

AMERICAN STATES WATER CO

Form 10-K

March 13, 2009

[Table of Contents](#)

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

PURSUANT TO SECTION 13 OR 15(d) OF THE

Edgar Filing: AMERICAN STATES WATER CO - Form 10-K

(Mark One)

- Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2008 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
001-14431

Registrant, State of Incorporation
Address, Zip Code and Telephone Number

IRS Employer
Identification No.
95-4676679

American States Water Company

(Incorporated in California)
630 E. Foothill Boulevard, San Dimas, CA 91773-1212
(909) 394-3600

001-12008

Golden State Water Company

(Incorporated in California)
630 E. Foothill Boulevard, San Dimas, CA 91773-1212
(909) 394-3600

95-1243678

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
American States Water Company Common Shares	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

American States Water Company	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>
Golden State Water Company	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

American States Water Company	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>
Golden State Water Company	Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>

Indicate by check mark whether 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 Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

American States Water Company	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
-------------------------------	---

Edgar Filing: AMERICAN STATES WATER CO - Form 10-K

Golden State Water Company

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

American States Water Company

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Golden State Water Company

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

American States Water Company

Yes No

Golden State Water Company

Yes No

The aggregate market value of the total voting common stock held by non-affiliates of American States Water Company was approximately \$602,818,000 and \$529,930,000 on June 30, 2008 and March 11, 2009, respectively. The closing price per Common Share on March 11, 2009, as quoted in the *The Wall Street Journal website*, was \$30.60. As of March 11, 2009, the number of Common Shares of American States Water Company, outstanding was 17,317,982. As of that same date, American States Water Company owned all 134 outstanding Common Shares of Golden State Water Company. The aggregate market value of the total voting stock held by non-affiliates of Golden State Water Company was zero on June 30, 2008 and March 11, 2009.

Golden State Water Company meets the conditions set forth in General Instruction I(1) and (2) of Form 10-K and is therefore filing this Form, in part, with the reduced disclosure format for Golden State Water Company.

Documents Incorporated by Reference:

Portions of the Proxy Statement of American States Water Company will be subsequently filed with the Securities and Exchange Commission as to Part III, Item Nos. 10, 11, 13 and 14 and portions of Item 12, in each case as specifically referenced herein.

Table of Contents

AMERICAN STATES WATER COMPANY
and

GOLDEN STATE WATER COMPANY

FORM 10-K

INDEX

Part I

<u>Item 1:</u>	<u>Business</u>	3
<u>Item 1A:</u>	<u>Risk Factors</u>	6
<u>Item 1B:</u>	<u>Unresolved Staff Comments</u>	14
<u>Item 2:</u>	<u>Properties</u>	15
<u>Item 3:</u>	<u>Legal Proceedings</u>	17
<u>Item 4:</u>	<u>Submission of Matters to a Vote of Security Holders</u>	18

Part II

<u>Item 5:</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	19
<u>Item 6:</u>	<u>Selected Financial Data</u>	23
<u>Item 7:</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u>	24
<u>Item 7A:</u>	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	76
<u>Item 8:</u>	<u>Financial Statements and Supplementary Data</u>	78
<u>Item 9:</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	137
<u>Item 9A:</u>	<u>Controls and Procedures</u>	137
<u>Item 9A(T):</u>	<u>Controls and Procedures</u>	137
<u>Item 9B:</u>	<u>Other Information</u>	137

Part III

<u>Item 10:</u>	<u>Directors, Executive Officers and Corporate Governance</u>	138
<u>Item 11:</u>	<u>Executive Compensation</u>	138
<u>Item 12:</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	138
<u>Item 13:</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	138
<u>Item 14:</u>	<u>Principal Accounting Fees and Services</u>	138

Part IV

<u>Item 15:</u>	<u>Exhibits, Financial Statement Schedules</u>	139
	<u>Reports of Independent Registered Public Accounting Firm</u>	134
	<u>Report from Management on the Responsibility for Financial Statements</u>	136
	<u>Schedule I – Condensed Financial Information of Parent and Notes</u>	144

Table of Contents

PART I

Item 1. Business

Edgar Filing: AMERICAN STATES WATER CO - Form 10-K

This annual report on Form 10-K is a combined report being filed by two separate Registrants: American States Water Company (hereinafter "AWR"), and Golden State Water Company (hereinafter "GSWC"). References in this report to "Registrant" are to AWR and GSWC, collectively, unless otherwise specified. GSWC makes no representations as to the information contained in this report relating to AWR and its subsidiaries, other than GSWC.

AWR makes its periodic reports, Form 10-Q and Form 10-K, and current reports, Form 8-K, available free of charge through its website, www.aswater.com, as soon as material is electronically filed with or furnished to the Securities and Exchange Commission ("SEC"). Such reports are also available on the SEC's internet website at <http://www.sec.gov>. AWR also makes available free of charge its code of business conduct and ethics, its corporate governance guidelines and the charters of its Nominating and Governance Committee, its Compensation Committee, and its Audit and Finance Committee through its website or by calling (800) 999-4033. AWR and GSWC have filed the certification of officers required by Section 302 of the Sarbanes-Oxley Act as Exhibits 31.1 and 31.2 to its Form 10-K for the year ended December 31, 2008.

AWR submitted a CEO Certification to the New York Stock Exchange in June 2008 certifying that the Registrant was in compliance with the corporate governance rules of the New York Stock Exchange.

General

Edgar Filing: AMERICAN STATES WATER CO - Form 10-K

AWR is the parent company of GSWC, Chaparral City Water Company (CCWC) and American States Utility Services, Inc. (ASUS) and its subsidiaries (Fort Bliss Water Services Company (FBWS), Terrapin Utility Services, Inc. (TUS), Old Dominion Utility Services, Inc. (ODUS), Palmetto State Utility Services, Inc. (PSUS) and Old North Utility Services, Inc. (ONUS)). AWR was incorporated as a California corporation in 1998 as a holding company. AWR has three reportable segments: water, electric and contracted services. Within the segments, AWR has three principal business units: water and electric service utility operations conducted through GSWC, a water-service utility operation conducted through CCWC, and a contracted services unit conducted through ASUS and its subsidiaries. FBWS, TUS, ODUS, PSUS and ONUS may be referred to herein collectively as the Military Utility Privatization Subsidiaries .

GSWC is a California public utility company engaged principally in the purchase, production and distribution of water. GSWC also distributes electricity in one customer service area. GSWC is regulated by the California Public Utilities Commission (CPUC) and was incorporated as a California corporation on December 31, 1929. GSWC is organized into one electric customer service area and three water service regions operating within 75 communities in 10 counties in the State of California and provides water service in 21 customer service areas. Region I consists of 7 customer service areas in northern and central California; Region II consists of 4 customer service areas located in Los Angeles County; and Region III consists of 10 customer service areas in eastern Los Angeles County, and in Orange, San Bernardino and Imperial counties. GSWC also provides electric service to the City of Big Bear Lake and surrounding areas in San Bernardino County through its Bear Valley Electric Service (BVES) division.

GSWC served 254,482 water customers and 23,172 electric customers at December 31, 2008, or a total of 277,654 customers, compared with 254,546 water customers and 23,273 electric customers, or a total of 277,819 customers at December 31, 2007. GSWC s utility operations exhibit seasonal trends. Although GSWC s water utility operations have a diversified customer base, residential and commercial customers account for the majority of GSWC s water sales and revenues. Revenues derived from commercial and residential water customers accounted for approximately 90% of total water revenues for the years ended December 31, 2008, 2007 and 2006.

CCWC is an Arizona public utility company serving 13,423 customers as of December 31, 2008, compared with 13,488 customers at December 31, 2007. Located in the town of Fountain Hills, Arizona and a portion of the City of Scottsdale, Arizona, the majority of CCWC s customers are residential. The Arizona Corporation Commission (ACC) regulates CCWC.

ASUS, through its wholly-owned subsidiaries, has contracted with the U.S. government to provide water and/or wastewater services, including the operation and maintenance of water and/or wastewater systems pursuant to 50-year fixed price contracts, which are subject to periodic prospective price redeterminations and modifications for changes in circumstances. All of the contracts with the U.S. government may be terminated, in whole or in part, prior to the end of the 50-year term for convenience of the U.S. government or as a result of default or nonperformance by the subsidiary performing the contract. In either event, the ASUS subsidiary is entitled to recover the remaining amount of its capital investment pursuant to the terms of a termination settlement with the U.S. government at the time of termination as provided in each of the contracts. The contract price for each of these contracts is subject to redetermination two years after commencement of operations and every three years thereafter under the terms of these contracts. Prices are subject to

Edgar Filing: AMERICAN STATES WATER CO - Form 10-K

Table of Contents

equitable adjustment based upon changes in circumstances and changes in wages and fringe benefits to the extent provided in each of the contracts. Pursuant to the terms of these contracts, the Military Utility Privatization Subsidiaries operate, as of the effective date of their respective contracts, the following water and wastewater systems:

- FBWS - water and wastewater systems at Fort Bliss located near El Paso, Texas effective October 1, 2004;
- TUS - water and wastewater systems at Andrews Air Force Base in Maryland effective February 1, 2006;
- ODUS - wastewater systems at Fort Lee in Virginia effective February 23, 2006 and the water and wastewater systems at Fort Eustis, Fort Monroe and Fort Story in Virginia effective April 3, 2006;
- PSUS - water and wastewater systems at Fort Jackson in South Carolina effective January 2, 2008; and
- ONUS - water and wastewater systems at Fort Bragg, North Carolina effective March 1, 2008.

ASUS and GSWC have also been pursuing opportunities to provide retail water services within the service area of the Natomas Central Mutual Water Company (Natomas). Natomas is a California mutual water company which currently provides water service to its shareholders, primarily for agricultural irrigation in portions of Sacramento and Sutter counties in northern California. GSWC and Natomas have entered into various agreements including the purchase of certain water and water rights that may allow GSWC the ability to serve Sutter counties in the future.

Certain financial information for each of AWR's business segments - water distribution, electric distribution, and contracted services - is set forth in Note 16 to the Notes to Consolidated Financial Statements of American States Water Company and its subsidiaries. AWR's water and electric distribution segments are not dependent upon a single or only a few customers. The U.S. government is the largest customer for ASUS contracted services.

The revenue from most of AWR's business segments is seasonal. The impact of seasonality on AWR's businesses is discussed in more detail in Item 1A *Risk Factors* .

Environmental matters and compliance with such laws and regulations are discussed in detail in Item 7 *Management's Discussion and Analysis of Financial Condition and Results of Operations* under the section titled *Environmental Matters* .

Competition

The businesses of GSWC and CCWC are substantially free from direct and indirect competition with other public utilities, municipalities and other public agencies within their existing service territories. GSWC and CCWC compete with governmental agencies and other investor-owned utilities in connection with offering service to new real estate developments on the basis of financial terms, availability of water and ability to commence providing service on a timely basis. AWR's other subsidiary, ASUS, actively competes for business with other investor-owned utilities, other third party providers of water and/or wastewater services, and governmental entities on the basis of price and quality of service.

Employee Relations

GSWC had 569 employees as of December 31, 2008 as compared to 529 at December 31, 2007. Eighteen positions in GSWC's Bear Valley Electric customer service area are covered by a collective bargaining agreement with the International Brotherhood of Electrical Workers, which expires in 2009. Sixty eight positions in GSWC's Region II ratemaking district are covered by a collective bargaining agreement with the Utility Workers Union of America, which expires in 2011. GSWC has no other unionized employees.

AWR and its other subsidiaries had 106 employees as of December 31, 2008. Ten of the employees of a subsidiary of ASUS are covered by a collective bargaining agreement with the International Union of Operating Engineers which will expire in 2011.

Table of Contents

Forward-Looking Information

This Form 10-K and the documents incorporated by reference herein contain forward-looking statements intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements regarding our goals, beliefs, plans or current expectations, taking into account the information currently available to management. Forward-looking statements are not statements of historical facts. For example, when we use words such as believes, anticipates, expects, plans, estimates, intends, and other words that convey uncertainty of future events or outcome, we are making forward-looking statements. Such statements address future events and conditions concerning such matters as our ability to raise capital, capital expenditures, earnings, litigation, rates, water sales, water quality and other regulatory matters, adequacy of water supplies, our ability to recover electric, natural gas and water supply costs from ratepayers, contract operations, liquidity and capital resources, and accounting matters. We caution you that any forward-looking statements made by us are not guarantees of future performance and that actual results may differ materially from those currently anticipated in such statements, by reason of factors such as: changes in utility regulation; recovery of regulatory assets not yet included in rates; future economic conditions which affect changes in customer demand and changes in water and energy supply costs; repayment of amounts owed to us and changes in pension and postretirement benefit plan costs; future climatic conditions; delays in customer payments or price redeterminations or equitable adjustments on contracts executed by ASUS and its subsidiaries; potential assessments for failure to meet interim targets for the purchase of renewable energy; and legislative, legal proceedings, regulatory and other circumstances affecting anticipated revenues and costs.

Table of Contents

Item 1A Risk Factors

You should carefully read the risks described below and other information in this Form 10-K in order to understand certain of the risks of our business.

Our business is heavily regulated and, as a result, decisions by regulatory agencies and changes in laws and regulations can significantly affect our business

Our revenues depend substantially on the rates and fees we charge our customers and the ability to recover our costs on a timely basis, including the ability to recover the costs of purchased water, groundwater assessments, electric power, natural gas, chemicals, water treatment, security at water facilities and preventative maintenance and emergency repairs. Any delays by either the CPUC or the ACC in granting rate relief to cover increased operating and capital costs at our public utilities or delays in obtaining approval of our requests for equitable adjustments or price redetermination for contracted services from the U.S. government may adversely affect our financial performance. We may file for interim rates in California in situations where there may be delays in granting final rate relief during a general rate case proceeding. If the CPUC approves lower rates, the CPUC will require us to refund to customers the difference between the interim rates and the rates approved by the CPUC.

Regulatory decisions may also impact prospective revenues and earnings, affect the timing of the recognition of revenues and expenses, may overturn past decisions used in determining our revenues and expenses and could result in impairment of goodwill if the decision affects CCWC or ASUS. Management continually evaluates the anticipated recovery of regulatory assets, liabilities and revenues subject to refund and provides for allowances and/or reserves as deemed necessary. In the event that our assessment of the probability of recovery through the ratemaking process is incorrect, we will adjust the associated regulatory asset or liability to reflect the change in our assessment or any regulatory disallowances.

Management also reviews goodwill for impairment at least annually. A change in our evaluation of the probability of recovery of regulatory assets, a regulatory disallowance of all or a portion of our costs or material impairment of goodwill could have a material adverse effect on our financial results. We determined that CCWC's goodwill had been impaired by \$7.7 million as of December 31, 2008 due, in part, to regulatory lags and adverse regulatory decisions by the ACC. CCWC has \$3.5 million of goodwill remaining which may be at risk for potential impairment if rate increases that we have requested from the ACC are not granted. ASUS also has \$1.1 million of goodwill which may be at risk for potential impairment if requested price redeterminations and equitable adjustments are not granted.

We are also, in some cases, required to estimate future expenses and in others, we are required to incur the expense before recovering costs. As a result, our revenues and earnings may fluctuate depending on the accuracy of our estimates, timing of our investments or expenses or other factors. If expenses increase significantly over a short period of time, we may experience delays in recovery of these expenses, the inability to recover carrying costs for these expenses and increased risks of regulatory disallowances or write-offs.

Regulatory agencies may also change their rules and policies which may adversely affect our profitability and cash flows. Changes in policies of the U.S. government may also adversely affect our military base contract operations. In certain circumstances, the U.S. government may be unwilling or unable to appropriate funds to pay costs mandated by changes in rules and policies of state regulatory agencies or may seek bids on work that we believe is covered by the contract awarded to us, thereby reducing the returns that we anticipated at the time of execution of the

contract. The U.S. government may also delay approval of requests for equitable adjustment or redetermination of prices which could adversely affect our anticipated rates of return.

We may also be subject to fines or penalties if a regulatory agency determines that we have failed to comply with laws, regulations or orders applicable to our businesses, unless we appeal this determination or our appeal of an adverse determination is denied.

Our costs involved in maintaining water quality and complying with environmental regulation have increased and are expected to continue to increase

Our capital and operating costs have increased substantially as a result of increases in environmental regulation arising from increases in the cost of disposing of residuals from our water treatment plants, upgrading and building new water treatment plants, monitoring compliance activities and securing alternative supplies when necessary. Our public utilities may be able to recover these costs through the ratemaking process. We may also be able to recover these costs under contractual arrangements. In certain circumstances, costs may be recoverable from parties responsible or potentially responsible for contamination, either voluntarily or through specific court action.

Table of Contents

We may also incur significant costs in connection with seeking to recover costs due to contamination of water supplies. Our ability to recover these types of costs also depends upon a variety of factors, including approval of rate increases, the willingness of potentially responsible parties to settle litigation and otherwise address the contamination and the extent and magnitude of the contamination. We can give no assurance regarding the adequacy of any such recovery to offset the costs associated with the contamination or the cost of recovery of these costs.

Our subsidiaries operating water and/or wastewater systems on military bases are also subject to increasingly stringent environmental regulations. The contracts provide various mechanisms for recovery of costs, including increasing revenues through change in conditions provisions and equitable adjustment procedures. Our contracts with the U.S. government are, however, subject to the Anti-Deficiency Act. As a result, our recovery of these costs may depend upon Congressional action to appropriate funds.

Additional Risks Associated with our Public Utility Operations

Our operating costs have increased and are expected to continue to increase as a result of groundwater contamination

Our operations are impacted by groundwater contamination in certain service territories. We have taken a number of steps to address contamination, including the removal of wells from service, decreasing the amount of groundwater pumped from wells in order to slow the movement of plumes of contaminated water, constructing water treatment facilities and securing alternative sources of supply from other areas not affected by the contamination.

In some cases, potentially responsible parties have reimbursed us for some or all of our costs. In other cases, we have taken legal action against parties believed to be potentially responsible for the contamination. To date, the CPUC has permitted us to establish memorandum accounts in California for potential recovery of these types of costs. As a result, our memorandum and water supply balancing accounts are high by historical standards. We can give no assurance regarding the outcome of litigation arising out of contamination or our ability to recover these costs in the future.

Persons who are potentially responsible for causing the contamination of groundwater supplies have also been increasingly asserting claims against water distributors on a variety of theories and have thus far brought the water distributors (including us) within the class of potentially responsible parties in federal court actions pending in Los Angeles County. This increases the costs and risks of seeking recovery of these costs. Management believes that rate recovery, proper insurance coverage and reserves are in place to appropriately manage these types of claims. However, such claims, if ultimately resolved unfavorably to us, could, in the aggregate, have a material adverse effect on our results of operations and financial condition.

The adequacy of our water supplies depends upon a variety of uncontrollable factors

The adequacy of our water supplies varies from year to year depending upon a variety of factors, including:

Edgar Filing: AMERICAN STATES WATER CO - Form 10-K

- Rainfall, runoff, flood control and availability of reservoir storage;
- Availability of Colorado River water and imported water from northern California;
- The amount of useable water stored in reservoirs and groundwater basins;
- The amount of water used by our customers and others;
- Water quality, and
- Legal limitations on production, diversion, storage, conveyance and use.

Population growth and increases in the amount of water used in California and Arizona have caused increased stress on surface water supplies and groundwater basins. The importation of water from the Colorado River, one of our important sources of supply has decreased due to implementation of the California 4.4 Plan which limits the amount of water that the Metropolitan Water District of Southern California, or MWD, is entitled to take from the Colorado River. In addition, new court-ordered pumping restrictions on water obtained from the Sacramento-San Joaquin Delta have decreased the amount of water MWD is able to import from northern California. We are cooperating with MWD to secure additional supplies from conservation, desalination and water exchanges with agricultural water users, but it is not known to what extent these efforts will be successful and sustainable.

CCWC obtains its water supply from operating wells and from the Colorado River through the Central Arizona Project, or CAP. CCWC's water supply may be subject to interruption or reduction if there is an interruption or reduction in water supplies available to CAP. In addition, CCWC's ability to provide water service to new real estate developments is dependent upon CCWC's ability to meet the requirements of the Arizona Department of Water Resources regarding the CCWC's assured water supply account.

Table of Contents

Water shortages may:

- adversely affect our supply mix, for instance, causing increased reliance upon more expensive water sources;
- adversely affect our operating costs, for instance, by increasing the cost of producing water from more highly contaminated aquifers;
- result in an increase in our capital expenditures, for example by requiring the construction of pipelines to connect to alternative sources of supply, new wells to replace those that are no longer in service or are otherwise inadequate to meet the needs of our customers, and reservoirs and other facilities to conserve or reclaim water, and
- adversely affect the volume of water sold as a result of mandatory or voluntary conservation efforts by customers.

We may be able to recover increased operating and capital costs through the ratemaking process. We implemented a modified supply cost balancing account to track and recover costs from our supply mix changes, as authorized by the CPUC, in November 2008. We may also recover costs from certain third parties that may be responsible, or potentially responsible, for groundwater contamination.

Our liquidity may be adversely affected by changes in water supply costs

We obtain our water supplies for GSWC and CCWC from a variety of sources. For example, water is pumped from aquifers within our service areas to meet a portion of the demands of our customers. When water produced from wells is insufficient to meet customer demand or when such production is interrupted, we have purchased water from other suppliers. As a result, our cost of providing, distributing and treating water for our customers use can vary significantly. Furthermore, imported water wholesalers, such as MWD and CAP may not always have an adequate supply of water to sell to us.

We have established water supply cost balancing accounts at GSWC for expenses of purchased water, purchased power and groundwater related pump taxes for our water service areas. Under the water supply cost balancing account procedures prior to November 2008, changes in water supply costs, such as those that occurred due to changes in supply mix (purchased water volume vs. pumped water, for instance) compared to the authorized amount historically directly affected our earnings. In November 2008, the CPUC authorized GSWC to implement a modified balancing account that permits GSWC to reflect changes in all water supply costs, including those due to changes in water supply mix, in the balancing account.

Our liquidity and earnings could be adversely affected by increases in maintenance costs due to our aging infrastructure

Some of our systems in California are more than 50 to 75 years old. We have experienced a high number of leaks, water quality and mechanical problems in some of these older systems. In addition, well and pump maintenance expenses continue to increase due to rising labor and material costs and more stringent water discharge requirements. These costs can and do increase unexpectedly and in substantial amounts.

We include increases in maintenance costs in each general rate case filed by our rate-regulated public utilities for possible recovery. However, we estimate the amount of expenses expected to be incurred during future years in California. We may not recover overages from those estimates in rates, which may adversely affect our financial condition, results of operations, cash flow and liquidity.

Our liquidity and earnings may be adversely affected by our conservation efforts

Conservation by all customer classes at GSWC and CCWC is a top priority. However, customer conservation can result in lower volumes of water sold. We are also experiencing a decline in per residential customer water usage due to the use of more efficient household fixtures and appliances by residential consumers, and perhaps, efforts by our customers to reduce costs as a result of adverse economic conditions.

Our public utilities businesses are heavily dependent upon revenue generated from rates charged to our residential customers for the volume of water used. The rates we charge for water are regulated by the CPUC and the ACC and may not be unilaterally adjusted to reflect changes in demand. Declining usage also negatively impacts our long-term operating revenues if we are unable to secure rate increases or if growth in the residential customer base does not occur to the extent necessary to offset the per customer residential usage decline. In November 2008, we implemented a water revenue adjustment mechanism at GSWC which has the effect of reducing, in part, the adverse impacts of our customers conservation efforts.

Table of Contents

Our earnings may be affected, to some extent, by weather during different seasons

The demand for water and electricity varies by season. For instance, most water consumption occurs during the third quarter of each year when weather in California and Arizona tends to be hot and dry. During unusually wet weather, our customers generally use less water. In November 2008, GSWC implemented a new conservation rate design and a water revenue adjustment mechanism approved by the CPUC at two of its water regions, which should help mitigate fluctuations in revenues and earnings due to changes in water consumption in California. CCWC's revenues and profitability will, however, continue to be impacted by changes in water consumption in Arizona.

The demand for electricity in our electric customer service area is greatly affected by winter snows. An increase in winter snows reduces the use of snowmaking machines at ski resorts in the Big Bear area and, as a result, reduces our electric revenues. Likewise, unseasonably warm weather during a skiing season may result in temperatures too high for snowmaking conditions, which also reduces our electric revenues. We have requested a revenue adjustment mechanism from the CPUC for our electric business which, if approved, should help mitigate fluctuations in the revenues and earnings of our electric business due to changes in the amount of electricity used by GSWC's customers.

Our liquidity, and in certain circumstances, earnings, may be adversely affected by increases in electricity and natural gas prices in California

We purchase most of our electric energy sold to customers in our electric customer service area from others under purchased power contracts. In addition to purchased power contracts, we purchase additional energy from the spot market to meet peak demand. We may sell surplus power to the spot market during times of reduced energy demand. We also operate a natural gas-fueled 8.4 megawatt, or MW, generator in our electric service area.

During the energy crisis in late 2000 and 2001, we incurred approximately \$23.1 million of additional energy purchase costs that were not covered in rates. The CPUC authorized a surcharge of 2.2¢ per kilowatt hour from our customers through August 2011 to recover this under-collected balance. Based on projected electricity sales, we expect to recover all of this under-collected balance. In addition, the CPUC authorized recovery of energy purchase costs from customers, up to an annual weighted average cost of \$77 per MWh each year through August 2011. We are required to write-off costs in excess of this cap. As a result, we are at risk for increases in spot market prices of electricity purchased and for decreases in spot market prices for electricity sold. Since the energy crisis in late 2001, the under-collection in our energy supply cost balancing account incurred during the energy crisis has decreased to \$3.0 million as a result of the surcharge. However, this decrease has been offset by increases in the supply cost balancing account primarily due to increases in costs associated with the transportation of energy.

Unexpected generator downtime or a failure to perform by any of the counterparties to our electric and natural gas purchase contracts could further increase our exposure to fluctuating natural gas and electric prices.

Changes in electricity prices also affected the unrealized gains and losses on our block forward purchased power contracts that qualify as derivative instruments as we adjusted the asset or liability on these contracts to reflect the fair market value of