

CALIFORNIA WATER SERVICE GROUP

Form 10-Q

May 07, 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 March 31, 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

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 May 1, 2010 20,803,738

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TABLE OF CONTENTS

|   | <b>Page</b> |
|---|-------------|
| <u>PART I</u>   |             |
| <u>Financial Information</u>  | 3           |
| <u>Item 1 Financial Statements</u>  | 3           |
| <u>Condensed Consolidated Balance Sheets (unaudited) March 31, 2010 and December 31, 2009</u>                         | 3           |
| <u>Condensed Consolidated Statements of Income (unaudited) For the Three Months Ended March 31, 2010 and 2009</u>     | 4           |
| <u>Condensed Consolidated Statements of Cash Flows (unaudited) For the Three Months Ended March 31, 2010 and 2009</u> | 5           |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>   | 6           |
| <u>Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                   | 17          |
| <u>Item 3 Quantitative and Qualitative Disclosure about Market Risk.</u>  | 26          |
| <u>Item 4 Controls and Procedures</u>   | 26          |
| <u>PART II</u>  | 27          |
| <u>Other Information</u>  | 27          |
| <u>Item 1 Legal Proceedings</u>   | 27          |
| <u>Item 6 Exhibits</u>  | 28          |
| <u>Signatures</u>   | 29          |
| <u>Index to Exhibits</u>  | 30          |
| <u>EX-31.1</u>  |             |
| <u>EX-31.2</u>  |             |
| <u>EX-32</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>March 31,<br/>2010</b> | <b>December<br/>31,<br/>2009</b> |
|---|---------------------------|----------------------------------|
| <b>ASSETS</b>                                   |                           |                                  |
| <b>Utility plant:</b>                           |                           |                                  |
| Utility plant                                   | \$ 1,749,688              | \$ 1,709,062                     |
| Less accumulated depreciation and amortization  | (522,508)                 | (510,985)                        |
| Net utility plant                               | 1,227,180                 | 1,198,077                        |
| <b>Current assets:</b>                          |                           |                                  |
| Cash and cash equivalents                       | 11,352                    | 9,866                            |
| Receivables:                                    |                           |                                  |
| Customers                                       | 19,506                    | 25,567                           |
| Regulatory balancing accounts                   | 11,772                    | 10,513                           |
| Other   | 6,829                     | 9,043                            |
| Unbilled revenue                                | 12,321                    | 13,417                           |
| Materials and supplies at weighted average cost | 5,807                     | 5,530                            |
| Taxes, prepaid expenses and other assets        | 22,696                    | 18,305                           |
| Total current assets                            | 90,283                    | 92,241                           |
| <b>Other assets:</b>                            |                           |                                  |
| Regulatory assets                               | 211,802                   | 204,104                          |
| Goodwill  | 2,615                     | 2,615                            |
| Other assets                                    | 30,569                    | 28,544                           |
| Total other assets                              | 244,986                   | 235,263                          |
|   | <b>\$ 1,562,449</b>       | <b>\$ 1,525,581</b>              |
| <b>CAPITALIZATION AND LIABILITIES</b>           |                           |                                  |
| <b>Capitalization:</b>                          |                           |                                  |
| Common stock, \$.01 par value                   | \$ 208                    | \$ 208                           |
| Additional paid-in capital                      | 215,800                   | 215,528                          |
| Retained earnings                               | 200,738                   | 204,898                          |
| Total common stockholders' equity               | 416,746                   | 420,634                          |
| Long-term debt, less current maturities         | 381,048                   | 374,269                          |

|  |              |              |
|--|--------------|--------------|
| Total capitalization   | 797,794      | 794,903      |
| <b>Current liabilities:</b>                                    |              |              |
| Current maturities of long-term debt                           | 12,987       | 12,953       |
| Short-term borrowings  | 19,100       | 12,000       |
| Accounts payable   | 43,058       | 43,689       |
| Regulatory balancing accounts                                  | 2,104        | 2,430        |
| Accrued interest   | 9,101        | 4,258        |
| Accrued expenses and other liabilities                         | 33,056       | 35,028       |
| Total current liabilities                                      | 119,406      | 110,358      |
| <b>Unamortized investment tax credits</b>                      | 2,318        | 2,318        |
| <b>Deferred income taxes, net</b>                              | 90,806       | 91,851       |
| <b>Pension and postretirement benefits other than pensions</b> | 143,723      | 137,127      |
| <b>Regulatory and other liabilities</b>                        | 90,946       | 85,780       |
| <b>Advances for construction</b>                               | 186,045      | 185,027      |
| <b>Contributions in aid of construction</b>                    | 131,411      | 118,217      |
| <b>Commitments and contingencies</b>                           |              |              |
|  | \$ 1,562,449 | \$ 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>For the three months ended</b>                           | <b>March 31,<br/>2010</b> | <b>March 31,<br/>2009</b> |
|---|---------------------------|---------------------------|
| <b>Operating revenue</b>                                    | \$ 90,272                 | \$ 86,613                 |
| <b>Operating expenses:</b>                                  |                           |                           |
| Operations:   |                           |                           |
| Water production costs                                      | 30,455                    | 28,868                    |
| Administrative and general                                  | 17,444                    | 18,861                    |
| Other operations  | 13,566                    | 12,456                    |
| Maintenance   | 4,951                     | 4,635                     |
| Depreciation and amortization                               | 10,792                    | 10,198                    |
| Income taxes  | 1,403                     | 1,232                     |
| Property and other taxes                                    | 3,903                     | 4,088                     |
| Total operating expenses                                    | 82,514                    | 80,338                    |
| Net operating income  | 7,758                     | 6,275                     |
| <b>Other income and expenses:</b>                           |                           |                           |
| Non-regulated revenue                                       | 3,422                     | 2,881                     |
| Non-regulated expenses, net                                 | (3,546)                   | (2,641)                   |
| Gain on sale of non-utility property                        |                           | 603                       |
| Income taxes (expense) benefit on other income and expenses | 55                        | (338)                     |
| Net other (expenses) income                                 | (69)                      | 505                       |
| <b>Interest expense:</b>                                    |                           |                           |
| Interest expense  | 6,490                     | 5,038                     |
| Less: capitalized interest                                  | (819)                     | (679)                     |
| Total interest expense                                      | 5,671                     | 4,359                     |
| <b>Net income</b>   | <b>\$ 2,018</b>           | <b>\$ 2,421</b>           |
| <b>Earnings per share</b>                                   |                           |                           |
| Basic   | \$ 0.10                   | \$ 0.12                   |
| Diluted   | \$ 0.10                   | \$ 0.12                   |

|   |           |           |
|---|-----------|-----------|
| <b>Weighted average shares outstanding</b>          |           |           |
| Basic   | 20,778    | 20,730    |
| Diluted   | 20,793    | 20,759    |
| <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 CASH FLOWS**

Unaudited

(In thousands)

|   | <b>March 31,<br/>2010</b> | <b>March 31,<br/>2009</b> |
|---|---------------------------|---------------------------|
| <b>For the three months ended:</b>  |                           |                           |
| <b>Operating activities</b>   |                           |                           |
| Net income  | \$ 2,018                  | \$ 2,421                  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                           |                           |
| Depreciation and amortization   | 11,405                    | 10,792                    |
| Gain on sale of non-utility property  |                           | (603)                     |
| Change in value of life insurance contracts                                       | (599)                     | (8)                       |
| Other changes in noncurrent assets and liabilities                                | 3,219                     | (486)                     |
| Changes in operating assets and liabilities:                                      |                           |                           |
| Receivables   | 8,067                     | (2,372)                   |
| Accounts payable  | (768)                     | 1,543                     |
| Other current assets  | (4,693)                   | 1,280                     |
| Other current liabilities   | 2,871                     | (1,152)                   |
| Other changes, net  | 609                       | 63                        |
| Net adjustments   | 20,111                    | 9,057                     |
| Net cash provided by operating activities   | 22,129                    | 11,478                    |
| <b>Investing activities:</b>  |                           |                           |
| Utility plant expenditures  | (26,121)                  | (25,004)                  |
| Purchase of life insurance  | (1,566)                   | (1,373)                   |
| Proceeds on sale of non-utility property  |                           | 671                       |
| Restricted cash decrease  | 24                        |                           |
| Net cash used in investing activities   | (27,663)                  | (25,706)                  |
| <b>Financing activities:</b>  |                           |                           |
| Short-term borrowings   | 7,100                     | 12,000                    |
| Proceeds from long-term debt  | 7,805                     |                           |
| Repayment of long-term borrowings   | (991)                     | (483)                     |
| Advances and contributions in aid of construction                                 | 832                       | 1,269                     |
| Refunds of advances for construction  | (1,548)                   | (1,035)                   |
| Dividends paid  | (6,178)                   | (6,114)                   |
| Net cash provided by financing activities   | 7,020                     | 5,637                     |
| Change in cash and cash equivalents   | 1,486                     | (8,591)                   |
| Cash and cash equivalents at beginning of period                                  | 9,866                     | 13,869                    |

|  |           |          |
|--|-----------|----------|
| Cash and cash equivalents at end of period | \$ 11,352 | \$ 5,278 |
|--|-----------|----------|

**Supplemental information**

|   |        |        |
|---|--------|--------|
| Cash paid for interest (net of amounts capitalized) | \$ 906 | \$ 729 |
|---|--------|--------|

|                            |    |  |
|----------------------------|----|--|
| Cash paid for income taxes | 23 |  |
|----------------------------|----|--|

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

|   |          |          |
|---|----------|----------|
| Accrued payables for investments in utility plant | \$ 9,265 | \$ 5,641 |
|---|----------|----------|

|  |        |       |
|--|--------|-------|
| Utility plant contribution by developers | 16,943 | 2,747 |
|--|--------|-------|

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

**Table of Contents**

**CALIFORNIA WATER SERVICE GROUP**

**Notes to Unaudited Condensed Consolidated Financial Statements**

**March 31, 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, 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 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 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 regulatory 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 metered customers in the future.

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 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 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 March 31, 2010 included in the net regulatory balancing accounts, current and long-term assets were \$11.8 million and \$11.9 million, respectively, and the net regulatory balancing accounts current and long-term liabilities were \$2.1 million and \$0.3 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**

The Company has two stockholder-approved stock-based compensation plans.

**Long-Term Incentive Plan**

The long-term incentive plan was replaced on April 27, 2005, by a stockholder-approved equity 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. 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 at a 25% rate on their anniversary date over their first four years and are exercisable over a ten-year period. At March 31, 2010, options are fully vested and exercisable at a weighted average price of \$25.50. The intrinsic value of the vested shares at December 31, 2009 was \$0.7 million and the weighted average fair value at date of grant was \$4.67 per share. No options were granted for the three-month period ended March 31, 2010 and 2009.

**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. In the first quarters of 2010 and 2009, the Company granted Restricted Stock Awards (RSAs) of 38,268 and 21,000 shares, respectively, of common stock both to officers and to directors of the Company. Employee options vest over forty-eight months, while director options vest at the end of twelve months. In the first 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 quarter of 2009, the Company granted Stock Appreciation Rights (SARs) to officers for 71,500 shares, which vest ratably over forty-eight months and expire at the end of ten years. The Company did not grant any SARs in 2010.

The Company has recorded compensation costs for the RSAs and SARs in Operating Expense in the amount of \$0.3 million for both the quarter ended March 31, 2010, and March 31, 2009.

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

The computations of basic and diluted earnings per share are noted below. Basic earnings per share are computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. 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.

The SARs outstanding of 180,210 shares were anti-dilutive for the first 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 March<br/>31</b> |             |
|---|--|-------------|
|   | <b>2010</b>                            | <b>2009</b> |
| Net income available to common stockholders     | \$ 2,018                               | \$ 2,421    |
| Weighted average common shares, basic           | 20,778                                 | 20,730      |
| Dilutive common stock options (treasury method) | 15                                     | 29          |
| Shares used for dilutive computation            | 20,793                                 | 20,759      |
| Net income per share basic                      | \$ 0.10                                | \$ 0.12     |
| Net income per share diluted                    | \$ 0.10                                | \$ 0.12     |

**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.

The Company did not make cash contributions to the pension plans or other postretirement benefits during the three months ended March 31, 2010. The estimated cash contribution to the pension plans for 2010 is \$23.5 million. The estimated contribution to the other benefits plan for 2010 is \$5.6 million.

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.

|                                    | <b>Three Months Ended March 31</b> |             |                       |             |
|------------------------------------|------------------------------------|-------------|-----------------------|-------------|
|                                    | <b>Pension Plan</b>                |             | <b>Other Benefits</b> |             |
|                                    | <b>2010</b>                        | <b>2009</b> | <b>2010</b>           | <b>2009</b> |
| Service cost                       | \$ 2,451                           | \$ 2,206    | \$ 793                | \$ 504      |
| Interest cost                      | 3,332                              | 3,018       | 783                   | 518         |
| Expected return on plan assets     | (2,051)                            | (1,707)     | (279)                 | (185)       |
| Recognized net initial APBO (1)    | N/A                                | N/A         | 69                    | 69          |
| Amortization of prior service cost | 1,649                              | 1,533       | 29                    | 29          |
| Recognized net actuarial loss      | 524                                | 461         | 392                   | 199         |
| Net periodic benefit cost          | \$ 5,905                           | \$ 5,511    | \$ 1,787              | \$ 1,134    |

- (1) APBO
  - Accumulated
  - postretirement
  - benefit
  - obligation

Note 6. Short-term and Long-term Borrowings

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 unsecured revolving lines 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

**Table of Contents**

capitalization ratio. Likewise, the unused commitment fee can vary from 25 basis points to 35 basis points based on the same ratio. California Water Service Group and subsidiaries which it designates may borrow under the facilities. Borrowings by California Water Service Company will be repaid within twelve months unless otherwise authorized by the CPUC.

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. The unsecured credit agreements replaced the Company and Cal Water's previous credit facilities with Bank of America, N.A.

As of March 31, 2010 and 2009, the outstanding borrowings on the Company lines of credit were \$14.1 million and \$12 million, respectively, and borrowings on the Cal Water lines of credit were \$5 million and \$40 million, respectively.

During the first quarter of 2010, we added new long-term debt of \$7.8 million to fund Cal Water and Washington Water capital projects and repaid debt of \$1.0 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.

**Contingencies**

**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, dependant 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 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.

In 2008, we received \$34.2 million from our MTBE litigations. In April 2010, we received from the Internal Revenue Service a response to our request for a Private Letter Ruling on the taxability of the litigation proceeds. They stated that they would not be issuing a ruling on the matter. We plan to continue to reflect in our financial statements and on our tax returns, that the proceeds are used to replace the infrastructure damaged or lost due to the MTBE contamination in accordance with the Internal Revenue Code Section 1033. This treatment will reduce the tax basis of the replacement property and therefore deferring any taxable gain.

As previously reported, the Company 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 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.



**Table of Contents**

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, which contained 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. The Company has been dismissed without prejudice in several of these cases. 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 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 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 \$377 million and \$367 million as of March 31, 2010 and December 31, 2009, 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 was \$381 million and \$374 million as of March 31, 2010 and December 31, 2009, respectively. The fair value of advances for construction contracts was estimated at \$74 million as of March 31, 2010 and December 31, 2009.

**Note 9. Condensed Consolidating Financial Statements**

Cal Water issued on April 17, 2009, \$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 periods ended March 31, 2010 and 2009, the condensed consolidating statements of cash flows for the three-months ended March 31, 2010 and 2009 and the condensed consolidating balance sheets as of March 31, 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 March 31, 2010

(In thousands)

|  | Parent<br>Company | Cal Water    | All Other<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated |
|--|-------------------|--------------|---------------------------|------------------------------|--------------|
| <b>ASSETS</b>                                  |                   |              |                           |                              |              |
| <b>Utility plant:</b>                          |                   |              |                           |                              |              |
| Utility plant                                  | \$                | \$ 1,629,477 | \$ 127,410                | \$ (7,199)                   | \$ 1,749,688 |
| Less accumulated depreciation and amortization |                   | (499,091)    | (24,580)                  | 1,163                        | (522,508)    |
| Net utility plant                              |                   | 1,130,386    | 102,830                   | (6,036)                      | 1,227,180    |
| <b>Current assets:</b>                         |                   |              |                           |                              |              |
| Cash and cash equivalents                      | 935               | 7,371        | 3,046                     |                              | 11,352       |
| Receivables and unbilled revenue               | 58                | 46,386       | 3,984                     |                              | 50,428       |
| Receivables from affiliates                    | 14,722            | 12,839       | 2,661                     | (30,222)                     |              |
| Other current assets                           | 165               | 27,063       | 1,275                     |                              | 28,503       |
| Total current assets                           | 15,880            | 93,659       | 10,966                    | (30,222)                     | 90,283       |
| <b>Other assets:</b>                           |                   |              |                           |                              |              |
| Regulatory assets                              |                   | 209,932      | 1,870                     |                              | 211,802      |
| Investments in affiliates                      | 418,021           |              |                           | (418,021)                    |              |
| Long-term affiliate notes receivable           | 9,682             |              |                           | (9,682)                      |              |
| Other assets                                   |                   | 26,080       | 7,309                     | (205)                        | 33,184       |
| Total other assets                             | 427,703           | 236,012      | 9,179                     | (427,908)                    | 244,986      |
|  | \$ 443,583        | \$ 1,460,057 | \$ 122,975                | \$ (464,166)                 | \$ 1,562,449 |
| <b>CAPITALIZATION AND LIABILITIES</b>          |                   |              |                           |                              |              |
| <b>Capitalization:</b>                         |                   |              |                           |                              |              |
| Common stockholders equity                     | \$ 416,746        | \$ 385,673   | \$ 38,760                 | \$ (424,433)                 | \$ 416,746   |
| Affiliate long-term debt                       |                   |              | 9,682                     | (9,682)                      |              |
| Long-term debt, less current maturities        |                   | 376,660      | 4,388                     |                              | 381,048      |
| Total capitalization                           | 416,746           | 762,333      | 52,830                    | (434,115)                    | 797,794      |
| <b>Current liabilities:</b>                    |                   |              |                           |                              |              |
| Current maturities of long-term debt           |                   | 12,246       | 741                       |                              | 12,987       |
| Short-term borrowings                          | 14,100            | 5,000        |                           |                              | 19,100       |
| Payables to affiliates                         | 12,365            | 26           | 17,831                    | (30,222)                     |              |

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|  |            |              |            |              |              |
|--|------------|--------------|------------|--------------|--------------|
| Accounts payable   |            | 39,330       | 5,832      |              | 45,162       |
| Accrued expenses and other liabilities                         | 372        | 37,274       | 4,487      | 24           | 42,157       |
| Total current liabilities                                      | 26,837     | 93,876       | 28,891     | (30,198)     | 119,406      |
| <b>Unamortized investment tax credits</b>                      |            | 2,318        |            |              | 2,318        |
| <b>Deferred income taxes, net</b>                              |            | 89,284       | 1,375      | 147          | 90,806       |
| <b>Pension and postretirement benefits other than pensions</b> |            | 143,723      |            |              | 143,723      |
| <b>Regulatory and other liabilities</b>                        |            | 80,095       | 10,851     |              | 90,946       |
| <b>Advances for construction</b>                               |            | 184,506      | 1,539      |              | 186,045      |
| <b>Contributions in aid of construction</b>                    |            | 103,922      | 27,489     |              | 131,411      |
|  | \$ 443,583 | \$ 1,460,057 | \$ 122,975 | \$ (464,166) | \$ 1,562,449 |

**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING BALANCE SHEET**

As of December 31, 2009

(In thousands)

|   | Parent<br>Company | Cal Water    | All Other<br>Subsidiaries | Consolidating<br>Adjustments | Consolidated |
|---|-------------------|--------------|---------------------------|------------------------------|--------------|
| <b>ASSETS</b>                                     |                   |              |                           |                              |              |
| <b>Utility plant:</b>                             |                   |              |                           |                              |              |
| Utility plant                                     | \$                | \$ 1,604,680 | \$ 111,581                | \$ (7,199)                   | \$ 1,709,062 |
| Less accumulated depreciation and<br>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<br>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<br/>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<br>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<br>debt           |                   | 12,246       | 707                       |                              | 12,953       |
| Short-term borrowings                             | 12,000            |              |                           |                              | 12,000       |
| Payables to affiliates                            | 11,983            | 12           | 13,998                    | (25,993)                     |              |

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|  |            |              |            |              |              |
|--|------------|--------------|------------|--------------|--------------|
| 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 March 31, 2010****(In thousands)**

|   | <b>Parent<br/>Company</b> | <b>Cal<br/>Water</b> | <b>All Other<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated</b> |
|---|---------------------------|----------------------|-----------------------------------|--------------------------------------|---------------------|
| <b>Operating revenue</b>                                    | \$                        | \$ 83,613            | \$ 6,659                          | \$                                   | \$ 90,272           |
| <b>Operating expenses:</b>                                  |                           |                      |                                   |                                      |                     |
| Operations:   |                           |                      |                                   |                                      |                     |
| Purchased water   |                           | 23,867               | (2)                               |                                      | 23,865              |
| Purchased power   |                           | 3,306                | 1,863                             |                                      | 5,169               |
| Pump taxes  |                           | 1,294                | 127                               |                                      | 1,421               |
| Administrative and general                                  |                           | 15,440               | 2,004                             |                                      | 17,444              |
| Other   |                           | 11,773               | 1,919                             | (126)                                | 13,566              |
| Maintenance   |                           | 4,805                | 146                               |                                      | 4,951               |
| Depreciation and amortization                               |                           | 10,167               | 658                               | (33)                                 | 10,792              |
| Income taxes (benefit)                                      | (24)                      | 1,483                | (251)                             | 195                                  | 1,403               |
| Taxes other than income taxes                               |                           | 3,381                | 522                               |                                      | 3,903               |
| <b>Total operating expenses<br/>(income)</b>                | (24)                      | 75,516               | 6,986                             | 36                                   | 82,514              |
| <b>Net operating income</b>                                 | 24                        | 8,097                | (327)                             | (36)                                 | 7,758               |
| <b>Other Income and Expenses:</b>                           |                           |                      |                                   |                                      |                     |
| Non-regulated revenue                                       | 240                       | 2,460                | 1,154                             | (432)                                | 3,422               |
| Non-regulated expense                                       |                           | (2,582)              | (964)                             |                                      | (3,546)             |
| Income tax benefit (expense) on<br>other income and expense | (98)                      | 50                   | (79)                              | 182                                  | 55                  |
| Net other income (expense )                                 | 142                       | (72)                 | 111                               | (250)                                | (69)                |
| <b>Interest:</b>  |                           |                      |                                   |                                      |                     |
| Interest expense  | 60                        | 6,370                | 366                               | (306)                                | 6,490               |
| Less: capitalized interest                                  |                           | (554)                | (265)                             |                                      | (819)               |
| Net interest expense  | 60                        | 5,816                | 101                               | (306)                                | 5,671               |
| Gross income (loss)   | 106                       | 2,209                | (317)                             | 20                                   | 2,018               |
| <b>Equity earnings of subsidiaries</b>                      | 1,912                     |                      |                                   | (1,912)                              |                     |
| <b>Net income (loss)</b>                                    | \$ 2,018                  | \$ 2,209             | \$ (317)                          | \$ (1,892)                           | \$ 2,018            |



**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF INCOME**

For the three months ended March 31, 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>                                 | \$             | \$ 80,276    | \$ 6,337            | \$                   | \$ 86,613           |
| <b>Operating expenses:</b>                               |                |              |                     |                      |                     |
| Operations:  |                |              |                     |                      |                     |
| Purchased water  |                | 22,904       | 36                  |                      | 22,940              |
| Purchased power  |                | 2,904        | 1,639               |                      | 4,543               |
| Pump taxes   |                | 1,272        | 113                 |                      | 1,385               |
| Administrative and general                               |                | 17,239       | 1,622               |                      | 18,861              |
| Other  |                | 11,031       | 1,539               | (114)                | 12,456              |
| Maintenance  |                | 4,520        | 115                 |                      | 4,635               |
| Depreciation and amortization                            |                | 9,435        | 797                 | (34)                 | 10,198              |
| Income taxes (benefits)                                  | (25)           | 1,179        | (117)               | 195                  | 1,232               |
| Taxes other than income taxes                            |                | 3,509        | 579                 |                      | 4,088               |
| <b>Total operating expenses (income)</b>                 | (25)           | 73,993       | 6,323               | 47                   | 80,338              |
| <b>Net operating income</b>                              | 25             | 6,283        | 14                  | (47)                 | 6,275               |
| <b>Other Income and Expenses:</b>                        |                |              |                     |                      |                     |
| Non-regulated revenue                                    | 171            | 1,957        | 1,047               | (294)                | 2,881               |
| Non-regulated expense                                    |                | (1,742)      | (899)               |                      | (2,641)             |
| Gain on sale on non-utility property                     |                | 598          | 5                   |                      | 603                 |
| Income tax benefit (expense) on other income and expense | (70)           | (331)        | (118)               | 181                  | (338)               |
| Net other income (expense )                              | 101            | 482          | 35                  | (113)                | 505                 |
| <b>Interest:</b>   |                |              |                     |                      |                     |
| Interest expense   | 61             | 4,916        | 241                 | (180)                | 5,038               |
| Less: capitalized interest                               |                | (545)        | (134)               |                      | (679)               |
| Net interest expense                                     | 61             | 4,371        | 107                 | (180)                | 4,359               |
| <b>Equity earnings of subsidiaries</b>                   | 2,356          |              |                     | (2,356)              |                     |
| <b>Net income (loss)</b>                                 | \$ 2,421       | \$ 2,394     | \$ (58)             | \$ (2,336)           | \$ 2,421            |



**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****For the three months ended March 31, 2010****(In thousands)**

|   | <b>Parent<br/>Company</b> | <b>Cal<br/>Water</b> | <b>All Other<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated</b> |
|---|---------------------------|----------------------|-----------------------------------|--------------------------------------|---------------------|
| <b>Operating activities:</b>  |                           |                      |                                   |                                      |                     |
| Net income  | \$ 2,018                  | \$ 2,209             | \$ (317)                          | \$ (1,892)                           | \$ 2,018            |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                           |                      |                                   |                                      |                     |
| Equity earnings of subsidiaries   | (1,912)                   |                      |                                   | 1,912                                |                     |
| Dividends received from affiliates  | 6,178                     |                      |                                   | (6,178)                              |                     |
| Depreciation and amortization   |                           | 10,756               | 682                               | (33)                                 | 11,405              |
| Other changes in noncurrent assets and liabilities  |                           | 3,190                | 29                                |                                      | 3,219               |
| Change in value of life insurance contracts   |                           | (599)                |                                   |                                      | (599)               |
| Changes in operating assets and liabilities:  |                           |                      |                                   |                                      |                     |
| Net advance to affiliates   | (3,228)                   | 1                    | 3,227                             |                                      |                     |
| Other changes, net  | 38                        | 4,429                | 1,606                             | 13                                   | 6,086               |
| Net adjustments   | 1,076                     | 17,777               | 5,544                             | (4,286)                              | 20,111              |
| Net cash provided by (used in) operating activities   | 3,094                     | 19,986               | 5,227                             | (6,178)                              | 22,129              |
| <b>Investing activities:</b>  |                           |                      |                                   |                                      |                     |
| Utility plant expenditures  |                           | (21,434)             | (4,687)                           |                                      | (26,121)            |
| Proceeds from affiliates long-term debt   | 1,387                     |                      |                                   | (1,387)                              |                     |
| Purchase of life insurance  |                           | (1,566)              |                                   |                                      | (1,566)             |
| Restricted cash   |                           | 24                   |                                   |                                      | 24                  |
| Net cash provided by (used in) investing activities   | 1,387                     | (22,976)             | (4,687)                           | (1,387)                              | (27,663)            |
| <b>Financing Activities:</b>  |                           |                      |                                   |                                      |                     |
| Short-term borrowings   | 2,100                     | 5,000                |                                   |                                      | 7,100               |
| Proceeds from long-term debt  |                           | 5,805                | 2,000                             |                                      | 7,805               |
| Repayment of long-term borrowings   |                           | (45)                 | (946)                             |                                      | (991)               |
| Repayment of affiliates long-term borrowings  |                           |                      | (1,387)                           | 1,387                                |                     |
|   |                           | 795                  | 37                                |                                      | 832                 |

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|   |         |          |          |       |           |
|---|---------|----------|----------|-------|-----------|
| Advances and contributions in aid for construction  |         |          |          |       |           |
| Refunds of advances for construction                |         | (1,529)  | (19)     |       | (1,548)   |
| Dividends paid to non-affiliates                    | (6,178) |          |          |       | (6,178)   |
| Dividends paid to affiliates                        |         | (5,665)  | (513)    | 6,178 |           |
| Net cash provided by (used in) financing activities | (4,078) | 4,361    | (828)    | 7,565 | 7,020     |
| Change in cash and cash equivalents                 | 403     | 1,371    | (288)    |       | 1,486     |
| Cash and cash equivalents at beginning of period    | 532     | 6,000    | 3,334    |       | 9,866     |
| Cash and cash equivalents at end of period          | \$ 935  | \$ 7,371 | \$ 3,046 | \$    | \$ 11,352 |

**Table of Contents****CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS****For the three months ended March 31, 2009****(In thousands)**

|   | <b>Parent<br/>Company</b> | <b>Cal<br/>Water</b> | <b>All Other<br/>Subsidiaries</b> | <b>Consolidating<br/>Adjustments</b> | <b>Consolidated</b> |
|---|---------------------------|----------------------|-----------------------------------|--------------------------------------|---------------------|
| <b>Operating activities:</b>  |                           |                      |                                   |                                      |                     |
| Net income  | \$ 2,421                  | \$ 2,394             | \$ (58)                           | \$ (2,336)                           | \$ 2,421            |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                           |                      |                                   |                                      |                     |
| Equity earnings of subsidiaries   | (2,356)                   |                      |                                   | 2,356                                |                     |
| Dividends received from affiliates  | 6,114                     |                      |                                   | (6,114)                              |                     |
| Depreciation and amortization   |                           | 9,972                | 854                               | (34)                                 | 10,792              |
| Other changes in noncurrent assets and liabilities  |                           | (363)                | (123)                             |                                      | (486)               |
| Change in value of life insurance contracts   |                           | (8)                  |                                   |                                      | (8)                 |
| Gain on sale of non-utility property  |                           | (598)                | (5)                               |                                      | (603)               |
| Changes in operating assets and liabilities:  |                           |                      |                                   |                                      |                     |
| Net advance to affiliates   | (509)                     | 8,600                | (8,091)                           |                                      |                     |
| Other changes, net  | 306                       | (1,454)              | 496                               | 14                                   | (638)               |
| Net adjustments   | 3,555                     | 16,149               | (6,869)                           | (3,778)                              | 9,057               |
| Net cash provided by (used in) operating activities   | 5,976                     | 18,543               | (6,927)                           | (6,114)                              | 11,478              |
| <b>Investing activities:</b>  |                           |                      |                                   |                                      |                     |
| Utility plant expenditures  |                           | (24,248)             | (756)                             |                                      | (25,004)            |
| Proceeds from sale of non-utility assets  |                           | 666                  | 5                                 |                                      | 671                 |
| Proceeds from affiliates long-term debt   | 67                        |                      |                                   | (67)                                 |                     |
| Purchase of life insurance  |                           | (1,373)              |                                   |                                      | (1,373)             |
| Net cash provided by (used in) investing activities   | 67                        | (24,955)             | (751)                             | (67)                                 | (25,706)            |
| <b>Financing Activities:</b>  |                           |                      |                                   |                                      |                     |
| Short-term borrowings   |                           | 12,000               |                                   |                                      | 12,000              |
| Repayment of long-term borrowings   |                           | (272)                | (211)                             |                                      | (483)               |

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|   |         |          |          |       |          |
|---|---------|----------|----------|-------|----------|
| Reduction of affiliates long-term borrowings        |         |          | (67)     |       | 67       |
| Advances and contributions in aid for construction  |         | 1,198    | 71       |       | 1,269    |
| Refunds of advances for construction                |         | (1,025)  | (10)     |       | (1,035)  |
| Dividends paid to non-affiliates                    | (6,114) |          |          |       | (6,114)  |
| Dividends paid to affiliates                        |         | (5,625)  | (489)    | 6,114 |          |
| Net cash provided by (used in) financing activities | (6,114) | 6,276    | (706)    | 6,181 | 5,637    |
| Change in cash and cash equivalents                 | (71)    | (136)    | (8,384)  |       | (8,591)  |
| Cash and cash equivalents at beginning of period    | 427     | 3,025    | 10,417   |       | 13,869   |
| Cash and cash equivalents at end of period          | \$ 356  | \$ 2,889 | \$ 2,033 | \$    | \$ 5,278 |

**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 or 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;

17

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**Table of Contents**

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

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 2009 Form 10-K. 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



**Table of Contents**

For the period ended March 31, 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 FIRST QUARTER 2010 OPERATIONS COMPARED TO  
FIRST QUARTER 2009 OPERATIONS

Amounts in thousands except share data

**Overview**

First quarter 2010 net income was \$2.0 million equivalent to \$0.10 per share of common stock on a diluted basis compared to net income of \$2.4 million or \$0.12 per share of common stock on a diluted basis in the first quarter of 2009. The decrease in net income was primarily attributable to higher interest expenses and a decrease in other income and expenses mostly due to costs incurred evaluating potential acquisitions during the first quarter of 2010. While we had a decline in customer usage of water due to unfavorable weather, the impact was offset by the net increase in revenue from the Water Revenue Adjustment Mechanism and Modified Cost Balancing Account (WRAM and MCBA) and rate increases.

**Operating Revenue**

Operating revenue increased \$3.7 million or 4% to \$90.3 million in the first quarter of 2010. As disclosed in the following table, the increase was due to increases in rates. The decrease in usage by existing customers was offset by revenue recognized from the WRAM and MCBA.

The factors that impacted the operating revenue for the first quarter of 2010 compared to 2009 are as follows:

|   |          |
|---|----------|
| Rate increases  | \$ 4,297 |
| Net change due to actual versus adopted results, usage, and other | (638)    |
| Net operating revenue increase                                    | \$ 3,659 |

The net change due to actual versus adopted results, usage, and other in the above table refers primarily 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 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 as follows:

|                                   |          |
|-----------------------------------|----------|
| General rate case (GRC) increases | \$ 393   |
| Step rate increases               | 1,750    |
| Purchased water offset increases  | 1,573    |
| Other                             | 581      |
| Total increase in rates           | \$ 4,297 |

**Total Operating Expenses**

Total operating expenses were \$82.5 million for the first quarter of 2010, versus \$80.3 million for the same period in 2009, a 3% 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 37% of total operating expenses in the first quarter of 2010. Water production expenses increased 5% compared to the same period last year due to increased cost of all components of water production, although usage was down. Our wholly-owned operating subsidiaries, Washington Water, New Mexico Water, and Hawaii Water obtain all of their water supply from wells.

**Table of Contents**

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

|                 | <b>Three Months Ended March<br/>31</b> |             |
|-----------------|--|-------------|
|                 | <b>2010</b>                            | <b>2009</b> |
| Well production | 45%                                    | 42%         |
| Purchased       | 50%                                    | 54%         |
| Surface         | 5%                                     | 4%          |
| Total           | 100%                                   | 100%        |

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

|                 | <b>Three Months Ended March 31</b> |             |               |
|-----------------|------------------------------------|-------------|---------------|
|                 | <b>2010</b>                        | <b>2009</b> | <b>Change</b> |
| Purchased water | \$ 23,865                          | \$ 22,940   | \$ 925        |
| Purchased power | 5,169                              | 4,543       | 626           |
| Pump taxes      | 1,421                              | 1,385       | 36            |
| Total           | \$ 30,455                          | \$ 28,868   | \$ 1,587      |

Purchased water costs increased primarily due to price increases from water wholesalers. Total water production measured in acre feet decreased by 8% during the first quarter of 2010 as compared with the first quarter of 2009 due to lower demand, as compared to the same period in 2009.

Administrative and general expense and other operations expense decreased 1% to \$31.0 million. The primary reason for the decrease was the resolution of legal issues during 2009 resulting in a significant decrease in outside legal services during the first quarter of 2010. The decrease was partially offset by increases in employee benefit and payroll costs. Effective January 1, 2010, wage increases became effective and there was an increase in the number of employees. At March 31, 2010, there were 1,024 employees and at March 31, 2009, there were 925 employees. Maintenance expenses increased by 7% to \$5.0 million in the first quarter of 2010 compared to \$4.6 million in the first quarter of 2009, due to increase in main water treatment facilities and well repairs. Depreciation and amortization expense increased \$0.6 million, or 6%, because of 2009 capital additions.

Federal and state income taxes charged to operating expenses and other income and expenses decreased \$0.3 million, from a provision of \$1.6 million in the first quarter of 2009 to \$1.3 million in the first quarter of 2010, due to a decrease in pretax income. We expect the effective tax rate to be between 38% and 40% for fiscal year 2010.

**Other Income and Expense**

Non-regulated revenue, net of related expenses, and gain on sale of non-utility property reflected a loss of \$0.1 million for the first quarter of 2010, compared to income of \$0.5 million in the same period last year, which was a decrease of \$0.6 million. The change from the prior year was due to costs incurred to evaluate potential acquisitions and non-recurrence of non-utility property sales.

**Interest Expense**

Total interest expense, net of interest capitalized, increased \$1.3 million to \$5.7 million for the first quarter of 2010 compared to the same period last year. The increase was attributable to the issuance of the \$100 million first mortgage bond, series LL, during the month of April 2009.

**Company Health Care Benefits**

During the month of March 2010, both the federal Patient Protection and Affordable Care Act (P.L. 111-148) and Health Care and Education Reconciliation Act (H.R. 4872) were enacted. The new federal health care laws eliminated future Company federal and state income tax deductions of approximately \$11.4 million. We have not determined the impact of this legislation on the Company's health care costs during 2010 and in future years. However, we anticipate

that the Company's health care and other costs will increase as a result of the new federal health care laws and based on available information.

**Table of Contents****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. The CPUC is generally required to issue its GRC decision prior to the first day of the test year or authorize interim rates. As such, Cal Water's GRC decisions, prior to 2005, were generally issued in the fourth quarter. Effective with the 2009 GRC, the processing time is scheduled for eighteen months with rates 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 March 31, 2010. Included in this amount, Cal Water has 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. As a result, and based on past experience, Cal Water cannot predict at this time the ultimate rate change the Commission will order. The Commission is generally required under state law to allow Cal Water interim rates and an effective date of January 1, 2011 if a decision is not rendered in the proceeding by that date.

**Request for MTBE regulatory treatment**

On July 10, 2009, Cal Water filed an application requesting the CPUC adopt ratemaking treatment of proceeds from its partial settlement of MTBE contamination litigation. Cal Water has requested that all of the proceeds be reinvested in infrastructure to treat or replace MTBE-contaminated facilities. In addition, Cal Water has 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 has also requested specific regulatory treatment of future settlement or litigation proceeds that may occur in the consolidated MTBE cases. The CPUC has also opened a rulemaking proceeding, R.09-03-014, to consider, among other things, whether it should adopt a



## **Table of Contents**

standard policy for ratemaking treatment of litigation proceeds. This rulemaking is scheduled to be concluded in the second quarter of 2010. The CPUC has previously authorized a wide range of regulatory treatments of other utility companies' contamination litigation proceeds. Due to the open policy proceeding and the considerable variability in the CPUC's past treatment of contamination litigation proceeds, Cal Water cannot predict the outcome or timing of a decision in this proceeding at this time.

### **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 will be approved during the months of March, April, and May 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.

On January 7, 2010, Cal Water filed an application for additional financing authority with the CPUC. If adopted as proposed, Cal Water would be allowed authority to issue \$350 million of debt and common stock to finance capital projects and operations. Cal Water cannot predict the timing or outcome of the application at this time.

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 or will file advice letters for nineteen districts to recoup the net balance of the WRAM and MCBA from 2008 and 2009. The total requested was \$11.4 million. The recovery period requested was between twelve and eighteen months, consistent from past practice, from the date of advice letter approval. There can be no assurances that the CPUC will approve the advice letters as submitted.

In May 2010, as allowed in the Commission's 2007 Rate Case Plan, Cal Water intends to file advice letters for interim rate increases for eight districts effective in July 2010. Under the Commission's prior rate case plan, these districts would have had rates effective in July 2010. In addition, Cal Water expects to file adjusted interim rates for eight districts operating under interim rates since July 2009. 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 intends to file for escalation rate increases effective in July for eight districts. The CPUC's current practice on approving escalation rate increases is based partly on inflation through March 2010. Inputs to the weather-normalized earnings test include recorded information through March 2010. Therefore, Cal Water cannot determine the amount of its request at this time.

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 for all 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 flow from Operations**

Cash flow from operations was \$22.1 million for the first quarter of 2010. Cash flow from operations is primarily generated by changes in our operating assets and liabilities. Cash generated by operations varies during the year which is dependent upon customer billings, timing of contributions to our benefit plans, and timing of estimated tax payments.

## **Table of Contents**

During the first quarter of 2010, we did not make contributions to our pension and retiree health care plan compared to \$11.6 million paid during the first quarter of 2009. Collections on trade and other accounts receivable exceeded billings by approximately \$8.1 million during the first quarter of 2010 compared to a decrease of \$2.4 million during the first quarter of 2009. Prepaid income taxes and business insurance increased approximately \$4.7 million during the first quarter of 2010.

The water business is seasonal. Customer billings are lower in the cool, wet winter months when less water is used compared to the warm, dry summer months when water use is highest. 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 winter period. The increase in cash flows during the summer allows short-term borrowings to be paid down. Customer water usage can be lower than normal in years when more than normal precipitation falls in our service areas or temperatures are lower than normal, especially in the summer months. The reduction in water usage reduces cash flows from operations and increases the need for short-term bank borrowings. In addition, short-term borrowings are used to finance capital expenditures until long-term financing is arranged.

### **Investing Activities**

During the first quarter of 2010, we used \$26.1 million of cash for both company-funded and developer-funded capital expenditures. For 2010, our capital budget is approximately \$120 to \$140 million.

### **Financing Activities**

During the first quarter of 2010, there were no equity offerings; however, we borrowed \$7.1 million on our bank lines of credit and added new debt of \$7.8 million. Advances for construction increased \$1.0 million and contributions in aid of construction increased \$13.2 million during the first quarter of 2010 due to developer activity. 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 March 31, 2010, there were short-term borrowings of \$19.1 million outstanding on the line of credit compared to \$52 million as of March 31, 2009.

Given our ability to access our lines of credit on a daily basis, cash balances are managed to levels required for daily cash needs and excess cash is invested in short-term or cash equivalent instruments. Minimal operating levels of cash are maintained for Washington Water, New Mexico Water, and Hawaii Water.

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 ratio. 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 twelve months unless otherwise authorized by the CPUC.

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. As of March 31, 2010, we have met all of the covenant requirements and are eligible to use the full amount of the commitment.

There was \$7.8 million of new debt added to long-term debt during the first quarter of 2010, and we made principal payments on our first mortgage bonds and other long-term debt of \$1 million during the first quarter of 2010.

Long-term financing, which includes senior notes, 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 five 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

## **Table of Contents**

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.

### **Credit Ratings**

Cal Water's first mortgage bonds are rated by Standard & Poor's (S&P). Since 2004, the credit rating agency has maintained their rating of A+ and characterized us as stable. On April 8, 2009, Standard & Poor's issued a rating of AA- on our long-term bonds. If rating were downgraded in the future, it may result in a higher interest rate on future debt.

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

The first quarter of 2010, common stock dividend of \$0.2975 per share was paid on February 19, 2010, compared to a quarterly dividend in the first quarter of 2009 of \$0.2950. This was Cal Water's 260th consecutive quarterly dividend. Annualized, 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 April 28, 2010 meeting, the Board declared the second quarter dividend of \$0.2975 per share payable on May 21, 2010, to stockholders of record on May 10, 2010. This was our 261st consecutive quarterly dividend.

### **2010 Financing Plan**

Cal Water is currently reviewing its financing needs for 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 March 31, 2010, the Company's availability on these unsecured revolving lines of credit was \$280.9 million.

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

Book value per common share was \$20.03 at March 31, 2010 compared to \$20.26 at December 31, 2009.

There were approximately 2,596 stockholders of record for our common stock, as of our record date, March 31, 2010.

### **Utility Plant Expenditures**

During the first quarter of 2010, capital expenditures totaled \$26.1 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 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 March 31, 2010, construction work in progress was \$103.0 million compared to \$91.9 million at March 31, 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 subsequent delivery to customers. To date, the State of California snowpack water content and rainfall accumulation during the 2009 - 2010 water year is 98% of normal (as of April 1, 2010, per the California Department of Water Resources, Northern Sierra Precipitation Accumulation report).

Precipitation in the prior year was below average. Management believes that supply pumped



**Table of Contents**

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 in 2010, 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 three-months ended March 31, 2010, there were no material changes in contractual obligations outside the normal course of business.

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 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 as of April 13, 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

We have been and are 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, dependant upon the nature of the settlement.

We are involved in a lawsuit against major oil refineries regarding the contamination of the ground water as a result of the gas additive MTBE. We 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, we received \$34.2 million after deducting attorneys fees and litigation expenses. We are aggressively pursuing legal action against the remaining responsible parties. Pursuant to Internal Revenue Code Section 1033, we have deferred recognition of tax on receipt of the contamination proceeds. We intend to use all proceeds on replacement facilities and properties. Cal Water has filed with the Commission to determine the appropriate regulatory treatment of the proceeds. It anticipates that the proceeds will have been used on MTBE capital investments. When an agreement is reached with the Commission regarding the regulatory treatment, we will adjust the accounting of the settlement, accordingly.

As previously reported, we have 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. We have entered into a settlement with one of the distributor defendants, FMC Corporation. Cal Water will record the proceeds in a memorandum account until the Commission approves an allocation between ratepayers and shareholders.

We have 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, which contained perchloroethylene, also know 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. No trial date has yet been set.

Other Legal Matters

From time to time, we have been named as a co-defendant in several asbestos related lawsuits. We have 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 our financial statements. As such we do 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, we are 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, we accrue a liability 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 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.

**Table of Contents**

Item 6.  
EXHIBITS

| <b>Exhibit</b> | <b>Description</b>  |
|----------------|---|
| 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 |

**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

May 7, 2010

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

29

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**Table of Contents**

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