CALIFORNIA WATER SERVICE GROUP
Form 10-Q
May 01, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

or

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

For the transition period from to

Commission file number 1-13883

CALIFORNIA WATER SERVICE GROUP

(Exact name of registrant as specified in its charter)

Delaware (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 x No o

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

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

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

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

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 April 27, 2014 47,803,849

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1.

FINANCIAL STATEMENTS

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

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(In thousands, except per share data)

	March 31, 2014	December 31, 2013
ASSETS		
Utility plant:		
Utility plant	$ 2,236,187	$ 2,213,328
Less accumulated depreciation and amortization	(713,069)	(697,497)
Net utility plant	1,523,118	1,515,831
Current assets:		
Cash and cash equivalents	21,744	27,506
Receivables:		
Customers	26,799	31,468
Regulatory balancing accounts	28,547	30,887
Other	19,878	18,700
Unbilled revenue	14,594	17,034
Materials and supplies at weighted average cost	5,966	5,571
Taxes, prepaid expenses and other assets	12,578	8,324
Total current assets	130,106	139,490
Other assets:		
Regulatory assets	254,345	251,681
Goodwill	2,615	2,615
Other assets	52,404	50,238
Total other assets	309,364	304,534
	$ 1,962,588	$ 1,959,855
CAPITALIZATION AND LIABILITIES		
Capitalization:		

Common stock, $.01 par value; 68,000,000 shares authorized, 47,804,000 and 47,741,000 outstanding in 2014 and 2013, respectively	$ 478	$ 477
Additional paid-in capital	328,826	328,364
Retained earnings	256,680	269,915
Total common stockholders equity	585,984	598,756
Long-term debt, less current maturities	425,730	426,142
Total capitalization	1,011,714	1,024,898
Current liabilities:		
Current maturities of long-term debt	7,860	7,908
Short-term borrowings	64,015	46,815
Accounts payable	50,731	55,087
Regulatory balancing accounts	6,130	1,827
Accrued interest	9,828	4,245
Accrued expenses and other liabilities	53,675	50,702
Total current liabilities	192,239	166,584
Unamortized investment tax credits	2,106	2,106
Deferred income taxes, net	179,369	183,245
Pension and postretirement benefits other than pensions	145,836	145,451
Regulatory and other liabilities	81,699	86,455
Advances for construction	182,042	183,393
Contributions in aid of construction	167,583	167,723
Commitments and contingencies (Note 10)		
	$ 1,962,588	$ 1,959,855

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

Table of Contents

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

(In thousands, except per share data)

For the three months ended		March 31, 2014		March 31, 2013
Operating revenue	$	110,515	$	111,444
Operating expenses:				
Operations:				
Water production costs		45,402		41,697
Administrative and general		25,141		25,281
Other operations		16,376		15,645
Maintenance		5,005		4,133
Depreciation and amortization		16,053		14,629
Income tax (benefit)		(3,839)		(1,146)
Property and other taxes		5,225		5,435
Total operating expenses		109,363		105,674
Net operating income		1,152		5,770
Other income and expenses:				
Non-regulated revenue		4,280		3,522
Non-regulated expenses, net		(4,119)		(2,417)
Income tax (expense) on other income and expenses		(79)		(451)
Net other income		82		654
Interest expense:				
Interest expense		7,075		8,037
Less: capitalized interest		(365)		(540)
Net interest expense		6,710		7,497
Net loss	$	(5,476)	$	(1,073)
Loss per share				
Basic	$	(0.11)	$	(0.03)
Diluted		(0.11)		(0.03)
Weighted average shares outstanding				
Basic		47,756		42,248
Diluted		47,756		42,248
Dividends declared per share of common stock	$	0.1625	$	0.1600

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)

For the three months ended:		March 31, 2014		March 31, 2013
Operating activities				
Net (loss)	$	(5,476)	$	(1,073)
Adjustments to reconcile net (loss) to net cash provided by operating activities:				
Depreciation and amortization		16,564		15,110
Change in value of life insurance contracts		(158)		(510)
Changes in operating assets and liabilities:				
Receivables		6,006		(1,645)
Accounts payable		178		(730)
Other current assets		(5,065)		(1,729)
Other current liabilities		7,458		10,164
Other changes in noncurrent assets and liabilities		(9,034)		(38)
Net cash provided by operating activities		10,473		19,549
Investing activities:				
Utility plant expenditures		(24,620)		(32,101)
Purchase of life insurance		(1,674)		(1,539)
Changes in restricted cash and other changes, net		418		108
Net cash (used in) investing activities		(25,876)		(33,532)
Financing activities:				
Short-term borrowings		22,200		3,800
Repayment of short-term borrowings		(5,000)		
Repayment of long-term debt		(460)		(355)
Advances and contributions in aid of construction		2,194		1,916
Refunds of advances for construction		(1,535)		(1,621)
Issuance of common stock				110,688
Common stock issuance costs				(4,853)
Dividends paid		(7,758)		(6,705)
Net cash provided by financing activities		9,641		102,870
Change in cash and cash equivalents		(5,762)		88,887
Cash and cash equivalents at beginning of period		27,506		38,790
Cash and cash equivalents at end of period	$	21,744	$	127,677
Supplemental information				
Cash paid for interest (net of amounts capitalized)	$	837	$	1,061
Cash paid for income taxes				
Supplemental disclosure of non-cash activities:				
Accrued payables for investments in utility plant	$	10,690	$	6,959
Utility plant contribution by developers		1,020		1,278

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

5

Table of Contents

CALIFORNIA WATER SERVICE GROUP

Notes to Unaudited Condensed Consolidated Financial Statements

March 31, 2014

(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.

The Company operates in one reportable segment, providing water and related utility 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, 2013, included in its annual report on Form 10-K as filed with the SEC on February 27, 2014.

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. These include, but are not limited to, estimates and assumptions used in determining the Company s regulatory asset and liability balances based upon probability assessments of regulatory recovery, revenues earned but not yet billed, asset retirement obligations, allowance for doubtful accounts, pension and other employee benefit plan liabilities, and income tax-related assets and liabilities. Actual results could differ from these estimates.

In the opinion of management, the accompanying condensed consolidated financial statements reflect all adjustments, consisting of normal recurring accruals 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 12-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 generally lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

Note 2. Summary of Significant Accounting Policies

Revenue

Revenue generally includes monthly cycle customer billings for regulated water and wastewater services at rates authorized by regulatory commissions (plus an estimate for water used between the customer s last meter reading and the end of the accounting period) and billings to certain non-regulated customers at rates authorized by contract with government agencies.

The Company s regulated water and waste water revenue requirements are authorized by the Commissions in the states in which it operates. The revenue requirements are intended to provide the Company an opportunity to recover its operating costs and earn a reasonable return on investments.

For metered customers, Cal Water recognizes revenue from rates which are designed and authorized by the California Public Utilities Commission (CPUC). Under the Water Revenue Adjustment Mechanism (WRAM), Cal Water records the adopted level

Table of Contents

of volumetric revenues, which would include recovery of cost of service and a return on investments, as established 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 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 regulatory asset or liability balancing account (tracked individually for each Cal Water district) subject to certain criteria under the accounting for regulated operations being met. The variance amount may be positive or negative and represents amounts that will be billed or refunded to customers in the future.

Cost-recovery rates are designed to permit full recovery of certain costs. Cost-recovery rates such as the Modified Cost Balancing Account (MCBA) provides for recovery of adopted expense levels for purchased water, purchased power and pump taxes, as established by the CPUC. In addition, cost-recovery rates include recovery of cost related to water conservation programs and certain other operation expenses adopted by the CPUC. There is no markup for return or profit for cost-recovery expenses and are generally recognized when expenses are incurred. Variances (which include the effects of changes in both rate and volume for the MCBA) between adopted and actual costs are recorded as a component of revenue, as the amount of such variances will be recovered from or refunded to our customers at a later date. The variance between adopted costs and actual costs for metered accounts is recorded as a component of revenue with an offsetting entry to a regulatory asset or liability balancing account (transferred individually for each Cal Water District) subject to certain criteria under the accounting for regulated operations being met.

The balances in the WRAM and MCBA assets and liabilities accounts will fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of the WRAM is netted against the MCBA over- or under-recovery for the corresponding district and is interest bearing at the current 90 day commercial paper rate. At the end of any calendar year, Cal Water files with the CPUC to refund or collect the balance in the accounts. Most undercollected net WRAM and MCBA receivable balances are collected over 12 or 18 months. Cal Water defers net WRAM and MCBA operating revenues and associated costs whenever the net receivable balances are estimated to be collected more than 24 months after the respective reporting periods in which it was recognized. The deferred net WRAM and MCBA revenues and associated costs were determined using forecasts of rate payer consumption trends in future reporting periods and the timing of when the CPUC will authorize Cal Water s filings to recover the undercollected balances. Deferred net WRAM and MCBA revenues and associated costs will be recognized as revenues and costs in future periods when collection is within twenty-four months of the respective reporting period.

The net WRAM and MCBA balances included in regulatory balancing account, assets, and liabilities were:

		March 31, 2014		December 31, 2013
Net short-term receivable	$	28,547	$	30,887
Net long-term receivable		16,716		15,423
Total receivable	$	45,263	$	46,310
Net short-term payable	$	2	$	1,032
Net long-term payable		927		906
Total payable	$	929	$	1,938

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 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. The unearned revenue liability was $1.4 million as of March 31, 2014 and $1.5 million as of December 31, 2013. This liability is included in accrued expenses and other liabilities on the condensed consolidated balance sheets.

Cash and Cash Equivalents

Cash equivalents include highly liquid investments with maturities of three months or less. Cash and cash equivalents was $21.7 million and $27.5 million as of March 31, 2014 and December 31, 2013, respectively. Restricted cash was presented on the condensed consolidated balance sheet as taxes, prepaid expenses and other assets and was $0.8 million and $1.2 million as of March 31, 2014 and December 31, 2013, respectively.

Table of Contents

Note 3. Stock-based Compensation

Equity Incentive Plan

The Company s equity incentive plan was approved by stockholders on April 27, 2005. The Company is authorized to issue awards up to 2,000,000 shares of common stock.

During the three months ended March 31, 2014 and 2013, the Company granted annual Restricted Stock Awards (RSAs) of 58,378 and 70,557 shares, respectively, of common stock to officers and directors of the Company and 5,376 shares of RSAs were cancelled during the three months ended March 31, 2014. Employee RSAs granted in 2014 and 2013 vest over 36 months. Director RSAs generally vest at the end of 12 months. During the first three months of 2014 and 2013, the RSA granted were valued at $23.61 and $20.62 per share, respectively, based upon the fair market value of the Company s common stock on the date of grant.

During the three months ended March 31, 2014 and 2013, the Company granted performance-based Restricted Stock Unit Awards (RSUs) of 37,143 shares and 50,267 shares of common stock, respectively, to officers. Each award reflects a target number of shares that may be issued to the award recipient. The 2014 and 2013 awards may be earned upon the completion of the three-year performance period ending on March 4, 2017 and March 3, 2016, respectively. Whether RSUs are earned at the end of the performance period will be determined based on the achievement of certain performance objectives set by the Board of Director Compensation Committee in connection with the issuance of the RSUs. The performance objectives are based on the Company s business plan covering the performance period. The performance objectives include achieving the budgeted return on equity, budgeted investment in utility plant, customer service standards, water quality standards, and/or safety standards. Depending on the results achieved during the three-year performance period, the actual number of shares that a grant recipient receives at the end of the performance period may range from 0% to 200% of the target shares granted, provided that the grantee is continuously employed by the Company through the vesting date. If prior to the vesting date employment is terminated by reason of death, disability or normal retirement, then a pro rata portion of this award will vest. RSUs are not included in diluted shares for financial reporting until earned. The 2014 and 2013 RSUs are recognized as expense ratably over the three year performance period using a fair market value of $23.61 per share and $20.62 per share, respectively, and an estimate of RSUs earned during the performance period.

The Company has recorded compensation costs for the RSAs and RSUs in Operating Expense in the amount of $0.5 million and $0.4 million for the three months ended March 31, 2014 and March 31, 2013, respectively.

Note 4. Equity

The Company s changes in equity for the three months ended March 31, 2014 were as follows:

		Total Stockholders Equity
Balance at December 31, 2013	$	598,756
Common stock issued		

Share-based compensation expense		462
Common stock dividends declared		(7,758)
Net loss		(5,476)
Balance at March 31, 2014	$	585,984

On March 26, 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of approximately $105.8 million, net of $4.9 million underwriting discounts and commissions and offering expenses. The net proceeds from the sale of common stock were added to our general funds to be used for general corporate purposes. In April 2013, the Company used a portion of the net proceeds from the offering to repay outstanding borrowings on the Company and Cal Water lines of credit of $68.3 million and $25.0 million, respectively.

Table of Contents

Note 5. Net Loss Per Share Calculations

The computations of basic and diluted net loss per weighted average common share are noted below. Basic net loss per share is computed by dividing the net loss available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted net loss per share reflects the potential dilution that could occur if securities or other contracts were exercised or converted into common stock. RSAs are included in the weighted average common shares outstanding because the shares have all the same voting and dividend rights as issued and unrestricted common stock.

A total of 212,920 shares and 333,856 shares of Stock Appreciation Rights were vested and outstanding and all were anti-dilutive as of March 31, 2014 and March 31, 2013, respectively, as shown in the table below.

	Three Months Ended March 31	
	2014	**2013**
Net (loss) available to common stockholders	$ (5,476)	$ (1,073)
Weighted average common shares outstanding, basic	47,756	42,248
Dilutive common stock options (treasury method)		
Weighted average common shares outstanding, dilutive	47,756	42,248
Net (loss) per share - basic	$ (0.11)	$ (0.03)
Net (loss) per share - diluted	$ (0.11)	$ (0.03)

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 benefit plans were $7.7 million for the three months ended March 31, 2014 and were $7.5 million during the three months ended March 31, 2013. The 2014 estimated cash contribution to the pension plans is $26.8 million and to the other postretirement benefit plans is $9.6 million.

The following table lists components of net periodic benefit costs for 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 March 31			
	Pension Plan		Other Benefits	
	2014	2013	2014	2013
Service cost	$ 4,217	$ 4,658	$ 1,619	$ 1,695
Interest cost	4,726	4,063	1,337	1,109
Expected return on plan assets	(4,179)	(3,565)	(753)	(598)
Recognized net initial APBO (1)	N/A	N/A	N/A	2
Amortization of prior service cost	1,510	1,541	11	20
Recognized net actuarial loss	1,003	2,224	775	916
Net periodic benefit cost	$ 7,277	$ 8,921	$ 2,989	$ 3,144

(1) APBO - Accumulated postretirement benefit obligation

Table of Contents

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 that 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 12-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 March 31, 2014 and December 31, 2013, the outstanding borrowings on the Company lines of credit were $14.0 million and $16.8 million, respectively, and were $50.0 million and $30 million as of March 31, 2014 and December 31, 2013 on the Cal Water lines of credit, respectively. For the three months ended March 31, 2014, the average borrowing rate was 1.31% compared to 2.26% 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.

We anticipate that future rate actions by the regulatory commissions will reflect revenue requirements for the tax effects of temporary differences recognized, which have previously been passed through to customers. The regulatory commissions have granted us rate increases to reflect the normalization of the tax benefits of the federal accelerated methods and available Investment Tax Credits (ITCs) for all assets placed in service after 1980. ITCs are deferred and amortized over the lives of the related properties for book purposes.

During 2012, the Company filed an application for a change in tax accounting method with the IRS to implement the repairs and maintenance deduction. On September 19, 2013, the U.S. Department of the Treasury and Internal Revenue Service (IRS) issued the final and re-proposed tangible property regulations for repairs and maintenance deductions with an effective date of January 1, 2014. These tax regulations allowed the Company to deduct a significant amount of linear asset costs previously capitalized for book and tax purposes. The Company intends to implement the final regulations on its 2013 tax return. The Company s total federal NOL was $14.8 million and state NOL was $42.0 million as of March 31, 2014 and December 31, 2013. The NOL carry-forward amounts are more likely than not to be recovered and therefore require no valuation allowance. The NOL carry-forward does not begin to expire until 2033.

The State of Hawaii Department of Taxation is presently auditing the Company s 2011 and 2012 Hawaii state income tax returns. The State of California Board of Equalization is presently auditing the Company s 2010, 2011, and 2012 sales and use tax filings. It is uncertain when the state audits will be completed. The Company believes that the final resolution of the state audits will not have a material impact on its financial condition or results of operations.

Table of Contents

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 (CIAC) for remediation or replacement project costs once complete. Usage of the proceeds is reported to the CPUC through an Advice Letter or General Rate Case filing. As of December 31, 2013, $28.3 million of the proceeds was recorded as CIAC and $0.9 million was spent on MTBE legal services. Cal Water used $0.3 million of the proceeds for legal services during the first quarter of 2014. The remaining balance of $4.7 million is recorded as other long-term liabilities.

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 plan s 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 March 31, 2014 and December 31, 2013, the pension balancing account was a regulatory asset of $3.0 million. The conservation balancing account was a regulatory liability of $6.3 million as of March 31, 2014 and December 31, 2013.

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 Form 10-K for the year ended December 31, 2013. As of March 31, 2014, there were no significant changes from December 31, 2013.

Contingencies

Groundwater Contamination

The Company has undertaken 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. The Commission s general policy requires all proceeds from contamination litigation to be used first to pay transactional expenses, then to make ratepayers whole for water treatment costs to comply with the Commission s water quality standards. The Commission allows for a risk-based consideration of contamination proceeds which exceed the costs of the remediation described above and may result in some sharing of proceeds with the shareholder, determined on a case by case basis. The Commission has authorized various memorandum accounts that allow the Company to track significant litigation costs to request recovery of these costs in future filings and uses of proceeds to comply with Commission s general policy.

Table of Contents

Other Legal Matters

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. The Company recognized a liability of $1.2 million and $1.3 million for all known legal matters as of March 31, 2014 and December 31, 2013, respectively. 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 on the nature of the settlement.

Note 11. Fair Value of Financial Assets and Liabilities

The accounting guidance for fair value measurements and disclosures provides a single definition of fair value and requires certain disclosures about assets and liabilities measured at fair value. A hierarchal framework for disclosing the observability of the inputs utilized in measuring assets and liabilities at fair value is established by this guidance. The three levels in the hierarchy are as follows:

Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. The types of assets and liabilities included in Level 1 are highly liquid and actively traded instruments with quoted prices.

Level 2 - Pricing inputs are other than quoted prices inactive markets, but are either directly or indirectly observable as of the reporting date. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, or priced with discounted cash flow or option pricing models using highly observable inputs.

Level 3 - Significant inputs to pricing have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those valued with models requiring significant management judgment or estimation.

Specific valuation methods include the following:

Cash equivalents, accounts receivable and accounts payable carrying amounts approximated the fair value because of the short-term maturity of the instruments.

Long-term debt fair values were estimated using the published quoted market price, if available, or the discounted cash flow analysis, based on the current rates available using a risk-free rate (a U.S. Treasury securities yield curve) plus a risk premium of 1.19%.

Table of Contents

Advances for construction fair values were estimated using broker quotes from companies that frequently purchase these investments.

	March 31, 2014				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long -term debt, including current maturities	$ 433,590		$ 526,974		$ 526,974
Advances for construction	182,042		74,749		74,749
Total	$ 615,632	$	$ 601,723	$	$ 601,723

	December 31, 2013				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long -term debt, including current maturities	$ 434,050	$	$ 511,146	$	$ 511,146
Advances for construction	183,393		73,389		73,389
Total	$ 617,443		$ 584,535	$	$ 584,535

Note 12. Condensed Consolidating Financial Statements

On April 17, 2009, Cal Water issued $100 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, and on November 17, 2010, Cal Water issued $100 million aggregate principal amount of 5.500% First Mortgage Bonds due 2040, all of which are fully and unconditionally guaranteed by the Company. As a result of these guarantee arrangements, we are required to present the following condensed consolidating financial information.

The following tables present the condensed consolidating balance sheets as of March 31, 2014 and December 31, 2013, the condensed consolidating statements of operations for the three months ended March 31, 2014 and 2013 and the condensed consolidating statements of cash flows for the three months ended March 31, 2014 and 2013 of (i) California Water Service Group, the guarantor of the first mortgage bonds and the parent company; (ii) California Water Service Company, the issuer of the first mortgage bonds and a 100% owned consolidated subsidiary of California Water Service Group; and (iii) the other 100% owned non-guarantor consolidated subsidiaries of California Water Service Group.

Table of Contents

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING BALANCE SHEET

As of March 31, 2014

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	$ 1,318	$ 2,056,139	$ 185,927	$ (7,197)	$ 2,236,187
Less accumulated depreciation and amortization	(206)	(676,000)	(38,505)	1,642	(713,069)
Net utility plant	1,112	1,380,139	147,422	(5,555)	1,523,118