	7,742	(433,776)	234,513
	$ 443,972	$ 1,463,430	$ 105,013	$ (462,941)	$ 1,549,474
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders equity	$ 419,492	$ 389,579	$ 38,925	$ (428,504)	$ 419,492
Affiliate long-term debt			11,560	(11,560)	
Long-term debt, less current maturities		369,949	3,592		373,541
Total capitalization	419,492	759,528	54,077	(440,064)	793,033

Current liabilities:					
Current maturities of long-term debt		11,918	506		12,424
Short-term borrowings	12,000				12,000
Payables to affiliates	12,127	8	10,927	(23,062)	
Accounts payable		51,984	2,396		54,380
Accrued expenses and other liabilities	353	45,811	5,833	37	52,034
Total current liabilities	24,480	109,721	19,662	(23,025)	130,838
Unamortized investment tax credits		2,392			2,392
Deferred income taxes, net		81,990	1,374	148	83,512
Pension and postretirement benefits other than pensions		152,467			152,467
Regulatory and other liabilities		75,470	7,887		83,357
Advances for construction		181,230	1,533		182,763
Contributions in aid of construction		100,632	20,480		121,112
	$ 443,972	$ 1,463,430	$ 105,013	$ (462,941)	$ 1,549,474

Table of Contents

CALIFORNIA WATER SERVICE GROUP
CONDENSED CONSOLIDATING BALANCE SHEET
As of December 31, 2008
(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	$	$ 1,488,227	$ 102,051	$ (7,199)	$ 1,583,079
Less accumulated depreciation and amortization		(451,350)	(20,354)	992	(470,712)
Net utility plant		1,036,877	81,697	(6,207)	1,112,367
Current assets:					
Cash and cash equivalents	427	3,025	10,417		13,869
Receivables and unbilled revenue	72	44,049	3,848		47,969
Receivables from affiliates	9,295	11,976	372	(21,643)	
Other current assets	142	17,877	(59)		17,960
Total current assets	9,936	76,927	14,578	(21,643)	79,798
Other assets:					
Regulatory assets	905	196,990	398		198,293
Investments in affiliates	404,064			(404,064)	
Long-term affiliate notes receivable	10,851			(10,851)	
Other assets		20,242	7,612	(205)	27,649
Total other assets	415,820	217,232	8,010	(415,120)	225,942
	$ 425,756	$ 1,331,036	$ 104,285	$ (442,970)	$ 1,418,107
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders equity	$ 402,949	$ 372,337	$ 38,139	$ (410,476)	$ 402,949
Affiliate long-term debt			10,851	(10,851)	
Long-term debt, less current maturities		283,820	3,678		287,498
Total capitalization	402,949	656,157	52,668	(421,327)	690,447

Current liabilities:					
Current maturities of long-term debt		2,121	697		2,818
Short-term borrowings	12,000	28,000			40,000
Payables to affiliates	9,642	201	11,800	(21,643)	
Accounts payable		38,003	3,769		41,772
Accrued expenses and other liabilities	1,165	34,563	2,878		38,606
Total current liabilities	22,807	102,888	19,144	(21,643)	123,196
Unamortized investment tax credits		2,392			2,392
Deferred income taxes, net		70,003	2,341		72,344
Pension and postretirement benefits other than pensions		152,685			152,685
Regulatory and other liabilities		75,362	7,950		83,312
Advances for construction		174,625	1,538		176,163
Contributions in aid of construction		96,924	20,644		117,568
	$ 425,756	$ 1,331,036	$ 104,285	$ (442,970)	$ 1,418,107

Table of Contents

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

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	$	$ 130,659	$ 8,508	$	$ 139,167
Operating expenses:					
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
Total operating expenses	(64)	107,514	7,595	28	115,073
Net operating income	64	23,145	913	(28)	24,094
Other Income and Expenses:					
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)