

CALIFORNIA WATER SERVICE GROUP
Form 10-Q
August 05, 2011
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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 June 30, 2011

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)

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Delaware
(State or other jurisdiction
of incorporation or organization)

77-0448994
(I.R.S. Employer identification No.)

1720 North First Street, San Jose, CA.
(Address of principal executive offices)

95112
(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 July 31, 2011 41,752,032

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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)

	June 30, 2011	December 31, 2010
ASSETS		
Utility plant:		
Utility plant	\$ 1,895,384	\$ 1,843,766
Less accumulated depreciation and amortization	(567,788)	(549,469)
Net utility plant	1,327,596	1,294,297
Current assets:		
Cash and cash equivalents	32,882	42,277
Receivables:		
Customers	30,620	25,813
Regulatory balancing accounts	13,085	14,784
Other	6,148	5,386
Unbilled revenue	21,545	13,925
Materials and supplies at average cost	6,064	6,058
Taxes, prepaid expenses and other assets	21,267	17,967
Total current assets	131,611	126,210
Other assets:		
Regulatory assets	245,956	229,577
Goodwill	2,615	2,615
Other assets	37,375	39,367
Total other assets	285,946	271,559
	\$ 1,745,153	\$ 1,692,066
CAPITALIZATION AND LIABILITIES		
Capitalization:		

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Common stock, \$.01 par value 68,000 shares authorized, 41,752 and 41,667 outstanding in 2011 and 2010, respectively	\$	418	\$	417
Additional paid-in capital		217,937		217,308
Retained earnings		219,885		217,801
Total common stockholders' equity		438,240		435,526
Long-term debt, less current maturities		477,968		479,181
Total capitalization		916,208		914,707
Current liabilities:				
Current maturities of long-term debt		2,377		2,380
Short-term borrowings		32,760		23,750
Accounts payable		51,647		39,505
Regulatory balancing accounts		2,297		3,025
Accrued interest		4,689		4,651
Accrued expenses and other liabilities		37,856		34,037
Total current liabilities		131,626		107,348
Unamortized investment tax credits		2,244		2,244
Deferred income taxes, net		120,046		107,084
Pension and postretirement benefits other than pensions		162,439		155,224
Regulatory and other liabilities		70,726		82,204
Advances for construction		187,277		186,899
Contributions in aid of construction		154,587		136,356
	\$	1,745,153	\$	1,692,066

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

Unaudited

(In thousands, except per share data)

For the three months ended	June 30,	June 30,
	2011	2010
Operating revenue	\$ 131,397	\$ 118,321
Operating expenses:		
Operations:		
Water production costs	44,745	41,834
Administrative and general	20,554	18,480
Other operations	15,738	14,749
Maintenance	5,288	5,158
Depreciation and amortization	12,373	10,638
Income taxes	8,638	7,091
Property and other taxes	4,506	4,087
Total operating expenses	111,842	102,037
Net operating income	19,555	16,284
Other income and expenses:		
Non-regulated revenue	3,739	3,692
Non-regulated expenses, net	(3,509)	(3,691)
Gain on sale of non-utility property	62	
Income tax (expense) on other income and expenses	(112)	
Net other income	180	1
Interest expense:		
Interest expense	8,061	6,939
Less: capitalized interest	(516)	(1,035)
Net interest expense	7,545	5,904
Net income	\$ 12,190	\$ 10,381
Earnings per share		
Basic	\$ 0.29	\$ 0.25
Diluted	\$ 0.29	\$ 0.25
Weighted average shares outstanding		
Basic	41,752	41,606
Diluted	41,768	41,636
Dividends declared per share of common stock	\$ 0.15375	\$ 0.14875

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

Unaudited

(In thousands, except per share data)

For the six months ended	June 30,		June 30,
	2011		2010
Operating revenue	\$ 229,546	\$	208,593
Operating expenses:			
Operations:			
Water production costs	76,703		72,289
Administrative and general	41,056		35,924
Other operations	30,373		28,315
Maintenance	10,487		10,109
Depreciation and amortization	24,961		21,430
Income taxes	7,397		8,499
Property and other taxes	9,066		7,990
Total operating expenses	200,043		184,556
Net operating income	29,503		24,037
Other income and expenses:			
Non-regulated revenue	8,072		7,113
Non-regulated expenses, net	(6,933)		(7,237)
Gain on sale of non-utility property	62		
Income tax (expense) benefit on other income and expenses	(478)		60
Net other income (expense)	723		(64)
Interest expense:			
Interest expense	16,549		13,428
Less: capitalized interest	(1,232)		(1,854)
Net interest expense	15,317		11,574
Net income	\$ 14,909	\$	12,399
Earnings per share			
Basic	\$ 0.36	\$	0.30
Diluted	\$ 0.36	\$	0.30
Weighted average shares outstanding			
Basic	41,724		41,582
Diluted	41,740		41,612
Dividends declared per share of common stock	\$ 0.30750	\$	0.29750

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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

Unaudited

(In thousands)

	June 30,		June 30,
	2011		2010
For the six months ended:			
Operating activities			
Net income	\$ 14,909	\$	12,399
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	25,837		22,857
Gain on sale of non-utility property	(62)		
Change in value of life insurance contracts	(40)		83
Other changes in noncurrent assets and liabilities	8,625		(1,008)
Changes in operating assets and liabilities:			
Receivables	(11,489)		(2,095)
Accounts payable	10,254		5,327
Other current assets	(3,088)		(1,509)
Other current liabilities	3,735		(1,347)
Other changes, net	(1,014)		(1,851)
Net adjustments	32,758		20,457
Net cash provided by operating activities	47,667		32,856
Investing activities:			
Utility plant expenditures	(52,268)		(60,458)
Purchase of life insurance	(1,658)		(1,706)
Proceeds on sale of non-utility property	63		
Restricted cash (increase)	(220)		(13)
Net cash used in investing activities	(54,083)		(62,177)
Financing activities:			
Short-term borrowings, net	9,010		43,150
Proceeds from long-term debt	110		7,903
Repayment of long-term debt	(1,326)		(12,187)
Advances and contributions in aid of construction	5,061		1,620
Refunds of advances for construction	(3,008)		(3,018)
Dividends paid	(12,826)		(12,367)
Net cash (used in) provided by financing activities	(2,979)		25,101
Change in cash and cash equivalents	(9,395)		(4,220)
Cash and cash equivalents at beginning of period	42,277		9,866
Cash and cash equivalents at end of period	\$ 32,882	\$	5,646
Supplemental information			
Cash paid for interest (net of amounts capitalized)	\$ 12,983	\$	11,316
Cash paid for income taxes	\$ 26	\$	45
Refund for income taxes	\$ 4,000	\$	
Supplemental disclosure of non-cash activities:			
Accrued payables for investments in utility plant	\$ 6,614	\$	8,755
Utility plant contribution by developers	\$ 7,746	\$	23,239

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See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2011

(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, 2010, included in its annual report on Form 10-K as filed with the SEC on March 1, 2011.

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. Due to the 2 for 1 stock split effective on June 10, 2011, all common stock shares and per share amounts have been adjusted retroactively for all periods presented to reflect shares on a post-split basis.

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

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

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

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

Note 2. Summary of Significant Accounting Policies

Revenue

Revenue includes monthly cycle customer billings for regulated water and wastewater services at rates authorized by regulatory commissions and billings to certain non-regulated customers. Revenue from metered customers includes billings to customers based on monthly meter readings plus an estimate for water used between the customer's last meter reading and the end of the accounting period. Flat rate customers are billed in advance at the beginning of the service period. The revenue is prorated so that the portion of revenue applicable to the current accounting period is included in that period's revenue, with the balance recorded as unearned revenue on the balance sheet and recognized as revenue when earned in the subsequent accounting period. 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).

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

Under the MCBA, Cal Water tracks adopted expense levels for water production costs (purchased water, purchased power, and pump taxes), as established by the CPUC. Variances (which include the effects of changes in both rate and volume) between adopted and actual purchased water, purchased power, and pump tax expenses are recorded as a component of revenue, as the amount of such variances will be recovered from or refunded to Cal Water'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). 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 June 30, 2011 included in the net regulatory balancing accounts, current and long-term assets were \$13.0 million and \$28.1 million, respectively, and current and long-term liabilities were \$2.3 million and \$0.5 million, respectively. As of December 31, 2010, included in the net regulatory balancing accounts, current and long-term assets were \$14.8 million and \$16.8 million, respectively, and the net regulatory balancing accounts current and long-term liabilities were \$3.0 million and \$0.6 million, respectively.

Note 3. Stock-based Compensation

Equity Incentive Plan

The Company's Equity Incentive Plan, which was approved by shareholders on April 27, 2005. The 2 for 1 stock split effective June 10, 2011, increased the plan's authorized shares to 2,000,000 shares of common stock. As of June 30, 2011 and 2010, the Company granted annual Restricted Stock Awards (RSAs) of 85,426 and 77,956 shares, respectively, of common stock to officers and directors of the Company. Employee options vest over forty-eight months, while director options vest at the end of twelve months. During the first six months of 2011 and 2010, the shares granted were valued at \$17.44 and \$17.74 per share, respectively, based upon the fair market value of the Company's common stock on the date of grant.

The Company did not grant Stock Appreciation Rights (SARs) to officers during 2010 and 2011.

The Company has recorded compensation costs for the RSAs and SARs in Operating Expense in the amount of \$0.6 million and \$0.5 million for the six months ended June 30, 2011 and June 30, 2010, respectively.

Note 4. Common Stockholders' Equity

Effective on June 8, 2011, the Company's Certificate of Incorporation was amended to increase the number of authorized shares of the Company's common stock from 25 million shares to 68 million shares. The equity incentive plan authorized shares also increased as described in Note 3 above. The common stock par value of \$0.01 was not changed. The increased number of authorized shares and 2 for 1 stock split effective June 10, 2011, are retroactively applied to these financial statements resulting in an increase in the number of shares outstanding.

Note 5. 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.

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into common stock. RSAs are included in the common shares outstanding because the shares have all the same voting and dividend rights as issued and unrestricted common stock. At the close of business on June 10th, the Company's 2 for 1 stock split has been adjusted retroactively for all periods presented.

The SARs outstanding of 361,356 shares are anti-dilutive for the three and six months ended June 30, 2011 and 2010. All options are dilutive and the dilutive effect is shown in the table below.

(In thousands, except per share data)

	Three Months Ended June 30			
	2011		2010	
Net income available to common stockholders	\$	12,190	\$	10,381
Weighted average common shares, basic		41,752		41,606
Dilutive common stock options (treasury method)		16		30
Shares used for dilutive computation		41,768		41,636
Net income per share basic	\$	0.29	\$	0.25
Net income per share diluted	\$	0.29	\$	0.25

	Six Months Ended June 30			
	2011		2010	
Net income available to common stockholders	\$	14,909	\$	12,399
Weighted average common shares, basic		41,724		41,582
Dilutive common stock options (treasury method)		16		30
Shares used for dilutive computation		41,740		41,612
Net income per share basic	\$	0.36	\$	0.30
Net income per share diluted	\$	0.36	\$	0.30

Note 6. Pension Plan and Other Postretirement Benefits

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

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

Cash payments by the Company related to pension plans and other postretirement benefits were \$8.1 million for the six months ended June 30, 2011 compared to \$6.6 million for the same period last year. The estimated cash contribution to the pension plans for 2011 is \$24.6 million. The estimated contribution to the other benefit plans for 2011 is \$7.0 million.

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

	Three Months Ended June 30				Six Months Ended June 30			
	Pension Plan		Other Benefits		Pension Plan		Other Benefits	
	2011	2010	2011	2010	2011	2010	2011	2010
Service cost	\$ 2,716	\$ 2,451	\$ 1,002	\$ 793	\$ 5,857	\$ 4,902	\$ 1,981	\$ 1,586
Interest cost	3,600	3,332	955	783	7,342	6,664	1,788	1,566
Expected return on plan assets	(2,231)	(2,051)	(347)	(279)	(4,475)	(4,102)	(688)	(558)
Recognized net initial APBO (1)	N/A	N/A	69	69	N/A	N/A	138	138
Amortization of prior service cost	1,579	1,649	29	29	3,159	3,298	58	58
Recognized net actuarial loss	955	524	583	392	2,034	1,048	1,008	784
Net periodic benefit cost	\$ 6,619	\$ 5,905	\$ 2,291	\$ 1,787	\$ 13,917	\$ 11,810	\$ 4,285	\$ 3,574

(1) APBO Accumulated postretirement benefit obligation

Note 7. Short-term and Long-term Borrowings

On June 29, 2011, the Company and Cal Water entered into Syndicated Credit Agreements, which provide for unsecured revolving credit facilities of up to an initial aggregate amount of \$400 million. The Syndicated Credit Facilities amend, expand, and replace the Company's and its subsidiaries' existing credit facilities originally entered into on October 27, 2009. The new credit facilities extended the terms until June 29, 2016, increased the Company's and Cal Water's unsecured revolving lines of credit, and lowered interest rates and fees. The Company and subsidiaries which it designates may borrow up to \$100 million under the Company's revolving credit facility. Cal Water may borrow up to \$300 million under its revolving credit facility; however, all borrowings need to be repaid within twelve months unless otherwise authorized by the CPUC. The proceeds from the revolving credit facilities may be used for working capital purposes, including the short-term financing of capital projects. The base loan rate may vary from LIBOR plus 72.5 basis points to LIBOR plus 95 basis points, depending on the Company's total capitalization ratio. Likewise, the unused commitment fee may vary from 8 basis points to 12.5 basis points based on the same ratio.

Both short-term 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 June 30, 2011, the Company and Cal Water have met all borrowing covenants for both credit agreements.

As of June 30, 2011 and December 31, 2010, the outstanding borrowings on the Company lines of credit were \$32.8 million and \$23.8 million, respectively, and there were no borrowings on the Cal Water lines of credit for both periods. For the six months ended June 30, 2011, the average borrowing rate was 2.9% compared to 3.2% for the same period last year.

Note 8. Income Taxes

The Company accounts for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Measurement of the deferred tax assets and liabilities is at enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the period that includes the enactment date.

During 2010, the Company filed an application for a change in accounting method (Section 481 adjustment) with the State of California to change its plant-in-service state tax depreciation method from the double-declining method to the straight line method at the respective assets mid-life. The Company's application was approved by the State of California during the first

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quarter of 2011. California uses the flow-through method of accounting for income tax depreciation. As a result, the Company reduced its 2010 income tax obligation by \$1.6 million, net of federal income taxes in the quarter ended March 31, 2011.

The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 will provide the Company with additional federal income tax deductions for assets placed in service after September 8, 2010 and before December 31, 2011. As a result of this change, the Company estimates a net operating loss (NOL) on its consolidated 2011 federal income tax filing. The estimated 2011 federal income tax NOL will not impact the Company's effective tax rate for calendar year 2011.

The California Franchise Tax Board (FTB) is auditing the Company's 2008 and 2009 California income tax returns. It is uncertain when the FTB will complete its audit. The Company believes that the final resolution of the FTB audit will not have a material adverse impact on its financial condition or results of operations. The Company is not under audit by any other jurisdiction.

Note 9. Regulatory Assets and Liabilities

During 2011, the CPUC issued a decision regarding the \$34.2 million of litigation proceeds previously received by Cal Water during 2008 which is being used to replace infrastructure damaged by the gasoline additive Methyl tert-butyl ether (MTBE). The decision requires use of these proceeds for costs incurred as a result of MTBE contamination with any related benefits to be provided to Cal Water customers. Such usage includes transfer of the amount to contributions in aid of construction for remediation or replacement project costs once complete. Usage of the proceeds is reported to the CPUC through an Advise Letter or General Rate Case filing. As a result, the entire amount of the proceeds was reclassified from other long term liabilities to regulatory liabilities. As of June 30, 2011, a total of \$16.7 million of the proceeds have been transferred to contributions in aid of construction.

During 2011, Cal Water added balancing accounts for its pension plans and conservation program. Both balancing account effective dates were January 1, 2011. The pension plans balancing account is a two-way balancing account that tracks the differences between actual expenses and adopted rate recovery which will result in either a regulatory asset or liability. The conservation program is a one-way balancing account that tracks the differences between actual expenses and adopted rate recovery which may result in a regulatory liability if actual conservation expenses are less than adopted over the three year period ending December 31, 2013. As of June 30, 2011, there was a regulatory liability of \$2.9 million for both balancing accounts.

Note 10. Commitment and Contingencies

Commitments

The Company has significant commitments to lease certain office spaces and water systems and to purchase water from water wholesalers. These commitments are described in footnote 15 of the current report on Form 10-K for the year ending December 31, 2010. As of June 30, 2011, there were no significant changes from December 31, 2010.

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, depending upon the nature of the settlement.

The Company continues to pursue a lawsuit against major oil refineries regarding the contamination of the ground water as a result of the gas additive MTBE. MTBE has been detected in the ground water. The lawsuit seeks to recover treatment costs necessary to remove MTBE. No trial date has yet been set.

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As previously reported, the Company has jointly filed with the City of Bakersfield a lawsuit in the Superior Court of California that names potentially responsible parties that manufactured and distributed products containing 1,2,3 trichloropropane (TCP) in California. TCP has been detected in the ground water. The lawsuit seeks to recover treatment costs necessary to remove TCP. The Court has now coordinated the Company's action with other water purveyor cases in San Bernardino County. No trial date has yet been set.

On May 22, 2008, the Company filed in San Mateo County Superior Court a complaint (California Water Service Company v. The Dow Chemical Company, et al. CIV 473093) against potentially responsible parties that manufactured and distributed products in California containing perchloroethylene, also known as tetrachloroethylene (PCE) for recovery of past, present, and future treatment costs. The case has not been consolidated with other PCE cases. Discovery is continuing. No trial date has yet been set.

Other Legal Matters

From time to time, the Company has been named as a co-defendant in asbestos-related lawsuits. Several of these cases against the Company have been dismissed without prejudice. In other cases the Company's contractors and insurance policy carriers have settled the cases with no effect on the Company's financial statements. As such, the Company does not currently believe there is any potential loss that is probable to occur related to these matters and therefore no accrual 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, the Company 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 11. 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 \$559 million and \$537 million as of June 30, 2011 and December 31, 2010, 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 carrying value of the long-term debt was \$480 million and \$482 million as of June 30, 2011 and December 31, 2010, respectively. The fair value of advances for construction contracts was estimated at \$73 million as of June 30, 2011 and \$74 million as of December 31, 2010, using broker quotes. The carrying value of advances for construction contracts was \$187 million as of June 30, 2011 and December 31, 2010.

Note 12. Condensed Consolidating Financial Statements

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The following tables present the condensed consolidating statements of income of California Water Service Group (Guarantor and Parent), Cal Water (issuer and wholly-owned consolidated subsidiary of California Water Service Group) and other wholly-owned subsidiaries of the Company for the three-month and six-month periods ended June 30, 2011 and 2010, the condensed consolidating statements of cash flows for the six months ended June 30, 2011 and 2010 and the condensed consolidating balance sheets as of June 30, 2011 and December 31, 2010. 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 June 30, 2011

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	\$ 324	\$ 1,757,453	\$ 144,806	\$ (7,199)	\$ 1,895,384
Less accumulated depreciation and amortization	(23)	(540,388)	(28,700)	1,323	(567,788)
Net utility plant	301	1,217,065	116,106	(5,876)	1,327,596
Current assets:					
Cash and cash equivalents	803	30,236	1,843		32,882
Receivables and unbilled revenue	182	67,479	3,737		71,398
Receivables from affiliates	14,676	1,433	3,524	(19,633)	
Other current assets	123	25,992	1,216		27,331
Total current assets	15,784	125,140	10,320	(19,633)	131,611
Other assets:					
Regulatory assets		243,750	2,206		245,956
Investments in affiliates	436,185			(436,185)	
Long-term affiliate notes receivable	31,871	7,856	1,891	(41,618)	
Other assets	848	32,363	6,984	(205)	39,990
Total other assets	468,904	283,969	11,081	(478,008)	285,946
	\$ 484,989	\$ 1,626,174	\$ 137,507	\$ (503,517)	\$ 1,745,153
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders' equity	\$ 438,240	\$ 406,183	\$ 35,658	\$ (441,841)	\$ 438,240
Affiliate long-term debt	9,747		31,871	(41,618)	
Long-term debt, less current maturities		474,023	3,945		477,968
Total capitalization	447,987	880,206	71,474	(483,459)	916,208
Current liabilities:					
Current maturities of long-term debt		1,709	668		2,377
Short-term borrowings	32,760				32,760
Payables to affiliates	4,377	201	15,055	(19,633)	
Accounts payable		50,838	3,106		53,944
Accrued expenses and other liabilities	424	36,480	5,583	58	42,545
Total current liabilities	37,561	89,228	24,412	(19,575)	131,626
Unamortized investment tax credits		2,244			2,244
Deferred income taxes, net	(559)	118,749	2,339	(483)	120,046
Pension and postretirement benefits other than pensions		162,439			162,439
Regulatory and other liabilities		62,093	8,633		70,726
Advances for construction		185,834	1,443		187,277
Contributions in aid of construction		125,381	29,206		154,587
	\$ 484,989	\$ 1,626,174	\$ 137,507	\$ (503,517)	\$ 1,745,153

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING BALANCE SHEET

As of December 31, 2010

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	\$ 324	\$ 1,710,213	\$ 140,428	\$ (7,199)	\$ 1,843,766
Less accumulated depreciation and amortization		(522,486)	(28,244)	1,261	(549,469)
Net utility plant	324	1,187,727	112,184	(5,938)	1,294,297
Current assets:					
Cash and cash equivalents	188	40,446	1,643		42,277
Receivables		56,068	3,840		59,908
Receivables from affiliates	3,478	4,907	3,621	(12,006)	
Other current assets	181	22,842	1,002		24,025
Total current assets	3,847	124,263	10,106	(12,006)	126,210
Other assets:					
Regulatory assets		227,440	2,137		229,577
Investments in affiliates	434,322			(434,322)	
Long-term affiliate notes receivable	34,517	7,880	1,928	(44,325)	
Other assets	848	34,153	7,186	(205)	41,982
Total other assets	469,687	269,473	11,251	(478,852)	271,559
	\$ 473,858	\$ 1,581,463	\$ 133,541	\$ (496,796)	\$ 1,692,066
CAPITALIZATION AND LIABILITIES					
Capitalization:					
Common stockholders' equity	\$ 435,527	\$ 402,402	\$ 37,611	\$ (440,014)	\$ 435,526
Affiliate long-term debt	9,808		34,517	(44,325)	
Long-term debt, less current maturities		475,030	4,151		479,181
Total capitalization	445,335	877,432	76,279	(484,339)	914,707
Current liabilities:					
Current maturities of long-term debt		1,709	671		2,380
Short-term borrowings	23,750				23,750
Payables to affiliates	5,265	56	6,685	(12,006)	
Accounts payable		38,204	4,326		42,530
Accrued expenses and other liabilities	67	34,444	4,145	32	38,688
Total current liabilities	29,082	74,413	15,827	(11,974)	107,348
Unamortized investment tax credits		2,244			2,244
Deferred income taxes, net	(559)	105,786	2,340	(483)	107,084
Pension and postretirement benefits other than pensions		155,224			155,224
Regulatory and other liabilities		74,057	8,147		82,204
Advances for construction		185,332	1,567		186,899
Contributions in aid of construction		106,975	29,381		136,356
	\$ 473,858	\$ 1,581,463	\$ 133,541	\$ (496,796)	\$ 1,692,066

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

For the three months ended June 30, 2011

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$ 123,879	\$ 7,518	\$	\$ 131,397
Operating expenses:					
Operations:					
Water production costs		42,203	2,542		44,745
Administrative and general		18,679	1,875		20,554
Other operations		14,011	1,853	(126)	15,738
Maintenance		5,110	178		5,288
Depreciation and amortization	(5)	11,763	646	(31)	12,373
Income tax (benefit) expense	(140)	8,632	(244)	390	8,638
Property and other taxes		3,936	570		4,506
Total operating expenses	(145)	104,334	7,420	233	111,842
Net operating income	145	19,545	98	(233)	19,555
Other Income and Expenses:					
Non-regulated revenue	566	2,705	1,319	(851)	3,739
Non-regulated expense, net		(2,559)	(950)		(3,509)
Gain on sale of properties		62			62
Income tax (expense) on other income and expense	(231)	(85)	(173)	377	(112)
Net other income	335	123	196	(474)	180
Interest:					
Interest expense	350	7,814	622	(725)	8,061
Less: capitalized interest		(333)	(183)		(516)
Net interest expense	350	7,481	439	(725)	7,545
Equity earnings of subsidiaries	12,060			(12,060)	
Net income	\$ 12,190	\$ 12,187	\$ (145)	\$ (12,042)	\$ 12,190

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

For the six months ended June 30, 2011

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$ 215,554	\$ 13,992	\$	\$ 229,546
Operating expenses:					
Operations:					
Water production costs		72,091	4,612		76,703
Administrative and general		37,223	3,833		41,056
Other operations		26,995	3,632	(254)	30,373
Maintenance		10,150	337		10,487
Depreciation and amortization		23,692	1,331	(62)	24,961
Income tax (benefit) expense	(292)	7,611	(690)	768	7,397
Property and other taxes		7,968	1,098		9,066
Total operating expenses	(292)	185,730	14,153	452	200,043
Net operating income (loss)	292	29,824	(161)	(452)	29,503
Other Income and Expenses:					
Non-regulated revenue	1,089	5,727	2,917	(1,661)	8,072
Non-regulated expense, net		(4,810)	(2,123)		(6,933)
Gain on sale on non-utility property		62			62
Income tax (expense) on other income and expense	(444)	(399)	(377)	742	(478)
Net other income	645	580	417	(919)	723
Interest:					
Interest expense	717	16,036	1,204	(1,408)	16,549
Less: capitalized interest		(864)	(368)		(1,232)
Net interest expense	717	15,172	836	(1,408)	15,317
Equity earnings of subsidiaries	14,689			(14,689)	
Net income (loss)	\$ 14,909	\$ 15,232	\$ (580)	\$ (14,652)	\$ 14,909

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

For the three months ended June 30, 2010

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$ 111,376	\$ 6,945	\$	\$ 118,321
Operating expenses:					
Operations:					
Water production costs		39,556	2,278		41,834
Administrative and general		16,581	1,899		18,480
Other operations		12,954	2,049	(254)	14,749
Maintenance		4,951	207		5,158
Depreciation and amortization		10,113	590	(65)	10,638
Income tax (benefit) expense	(71)	7,134	(381)	409	7,091
Property and other taxes		3,567	520		4,087
Total operating expenses	(71)	94,856	7,162	90	102,037
Net operating income (loss)	71	16,520	(217)	(90)	16,284
Other Income and Expenses:					
Non-regulated revenue	290	2,313	1,560	(471)	3,692
Non-regulated expense, net		(2,593)	(1,098)		(3,691)
Income tax benefit (expense) on other income and expense	(118)	109	(191)	200	
Net other income	172	(171)	271	(271)	1
Interest:					
Interest expense	174	6,730	379	(344)	6,939
Less: capitalized interest		(706)	(329)		(1,035)
Net interest expense	174	6,024	50	(344)	5,904
Equity earnings of subsidiaries	10,312			(10,312)	
Net income	\$ 10,381	\$ 10,325	\$ 4	\$ (10,329)	\$ 10,381

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING STATEMENT OF INCOME

For the six months ended June 30, 2010

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
Operating revenue	\$	\$	194,989	\$	\$
			13,604		208,593
Operating expenses:					
Operations:					
Water production costs		68,023	4,266		72,289
Administrative and general		32,021	3,903		