

CALIFORNIA WATER SERVICE GROUP  
Form 10-K  
February 26, 2015

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**Form 10-K**

ý ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 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 No. 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, California**

(Address of Principal Executive Offices)

**95112**

(Zip Code)

**(408) 367-8200**

(Registrant's Telephone Number, including Area Code)

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

**Title of Each Class:**

Common Stock, \$0.01 par value per share

**Name of Each Exchange on Which Registered:**

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. Yes o No ý

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 of Section 15(d) of the Act. Yes  No

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 (§ 232,405 of this chapter) 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 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 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 Act). Yes  No

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant was \$1,156.9 million on June 30, 2014, the last business day of the registrant's most recently completed second fiscal quarter. The valuation is based on the closing price of the registrant's common stock as traded on the New York Stock Exchange.

Common stock outstanding at February 09, 2015, 47,800,997 shares.

### DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive proxy statement for the California Water Service Group 2015 Annual Meeting are incorporated by reference into Part III hereof.

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**PART I**

**Item 1. Business.**

**Forward-Looking Statements**

This annual report, including all documents incorporated by reference, contains forward-looking statements within the meaning established by the Private Securities Litigation Reform Act of 1995. Forward-looking statements in this annual report are based on currently available information, expectations, estimates, assumptions and projections, and our management's beliefs, assumptions, judgments and expectations about us, the water utility industry and general economic conditions. These statements are not statements of historical fact. When used in our documents, statements that are not historical in nature, including words like "expects," "intends," "plans," "believes," "may," "estimates," "assumes," "anticipates," "projects," "predicts," "forecasts," "should," "seeks," or variations of these words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. They are based on numerous assumptions that we believe are reasonable, but they are open to a wide range of uncertainties and business risks. Consequently, actual results may vary materially from what is contained in a forward-looking statement.

Factors which may cause actual results to be different than those expected or anticipated include, but are not limited to:

governmental and regulatory commissions' decisions, including decisions on proper disposition of property;

changes in regulatory commissions' policies and procedures;

the timeliness of regulatory commissions' actions concerning rate relief;

changes in the capital markets and access to sufficient capital on satisfactory terms;

new legislation;

changes in California State Water Resources Control Board water quality standards;

changes in environmental compliance and water quality requirements;

changes in accounting valuations and estimates;

changes in accounting treatment for regulated companies, including adoption of International Financial Reporting Standards, if required;

electric power interruptions;

increases in suppliers' prices and the availability of supplies including water and power;

fluctuations in interest rates;

litigation that may result in damages or costs not recoverable from third parties;

acquisitions and the ability to successfully integrate acquired companies;

the ability to successfully implement business plans;

civil disturbances or terrorist threats or acts, or apprehension about the possible future occurrences of acts of this type;

the involvement of the United States in war or other hostilities;

our ability to attract and retain qualified employees;

labor relations matters as we negotiate with the unions;

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

changes in federal and state income tax regulations and treatment of such by regulatory commissions;

implementation of new information technology systems;

changes in operations that result in an impairment to acquisition goodwill;

restrictive covenants in or changes to the credit ratings on current or future debt that could increase financing costs or affect the ability to borrow, make payments on debt, or pay dividends;

general economic conditions, including changes in customer growth patterns and our ability to collect billed revenue from customers;

changes in customer water use patterns and the effects of conservation;

the impact of weather and climate on water availability, water sales and operating results;

the ability to satisfy requirements related to the Sarbanes-Oxley and Dodd-Frank Acts and other regulations on internal controls;

the unknown impact of contagious diseases, such as Ebola, avian flu, H1N1 flu and severe acute respiratory syndrome (SARs), on the Company's operations;

the impact of cyber security breaches on the Company's financial, human resources, and operational information systems; and

the risks set forth in "Risk Factors" included elsewhere in this annual report.

In light of these risks, uncertainties and assumptions, investors are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this annual report or as of the date of any document incorporated by reference in this annual report, as applicable. When considering forward-looking statements, investors should keep in mind the cautionary statements in this annual report and the documents incorporated by reference. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise.

## **Overview**

California Water Service Group is a holding company incorporated in Delaware with six operating subsidiaries: California Water Service Company (Cal Water), New Mexico Water Service Company (New Mexico Water), Washington Water Service Company (Washington Water), Hawaii Water Service Company, Inc. (Hawaii Water), and CWS Utility Services and HWS Utility Services LLC (CWS Utility Services and HWS Utility Services LLC being referred to collectively in this annual report as Utility Services). Cal Water, New Mexico Water, Washington Water, and Hawaii Water are regulated public utilities. The regulated utility entities also provide some non-regulated services. Utility Services provides non-regulated services to private companies and municipalities. Cal Water was the original operating company and began operations in 1926.

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Our business is conducted through our operating subsidiaries. The bulk of the business consists of the production, purchase, storage, treatment, testing, distribution and sale of water for domestic, industrial, public and irrigation uses, and for fire protection. We also provide non-regulated water-related services under agreements with municipalities and other private companies. The non-regulated services include full water system operation, billing and meter reading services. Non-regulated operations also include the lease of communication antenna sites, lab services, and promotion of other non-regulated services. Earnings may be significantly affected by the sale of surplus real properties if and when they occur.



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During the year ended December 31, 2014, there were no significant changes in the kind of products produced or services rendered or those provided by our operating subsidiaries, or in the markets or methods of distribution.

Our mailing address and contact information is:

California Water Service Group  
1720 North First Street  
San Jose, California 95112-4598  
telephone number: 408-367-8200  
www.calwatergroup.com

Annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports are available free of charge through our website. The reports are available on our website as soon as reasonably practicable after such reports are filed with the SEC.

### **Regulated Business**

California water operations are conducted by the Cal Water and CWS Utility Services entities, which provide service to approximately 477,900 customers in 83 California communities through 25 separate districts. Of these 25 districts, 23 districts are regulated water systems, which are subject to regulation by the California Public Utilities Commission (CPUC). Cal Water operates two leased water systems, the City of Hawthorne and the City of Commerce, which are governed through their respective city councils and are outside of the CPUC's jurisdiction. California water operations account for approximately 94% of our total customers and approximately 94% of our total consolidated operating revenue.

Hawaii Water provides service to approximately 4,300 water and wastewater customers on the islands of Maui and Hawaii, including several large resorts and condominium complexes. Hawaii's regulated operations are subject to the jurisdiction of the Hawaii Public Utilities Commission. Hawaii Water accounts for less than 1% of our total customers and approximately 3% of our total operating revenue.

Washington Water provides domestic water service to approximately 16,300 customers in the Tacoma and Olympia areas. Washington Water's utility operations are regulated by the Washington Utilities and Transportation Commission. Washington Water accounts for approximately 3% of our total customers and approximately 2% of our total consolidated operating revenue.

New Mexico Water provides service to approximately 7,600 water and wastewater customers in the Belen, Los Lunas and Elephant Butte areas in New Mexico. New Mexico's regulated operations are subject to the jurisdiction of the New Mexico Public Regulation Commission. New Mexico Water accounts for approximately 2% of our total customers and approximately 1% of our total consolidated operating revenue.

The state regulatory bodies governing our regulated operations are referred to as the Commissions in this annual report. Rates and operations for regulated customers are subject to the jurisdiction of the respective state's regulatory commission. The Commissions require that water and wastewater rates for each regulated district be independently determined based on the cost of service. The Commissions are expected to authorize rates sufficient to recover normal operating expenses and allow the utility to earn a fair and reasonable return on invested capital.

We distribute water in accordance with accepted water utility methods. Where applicable, we hold franchises and permits in the cities and communities where we operate. The franchises and permits allow us to operate and maintain facilities in public streets and right-of-ways as necessary.

We operate the City of Hawthorne and the City of Commerce water systems under lease agreements. In accordance with the lease agreements, we receive all revenues from operating the systems and are responsible for paying the operating costs. The City of Hawthorne and the City of Commerce lease

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revenues are governed through their respective city councils and are considered non-regulated because they are outside of the CPUC's jurisdiction. We report revenue and expenses for the City of Hawthorne and City of Commerce leases in operating revenue and operating expenses because we are entitled to retain all customer billings and are generally responsible for all operating expenses. These leases are considered "nontariffed products and services (NTPS)" by the CPUC and require a 10% revenue sharing.

In October 2011, an agreement was negotiated with the City of Hawthorne to lease and operate its water system. The system, which is located near the Hermosa Redondo district, serves about half of Hawthorne's population. The capital lease agreement required an up-front \$8.1 million lease deposit to the city that is being amortized over the lease term. Additionally, annual lease payments of \$0.9 million are made to the city and shall be increased or decreased each year on July 1, by the same percentage that the rates charged to customers served by the water system increased or decreased, exclusive of pass-through increases or decreases in the cost of water, power, and city-imposed fees, compared to the rates in effect on July 1 of the prior year, provided, that in no event will the annual lease payment be less than \$0.9 million. Under the lease we are responsible for all aspects of system operation and capital improvements, although title to the system and system improvements reside with the city. Capital improvements are recorded as depreciable plant and equipment and depreciated per the asset lives set forth in the agreement. In exchange, we receive all revenue from the water system, which was \$7.8 million, \$7.7 million and \$7.6 million in 2014, 2013, and 2012, respectively. At the end of the lease, the city is required to reimburse us for the unamortized value of capital improvements made during the term of the lease. The City of Hawthorne capital lease is a 15-year lease and expires in 2026.

In July 2003, an agreement was negotiated with the City of Commerce to lease and operate its water system. The lease requires us to pay \$0.8 million per year in monthly installments and pay \$200 per acre-foot for water usage exceeding 2,000 acre-feet per year plus a percentage of certain operational savings that may be realized. Under the lease agreement, we are responsible for all aspects of the system's operations. The city is responsible for capital expenditures, and title to the system and system improvements resides with the city. We bear the risks of operation and collection of amounts billed to customers. The agreement includes a procedure to request rate changes for cost changes outside of our control and other cost changes. In exchange, we receive all revenue from the system, which totaled \$2.1 million in 2014, \$2.0 in 2013, and \$1.9 million in 2012. The City of Commerce lease is a 15-year lease and expires in 2018.

### **Non-Regulated Activities**

Fees for non-regulated activities are based on contracts negotiated between the parties. Under other non-regulated contract arrangements, we operate municipally owned water systems, privately owned water systems, and recycled water distribution systems, but are not responsible for all operating costs. Non-regulated revenue received from water system operations is generally determined on a fee-per-customer basis.

Non-regulated activities consist primarily of:

operating water and waste water systems, which are owned by other entities;

leasing communication antenna sites on our properties;

billing of optional third-party insurance programs to our residential customers;

operating recycled water systems;

providing meter reading and billing services;

providing lab services for water quality testing;

selling surplus property; and

other services as requested by the client.



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The revenues and expenses for leased water systems are included in operating revenues and operating expenses. All other non-regulated revenues and expenses are reported below net operating income on the income statement. Due to the variety of services provided and activities being outside of our core business, the number of customers is not tracked for these non-regulated activities, except customers for the City of Hawthorne and the City of Commerce. Effective June 30, 2011, the CPUC adopted new rules surrounding provision of unregulated services using utility assets and employees. As a result, nearly all California unregulated activities are now considered NTPS. The prescribed accounting for these NTPS is incremental cost allocation plus revenue sharing with regulated customers. Non-regulated services determined to be "active activities" require a 10% revenue sharing and "passive activities" require a 30% revenue sharing. The amount of non-regulated revenues subject to revenue sharing is the total billed revenues less any authorized pass through costs. Some examples of CPUC authorized pass through costs are purchased water, purchased power, and pump taxes. All of the non-regulated services listed above, except property leases, are "active activities" subject to a 10% revenue sharing. Property leases are "passive activities" subject to a 30% revenue sharing. The 2014 and 2013 revenue sharing was \$2.3 million and \$2.1 million, respectively. Any significant change in revenue sharing due to the new rules will be reflected in adopted rates after the next general rate case.

We provide operating and maintenance, meter reading and customer billing services for several municipalities in California. We also provide sewer and refuse billing services to several municipalities. Revenues for these services were \$10.6 million, \$9.3 million, and \$11.2 million in 2014, 2013, and 2012, respectively.

We lease antenna sites to telecommunication companies, which place equipment at various Company-owned sites. Lease revenues totaled \$2.0 million in each of 2014, 2013 and 2012. The antennas are used in cellular phone and personal communication applications. We continue to negotiate new leases for similar uses.

In 2006, we started an Extended Service Protection (ESP) program in California covering certain repairs to residential customer's water line between the meter and the home. The non-regulated program was operated by CWS Utility Services. Typically the utility is responsible for servicing and maintaining the water line up to and including the meter. The home owner is responsible for the water line from the meter to the house. In late 2007, we contracted with Home Service USA to replace the ESP program with an insurance product. Home Service USA now provides water line protection insurance, sewer line protection insurance, and internal plumbing protection insurance to Cal Water's customers who request it. Cal Water includes charges for these optional NTPS on its bills. Revenues for these services were \$2.1 million in each of 2014, 2013, and 2012.

### **Operating Segment**

We operate in one reportable segment, the supply, and distribution of water and providing water-related utility services. For information about revenue from external customers, net income and total assets; see "Item 8. Financial Statements and Supplementary Data."

### **Growth**

We intend to continue exploring opportunities to expand our regulated and non-regulated water and wastewater activities in the western United States. The opportunities could include system acquisitions, lease arrangements similar to the City of Hawthorne and City of Commerce contracts, full service system operation and maintenance agreements, meter reading, billing contracts and other utility-related services.

### **Geographical Service Areas and Number of Customers at Year-end**

Our principal markets are users of water within our service areas. Most of the geographical service areas are regulated; however, the City of Hawthorne and City of Commerce are included due to

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similarities in structure and risk of operations. The approximate number of customers served in each district is as follows:

Regulated Customers, City of Hawthorne and City of Commerce Customers at December 31, (rounded to the nearest hundred)

	2014	2013
<b>SAN FRANCISCO BAY AREA</b>		
Bayshore (serving South San Francisco, Colma, Broadmoor, San Mateo and San Carlos)	53,500	53,300
Bear Gulch (serving portions of Menlo Park, Atherton, Woodside and Portola Valley)	18,900	18,800
Los Altos (including portions of Cupertino, Los Altos Hills, Mountain View and Sunnyvale)	18,900	18,800
Livermore	18,500	18,400
	109,800	109,300
<b>SACRAMENTO VALLEY</b>		
Chico (including Hamilton City)	28,700	28,400
Oroville	3,600	3,500
Marysville	3,700	3,700
Dixon	2,900	2,900
Willows	2,400	2,400
	41,300	40,900
<b>NORTH COAST</b>		
Redwood Valley (Lucerne, Duncans Mills, Guerneville, Dillon Beach, Noel Heights & portions of Santa Rosa)	1,900	1,900
	1,900	1,900
<b>SALINAS VALLEY</b>		
Salinas	28,400	28,300
King City	2,600	2,500
	31,000	30,800
<b>SAN JOAQUIN VALLEY</b>		
Bakersfield	70,100	69,600
Stockton	43,300	43,000
Visalia	42,400	41,700
Selma	6,300	6,300
Kern River Valley	4,100	4,200
	166,200	164,800

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	2014	2013
<b>LOS ANGELES AREA</b>		
East Los Angeles	26,800	26,700
Hermosa Redondo (serving Hermosa Beach, Redondo Beach and a portion of Torrance)	26,700	26,700
Dominguez (Carson and portions of Compton, Harbor City, Long Beach, Los Angeles and Torrance)	34,000	33,900
Palos Verdes (including Palos Verdes Estates, Rancho Palos Verdes, Rolling Hills Estates and Rolling Hills)	24,100	24,100
Westlake (a portion of Thousand Oaks)	7,100	7,100
Antelope Valley (Fremont Valley, Lake Hughes, Lancaster & Leona Valley)	1,400	1,400
Hawthorne and Commerce (leased municipal systems)	7,600	7,500
	127,700	127,400
<b>CALIFORNIA TOTAL</b>	477,900	475,100
<b>HAWAII</b>	4,300	4,200
<b>NEW MEXICO</b>	7,600	7,600
<b>WASHINGTON</b>	16,300	16,000
 <b>COMPANY TOTAL</b>	 506,100	 502,900

### **Rates and Regulation**

The state regulatory commissions have plenary powers setting rates and operating standards. As such, state commission decisions significantly impact the Company's revenues, earnings, and cash flows. The amounts discussed herein are generally annual amounts, unless specifically stated, and the financial impact to recorded revenue is expected to occur over a 12-month period from the effective date of the decision. In California, water utilities are required to make several different types of filings. Most filings result in rate changes that remain in place until the next General Rate Case (GRC). As explained below, surcharges and surcredits to recover balancing and memorandum accounts as well as general rate case interim rate relief are temporary rate changes, which have specific time frames for recovery.

GRCs, escalation rate increase filings, and offset filings change rates to amounts that will remain in effect until the next GRC. The CPUC follows a rate case plan, which requires Cal Water to file a GRC for each of its regulated operating districts every three years. In a GRC proceeding, the CPUC not only considers the utility's rate setting requests, but may also consider other issues that affect the utility's rates and operations. The CPUC is generally required to issue its GRC decision prior to the first day of the test year or authorize interim rates. In accordance with the CPUC's rate case plan for Class A water utilities, Cal Water will file its next GRC application in July 2015.

Between GRC filings Cal Water may file escalation rate increases, which allows Cal Water to recover cost increases, primarily from inflation and incremental investment, during the second and third years of the rate case cycle. However, escalation rate increases are subject to an earnings test on a district-by-district basis. Under the earnings test, the CPUC may reduce the escalation rate increase if, in the most recent 12-month period, this earnings test reflects earnings in excess of what was authorized for that district.

In addition, California water utilities are entitled to make offset filings. Offset filings may be filed to adjust revenues for construction projects authorized in GRCs when the plant is placed in service (referred to as "ratebase offsets"), or for rate changes charged to Cal Water for purchased water, purchased power, and pump taxes (referred to as "offsettable expenses"). Such rate changes approved in offset filings remain in effect until the next GRC is approved.

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In pursuit of the CPUC's water conservation goals, the CPUC decoupled Cal Water's revenue requirement from customer consumption levels in 2008 by authorizing a Water Revenue Adjustment Mechanism (WRAM) and Modified Cost Balancing Account (MCBA) for each ratemaking area. The WRAM and MCBA ensure that Cal Water recovers all of the quantity revenues authorized by the CPUC regardless of customer consumption. This removes the Company's historical disincentive against promoting lower water usage among customers. Through an annual advice letter filing, Cal Water recovers any uncollected quantity revenue amounts authorized, or refunds over-collected quantity revenues, via surcharges and credits. The advice letters are filed between February and April of each year and address the net WRAM and MCBA balances collected for the previous calendar year. Most WRAM and MCBA balances have been revenue under- collections that are amortized through surcharges for a period of 12 or 18 months. The WRAM and MCBA amounts are cumulative, so if they are not amortized in a given calendar year, the balance is carried forward and included with the following year balance.

***2014 Regulatory Activity***

*California GRC filing*

On July 5, 2012, Cal Water filed a GRC application seeking rate increases in all regulated operating districts in California beginning January 1, 2014. The GRC application requested an increase of \$92.7 million or 19.4% in rates for 2014, \$17.2 million or 3.0% in rates for 2015 and \$16.9 million or 2.9% in rates for 2016. In addition to the CPUC's Office of Ratepayer Advocates (ORA), (formerly the Division of Ratepayer Advocates), several other entities representing various districts intervened in the case to become active parties. In early 2013, six parties submitted testimony in response to Cal Water's application, and Cal Water submitted rebuttal testimony. Settlement negotiations began in May 2013, and on October 30, 2013, Cal Water entered into a settlement agreement with all parties who were active in the case at the time.

On December 19, 2013, the assigned Administrative Law Judge granted Cal Water's request to continue applying existing rates on and after January 1, 2014 as interim rates and allowed Cal Water to track the difference between interim rates and the new rates eventually adopted in the proceeding in a memorandum account. On August 14, 2014, the Commission issued Decision 14-08-011 adopting the proposed settlement and authorizing Cal Water to recover the balance in the memorandum account for interim rates. The GRC decision authorizes Cal Water to increase rates by \$45.3 million or 9.2% in 2014, \$10.1 million or 1.9% in 2015 and \$10.0 million or 1.8% in 2016. Also, the decision authorizes Cal Water to invest \$449.4 million in districts throughout California over the three-year period from January 1, 2013 through December 31, 2015 in order to provide a safe and reliable water supply to its customers. Included in the \$449.4 million in water system infrastructure improvements is \$128.7 million that could be recovered through the CPUC's advice letter procedure upon completion of qualified projects which we estimate would provide an additional \$19.0 million in revenue. The new final rates went into effect on August 29, 2014. On September 25, 2014 Cal Water filed an advice letter to begin recovering the interim rate balance of \$30.6 million via surcharges starting September 30, 2014.

*Federal Income Tax Bonus Depreciation*

In 2011, Cal Water filed for and received approval to track the benefits from federal income tax accelerated depreciation in a memorandum account due to the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. Additional federal income tax deductions for assets placed in service after September 8, 2010, and before December 31, 2011, were \$0.1 million for 2010, \$16.5 million for 2011, \$14.4 million for 2012, and \$10.6 million for 2013. The memorandum account may result in a surcredit because of the impact to Cal Water's revenue requirement for changes to working cash estimates, reductions to federal income tax qualified U.S. production activities deductions (QPAD), and changes to contributions-in-aid-of-construction. As of December 31, 2014 the estimated surcredit range is between

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\$1.0 million and \$1.5 million. The CPUC will determine the disposition of amounts recorded in the memorandum account in Cal Water's 2015 GRC proceeding.

#### Selma Groundwater Surcharges

In January 2014, Cal Water and the City of Selma jointly filed an application to apply groundwater surcharges to customers in the Selma District via a line item on customers' bills. The surcharges will be used by the City of Selma and the Consolidated Irrigation District for groundwater recharge projects in the Upper Kings River Basin, which is in overdraft. The ORA submitted testimony opposing the application. Under the application, groundwater surcharges were to be phased in over 8 years to eventually collect approximately \$0.8 million a year. Under an all-party settlement filed on November 21, 2014, Cal Water will report on the progress of the recharge projects in future rate cases, and groundwater surcharges will be phased in over 8 years to eventually collect approximately \$0.6 million a year. The Commission is reviewing the proposed settlement, and will likely issue a proposed decision approving, modifying, or rejecting the settlement in the first quarter of 2015.

#### Asbestos Memorandum Account Application

On September 3, 2014, Cal Water filed an application with the CPUC requesting an asbestos litigation memorandum account to record costs associated with current and future asbestos lawsuits against Cal Water. Cal Water and the ORA engaged in mediation and reached a settlement. Cal Water and the ORA filed a joint motion for approval of the settlement with the CPUC on February 6, 2015.

#### WRAM/MCBA filings

In March 2014, Cal Water filed three advice letters totaling \$34.9 million to true up the revenue under-collections in the 2013 annual WRAM/MCBA regulated districts. The under- collection is being recovered from customers in the form of 12, 18 or 20+ month surcharges.

#### Expense Offset filings

Expense offsets are dollar-for-dollar increases in revenue to match increased expenses, and therefore do not affect net operating income. In July 2014, Cal Water filed advice letters to offset increased purchased water and pump taxes in six of its regulated districts totaling \$6.6 million.

#### Escalation Increase filings

As a part of the decision of the 2012 GRC, Cal Water was authorized to file annual escalation rate increases for 2015 and 2016. In November 2014, Cal Water filed for escalation rate increases in 16 districts. The annual gross revenue associated with these increases was \$4.8 million. New rates were effective January 2, 2015.

#### Ratebase Offset filings

For construction projects that are authorized in GRCs as advice letter projects, companies are allowed to file rate base offsets to increase revenues after the plant is placed into service. Cal Water did not file any Ratebase offsets in 2014.

### **Regulatory Activity Other States**

#### 2014 Kona (Hawaii) GRC Filing

In August 2014, Hawaii Water filed a GRC for Kona water and wastewater requesting \$3.3 million. Hawaii Water is currently working with the Consumer Advocate to reach a settlement on this filing.



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#### 2014 Washington Water GRC Filing

On August 14, 2014, Washington Water filed a GRC requesting \$1.5 million. On January 15, 2015, the Washington Public Utilities Commission approved the rate case authorizing annual revenue increase of \$1.7 million, in part due to updated information. New rates were effective February 1, 2015.

#### 2012 Waikoloa (Hawaii) GRC Filings

In August 2012, Hawaii Water filed GRCs for the Waikoloa Village Water, Waikoloa Village Wastewater and Waikoloa Resort Utilities requesting \$6.3 million in additional annual revenues. The cases were being processed on separate schedules. Hawaii Water and the Consumer Advocate reached settlements on the rate filings for Waikoloa Village Water, Wastewater, and Resort Utilities which would increase annual revenues by \$2.7 million if adopted by the Hawaii Public Utilities Commission. On July 23, 2014, the Hawaii Public Utilities Commission approved Waikoloa Resort Utilities, Inc. GRC authorizing revenue increases of \$2.0 million, phased in over two years.

#### 2011 Pukalani (Hawaii) GRC Filing

In August 2011, Hawaii Water filed a GRC for Pukalani. On January 15, 2014, Hawaii Water received a Decision and Order for the GRC for the Pukalani wastewater system approving \$0.59 million in additional annual revenues. This decision approved an increase of \$0.28 million in 2014, another increase of \$0.15 million in 2015, and another increase of \$0.15 million in 2016. Increases are anticipated to go into effect annually in February.

### **Water Supply**

Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of their supply from wholesale suppliers; and other districts obtain supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. To the best of management's knowledge, we are meeting water quality, environmental, and other regulatory standards for all company-owned systems.

Historically, approximately 48% of our annual water supply is pumped from wells. State groundwater management agencies operate differently in each state. Some of our wells extract ground water from water basins under state ordinances. These are adjudicated groundwater basins, in which a court has settled the dispute between landowners or other parties over how much annual groundwater can be extracted by each party. All of our adjudicated groundwater basins are located in the State of California. Our annual groundwater extraction from adjudicated groundwater basins approximates 6,500 million gallons or 11% of our total annual water supply pumped from wells. Historically, we have extracted less than 100% of our annual adjudicated groundwater rights and have the right to carry forward up to 20% of the unused amount to the next annual period. All of our remaining wells extract ground water from managed or unmanaged water basins. There are no set limits for the ground water extracted from these water basins; however, the state or local water management agencies have the authority to regulate the groundwater extraction quantity whenever there are unforeseen large decreases to water basin levels. Our annual groundwater extraction from managed groundwater basins approximates 35,600 million gallons or 61% of our total annual water supply pumped from wells. Our annual groundwater extraction from unmanaged groundwater basins approximates 16,100 million gallons or 28% of our total annual water supply pumped from wells. Most of the managed groundwater basins we extract water from have groundwater recharge facilities. We are required to pay well pump taxes to financially support these groundwater recharge facilities. Our well pump taxes for the twelve months ending December 31, 2014 and 2013 was 12.9 million and 10.8 million, respectively. In 2014, the State of California enacted the Sustainable Groundwater Management Act of 2014. The law and its implementing regulations will require most basins to select a

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sustainability agency by 2017, develop a sustainability plan by 2022, and show progress toward sustainability by 2027. We expect that in the future, groundwater will be produced mainly from managed and adjudicated basins.

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington Water service areas receive precipitation in all seasons, with the heaviest amounts during the winter. New Mexico Water's rainfall is heaviest in the summer monsoon season. Hawaii Water receives precipitation throughout the year, with the largest amounts in the winter months. Water usage in all service areas is highest during the warm and dry summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water aquifers and fill reservoirs, providing the water supply for subsequent delivery to customers. As of January 31, 2015, the State of California snowpack water content during the 2014-2015 water year is 25% of normal (per the California Department of Water Resources, Northern Sierra Precipitation Accumulation report). Precipitation in California during 2014 was below normal. Management believes that supply pumped from underground aquifers and purchased from wholesale suppliers will be adequate to meet customer demand during 2015 and beyond. However, water rationing may be required in future periods, if declared by the state or local jurisdictions. Long-term water supply plans are developed for each of our districts to help assure an adequate water supply under various operating and supply conditions. Some districts have unique challenges in meeting water quality standards, but management believes that supplies will meet current standards using current treatment processes.

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The following table shows the estimated quantity of water purchased and the percentage of purchased water to total water production in each California operating district that purchased water in 2014. Other than noted below, all other districts receive 100% of their water supply from wells.

District	Water Purchased (MG)	Percentage of Total Water Production	Source of Purchased Supply
<b>SAN FRANCISCO BAY AREA</b>			
Bayshore	6,994	95%	San Francisco Public Utilities Commission
Bear Gulch	4,295	100%	San Francisco Public Utilities Commission
Los Altos	2,239	52%	Santa Clara Valley Water District
Livermore	1,775	66%	Alameda County Flood Control and Water Conservation District, Zone 7
<b>SACRAMENTO VALLEY</b>			
Oroville	650	75%	Pacific Gas and Electric Co. and County of Butte
<b>NORTH COAST</b>			
Redwood Valley	80	72%	Yolo County Flood Control & Water Conservation District
<b>SAN JOAQUIN VALLEY</b>			
Bakersfield	8,476	36%	Kern County Water Agency and City of Bakersfield
Stockton	6,131	74%	Stockton East Water District
<b>LOS ANGELES AREA</b>			
East Los Angeles	3,384	65%	Central Basin Municipal Water District
Dominguez	11,481	85%	West Basin Municipal Water District and City of Torrance
City of Commerce	122	16%	Central Basin Municipal Water District
Hawthorne	883	57%	West Basin Municipal Water District
Hermosa Redondo	3,401	84%	West Basin Municipal Water District
Palos Verdes	6,888	100%	West Basin Municipal Water District
Westlake	2,861	100%	Calleguas Municipal Water District
Antelope/Kern	161	29%	Antelope Valley-East Kern Water Agency and City of Bakersfield

MG = million gallons

The Oroville and Redwood Valley districts in the Sacramento Valley and the Bakersfield and Kern River Valley districts in the San Joaquin Valley purchase water from a surface supply. Surface sources are processed through our water treatment plants before being delivered to the distribution system. The Bakersfield district also purchases treated water as a component of its water supply.

The Chico, Marysville, Dixon, and Willows districts in the Sacramento Valley, the Salinas and King City districts in the Salinas Valley, and the Selma and Visalia districts in the San Joaquin Valley obtain their entire supply from wells. In the Salinas district, which solely depends upon ground water, several wells were taken out of service in the last four years, primarily due to poor water quality. Treatment systems have been installed on some of these wells to meet customer demand. Management believes water supply issues in the Salinas district will be adequately resolved in the future by seeking additional sources or additional treatment.

Purchases for the Los Altos, Livermore, Oroville, Redwood Valley, Stockton, and Bakersfield districts are pursuant to long-term contracts expiring on various dates after 2014. The water supplies purchased for

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the Dominguez, East Los Angeles, Hermosa Redondo, Palos Verdes, and Westlake districts as well as the Hawthorne and Commerce systems are provided by public agencies pursuant to a statutory obligation of continued non-preferential service to purveyors within the agencies' boundaries. Purchases for the Bayshore and Bear Gulch districts are in accordance with long-term contracts with the San Francisco Public Utilities Commission (SFPUC) until June 30, 2034.

Management anticipates water supply contracts will be renewed as they expire though the price of wholesale water purchases is subject to pricing changes imposed by the various wholesalers.

Shown below are wholesaler price rates and increases that became effective in 2014 and estimated wholesaler price rates and percent changes for 2015. In 2014, several districts experienced significant purchased water cost increases resulting in a significant impact in the 2014 MCBA balance and the filing of several purchased water offsets.

District	Effective Month	2014 Unit Cost	Percent Change	Effective Month	2015 Unit Cost	Percent Change
Antelope	January	\$ 375.00 /af	7.45%	January	\$ 451.00 /af	20.27%
Bakersfield(1)	July	\$ 143.00 /af	0.70%	July	\$ 143.00 /af	0.00%
Bear Gulch	July	\$ 2.93 /ccf	19.59%	July	\$ 2.93 /ccf	0.00%
Commerce(2)	July	\$ 1,029.00 /af	4.26%	January	\$ 1,062.00 /af	3.21%
Dominguez(2)	July	\$ 1,171.00 /af	5.88%	January	\$ 1,204.00 /af	2.82%
East Los Angeles(2)	July	\$ 1,029.00 /af	4.26%	January	\$ 1,062.00 /af	3.21%
Hawthorne(2)	July	\$ 1,171.00 /af	5.88%	January	\$ 1,204.00 /af	2.82%
Hermosa Redondo(2)	July	\$ 1,171.00 /af	5.88%	January	\$ 1,204.00 /af	2.82%
Livermore	January	\$ 2.23 /ccf	2.76%	January	\$ 2.29 /ccf	2.69%
Los Altos	July	\$ 847.00 /af	8.59%	July	\$ 847.00 /af	0.00%
Oroville(2)	May	\$ 168,060.00 /yr	0.79%	April	\$ 168,060.00 /yr	0.00%
Palos Verdes(2)	July	\$ 1,171.00 /af	5.88%	January	\$ 1,204.00 /af	2.82%
Mid-Peninsula	July	\$ 2.93 /ccf	19.59%	July	\$ 2.93 /ccf	0.00%
Redwood Valley	January	\$ 59.85 /af	5.00%	January	\$ 59.85 /af	0.00%
So. San Francisco	July	\$ 2.93 /ccf	19.59%	July	\$ 2.93 /ccf	0.00%
Stockton	April	\$ 730,218.00/ mo	1.08%	April	\$ 730,218.00/mo	0.00%
Westlake	January	\$ 1,173.00 /af	4.83%	January	\$ 1,210.00 /af	3.15%

af = acre foot;

ccf = hundred cubic feet;

yr = fixed annual cost;

mo = fixed monthly cost

(1) untreated water

(2) wholesaler price changes occur every six months

We work with all local suppliers and agencies responsible for water supply to insure adequate, long-term supply for each system.

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations Water Supply" concerning more information on adequacy of supplies.

### **Seasonal Fluctuations**

In California, our customers' consumption pattern of water varies with the weather, in terms of rainfall and temperature. In the WRAM and MCBA design, the CPUC considers the historical pattern in



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determining the adopted sales and production costs. With a majority of our sales being subject to the WRAM and production costs being covered by the MCBA, variations from the adopted pattern have been minimized. However, cash flows from operations and short-term borrowings on our credit facilities are significantly impacted by seasonal fluctuations including recovery of the WRAM and MCBA.

Our water business is seasonal in nature. Weather conditions can have a material effect on customer usage. Customer demand for water generally is lower during the cooler and rainy, winter months. Demand increases in the spring when warmer weather returns and the rains end, and customer use more water for outdoor purposes, such as landscape irrigation. Warm temperatures during the generally dry summer months result in increased demand. Water usage declines during the fall as temperatures decrease and the rainy season begins. During years in which precipitation is especially heavy or extends beyond the spring into the early summer, customer demand can decrease from historic normal levels, generally due to reduced outdoor water usage. Likewise, an early start to the rainy season during the fall can cause a decline in customer usage. As a result, seasonality of water usage has a significant impact on our cash flows from operations and borrowing on our short-term facilities.

**Utility Plant Construction**

We have continually extended, enlarged, and replaced our facilities as required to meet increasing demands and to maintain the water systems. We obtain construction financing using funds from operations, short-term bank borrowings, long-term financing, advances for construction and contributions in aid of construction that are funded by developers. Advances for construction are cash deposits from developers for construction of water facilities or water facilities deeded from developers. These advances are generally refundable without interest over a period of 40 years in equal annual payment amounts. Contributions in aid of construction consist of nonrefundable cash deposits or facilities transferred from developers, primarily for fire protection and relocation projects. We cannot control the amounts received from developers. This amount fluctuates from year-to-year as the level of construction activity carried on by developers varies. This activity is impacted by the demand for housing, commercial development, and general business conditions, including interest rates.

See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for additional information.

**Sale of Surplus Real Properties**

When properties are no longer used and useful for public utility purposes, we are no longer allowed to earn a return on our investment in the property in the regulated business. The surplus property is transferred out of the regulated operations. From time to time, some properties have been sold or offered for sale. As these sales are subject to local real estate market conditions and can take several months or years to close, income from the sale of surplus properties may or may not be consistent from year-to-year.

**Energy Reliability**

We continue to use power efficiently to minimize the power expenses passed on to our customers, and maintain backup power systems to continue water service to our customers if the power companies' supplies are interrupted. Many of our well sites are equipped with emergency electric generators designed to produce electricity to keep the wells operating during power outages. Storage tanks also provide customers with water during blackout periods.

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**Impact of Climate Change Legislation**

Our operations depend on power provided by other public utilities and, in emergencies, power generated by our portable and fixed generators. If future legislation limits emissions from the power generation process, our cost of power may increase. Any increase in the cost of power will be passed along to our California rate payers through the MCBA or included in our cost of service paid by our rate payers as requested in our general rate case filings.

Approved in April 2009, the Low Carbon Fuel Standard Program, which went into effect January 1, 2011, requires diesel engines to use low carbon fuel such as biodiesel or other alternatives. This may increase the operating cost of our generators and vehicles.

We maintain a fleet of vehicles to provide service to our customers, including a number of heavy duty diesel vehicles that were retrofitted to meet California emission standards. If future legislation further impacts the cost to operate the fleet or the fleet acquisition cost in order to meet certain emission standards, it will increase our cost of service and our rate base. Any increase in fleet operating costs associated with meeting emission standards will be included in our cost of service paid by our rate payers as requested in our general rate case filings. While recovery of these costs is not guaranteed, we would expect recovery in the regulatory process.

Under the California Environmental Quality Act (CEQA), all capital projects of a certain type (primarily wells, tanks, major pipelines and treatment facilities) require mitigation of green house gas emissions. The cost to prepare the CEQA documentation and permit is estimated to add tens of thousands of dollars to such capital projects. This cost will be included in our capital cost and added to our rate base, which will be requested to be paid for by our rate payers. Any increase in the operating cost of the facilities will also be included in our cost of service paid by our rate payers as requested in our general rate case filings. While recovery of these costs is not guaranteed, we would expect recovery in the regulatory process.

Cap and trade regulations were implemented in 2012 with the goal of reducing emissions to 1990 levels by the year 2020. These regulations have not impacted water utilities at this time. In the future, if we are required to comply with these regulations, any increase in operating costs associated with meeting these standards will be included in our cost of service paid by our rate payers as requested in our general rate case filings. While recovery of these costs is not guaranteed, we would expect recovery in the regulatory process.

**Security at Company Facilities**

Due to terrorism and other risks, we have heightened security at our facilities and have taken added precautions to protect our employees and the water delivered to customers. In 2002, federal legislation was enacted that resulted in new regulations concerning security of water facilities, including submitting vulnerability assessment studies to the federal government. We have complied with regulations issued by the Environmental Protection Agency (EPA) pursuant to our federal legislation concerning vulnerability assessments and have made filings to the EPA as required. In addition, communication plans have been developed as a component of our procedures. While we do not make public comments on our security programs, we have been in contact with federal, state, and local law enforcement agencies to coordinate and improve our water delivery systems' security.

**Quality of Water Supply**

Our operating practices are designed to produce potable water in accordance with accepted water utility practices. Water entering the distribution systems from surface sources is treated in compliance with federal and state Safe Drinking Water Act (SDWA) standards. Most well supplies are chlorinated or chloraminated for disinfection. Water samples from each water system are analyzed on a regular, scheduled basis in compliance with regulatory requirements. We operate a state-certified water quality

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laboratory at the San Jose General Office that provides testing for most of our California operations. Certain tests in California are contracted with independent certified labs qualified under the Environmental Laboratory Accreditation Program. Local independent state certified labs provide water sample testing for the Washington, New Mexico and Hawaii operations.

In recent years, federal and state water quality regulations have resulted in increased water sampling requirements. The SDWA continues to be amended to address public health concerns. We monitor water quality standard changes and upgrade our treatment capabilities to maintain compliance with the various regulations.

**Competition and Condemnation**

Our principal operations are regulated by the Commission of each state. Under state laws, no privately owned public utility may compete within any service territory that we already serve without first obtaining a certificate of public convenience and necessity from the applicable Commission. Issuance of such a certificate would only be made upon finding that our service is deficient. To management's knowledge, no application to provide service to an area served by us has been made.

State law provides that whenever a public agency constructs facilities to extend a utility system into the service area of a privately owned public utility, such an act constitutes the taking of property and requires reimbursement to the utility for its loss. State statutes allow municipalities, water districts and other public agencies to own and operate water systems. These agencies are empowered to condemn properties already operated by privately owned public utilities. The agencies are also authorized to issue bonds, including revenue bonds, for the purpose of acquiring or constructing water systems. However, if a public agency were to acquire utility property by eminent domain action, the utility would be entitled to just compensation for its loss. In Washington, annexation was approved in February 2008 for property served by us on Orcas Island; however, we continue to serve the customers in the annexed area and do not expect the annexation to impact our operations. To management's knowledge, other than the Orcas Island property, no municipality, water district, or other public agency is contemplating or has any action pending to acquire or condemn any of our systems. We intend to continue the pursuit of opportunities to expand our business in the western United States, which may include expansion through acquisitions or mergers with other companies.

**Environmental Matters**

Our operations are subject to environmental regulation by various governmental authorities. Environmental health and safety programs have been designed to provide compliance with water discharge regulations, underground and aboveground fuel storage tank regulations, hazardous materials management plans, hazardous waste regulations, air quality permitting requirements, wastewater discharge limitations and employee safety issues related to hazardous materials. Also, we actively investigate alternative technologies for meeting environmental regulations and continue the traditional practices of meeting environmental regulations.

For a description of the material effects that compliance with environmental regulations may have on us, see Item 1A. "Risk Factors Risks Related to Our Regulatory Environment." We expect environmental regulation to increase, resulting in higher operating costs in the future, which may have a material adverse effect on earnings.

**Employees**

At December 31, 2014, we had 1,105 employees, including 55 at Washington Water, 44 at Hawaii Water, and 14 at New Mexico Water. In California, most non-supervisory employees are represented by the Utility Workers Union of America, AFL-CIO, except certain engineering and laboratory employees who are represented by the International Federation of Professional and Technical Engineers, AFL-CIO.



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At December 31, 2014, we had 708 union employees. In January 2015, we negotiated a six year contract that included 2015, 2016, and 2017 wage increases with both of our unions of 3.25% and 2.75%, and 2.75%, respectively. Annual wage increases for 2018, 2019, and 2020 are estimated to be in the range from 2.5% to 3.25%. The wage changes will fluctuate with the changes to the Consumer Price Index (CPI) for the Los Angeles area. In the event an annual wage increase is determined to be greater than 3.25% or less than 2.0%, either party may request to re-open negotiations for wages only. Such notice must be served on the other party no later than 60 days after the publication of such CPI data. The current agreement with the unions is effective through 2020. Management believes that it maintains good relationships with the unions.

Employees at Washington Water, New Mexico Water, and Hawaii Water are not represented by unions.

### **Executive Officers of the Registrant**

<b>Name</b>	<b>Positions and Offices with California Water Service Group</b>	<b>Age</b>
Martin A. Kropelnicki(1)	President and Chief Executive Officer since September 1, 2013. Formerly, President and Chief Operating Officer (2012-2013), Chief Financial Officer and Treasurer (2006-2012), served as Chief Financial Officer of Power Light Corporation (2005-2006), Chief Financial Officer and Executive Vice President of Corporate Services of Hall Kinion and Associates (1997-2004), Deloitte & Touche Consulting (1996-1997), held various positions with Pacific Gas & Electric (1989-1996).	48
Thomas F. Smegal III(2)	Vice President, Chief Financial Officer and Treasurer since October 1, 2012. Formerly, Vice President, Regulatory Matters and Corporate Relations (2008-2012), Manager of Rates (2002-2008), Regulatory Analyst (1997-2002), served as Utilities Engineer at the California Public Utilities Commission (1990-1997).	47
Francis S. Ferraro(2)	Vice President of Corporate Development and Legal since October 1, 2005. Formerly, Vice President of Regulatory Affairs and Corporate Communications (1989-2005), held various positions with the California Public Utilities Commission, including Administrative Law Judge, project manager on major energy and water rate proceedings, and Manager of the Energy Rate Design and Economics Branch (1973-1989).	65

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Name	Positions and Offices with California Water Service Group	Age
Paul G. Townsley(2)	Vice President of Regulatory Matters and Corporate Relations effective in March 2013. Formerly Divisional Vice President, Operations and Engineering for EPCOR Water USA (2012-2013), served as President of American Water Works Company subsidiaries in Arizona, New Mexico, and Hawaii (2007-2012), served as American Water Works Company's President, Western Region (2002-2007), held various other positions with Citizens Utilities Company (1982-2002).	57
Michael B. Luu(2)	Vice President of Customer Service and Information Technology since August 1, 2013. Formerly Acting California Water Service Company District Manager, Los Altos (2012-2013), Director of Information Technology (2008-2012), CIS Development Manager (2005-2008), held various other positions with California Water Service Company since 1999.	35
Michael J. Rossi(2)	Vice President of Continuous Improvement since July 1, 2013. Formerly Vice President, Engineering and Water Quality (2005-2013) Chief Engineer (1997-2005), Assistant Chief Engineer (1988-1997), held various other positions with California Water Service Company since 1977.	61
Timothy D. Treloar(2)	Vice President of Operations since August 1, 2013. Formerly Director of Water Quality (2013), California Water Service Company District Manager, Bakersfield (2002-2013), Assistant District Manager (1997-2002), General Superintendent (1994-1997).	57
Ronald D. Webb(2)	Vice President of Human Resources since August 11, 2014. Formerly Managing Director, Human Resources Partner for United Airlines (2006-2014), served as Vice President of Human Resources for Black & Decker Corporation (1995-2005), Human Resource Manager for General Electric Company (1990-1994), and held various labor relations positions for National Steel and Shipbuilding Company (1982-1989).	58

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<b>Name</b>	<b>Positions and Offices with California Water Service Group</b>	<b>Age</b>
Lynne P. McGhee(2)	Vice President and General Counsel since January 1, 2015. Formerly Corporate Secretary (2007-2014), Associate Corporate Counsel (2003-2014), and served as a Commissioner legal advisor and staff counsel at the California Public Utilities Commission (1998-2003).	50
David B. Healey(2)	Vice President, Corporate Controller and Assistant Treasurer since January 1, 2015. Formerly Corporate Controller and Assistant Treasurer (2012-2014), Director of Financial Reporting (2009-2012), served as Subsidiary Controller for SunPower Corporation (2005-2009), Corporate Controller for Hall, Kinion & Associates, Inc. (1997-2005), held various other positions with Pacific Gas & Electric Company (1985-1997).	58
Shannon C. Dean(2)	Vice President of Corporate Communications & Community Affairs since January 1, 2015. Formerly Director of Corporate Communications (2000-2014), held various corporate communications, government and community relations for Dominguez Water Company (1991-1999).	47
Michelle R. Mortensen(2)	Corporate Secretary since January 1, 2015. Formerly Assistant Corporate Secretary (2014), Treasury Manager (2012-2013), Assistant to the Chief Financial Officer (2011), Regulatory Accounting Manager (2008-2010), held various accounting positions at Piller Data Systems (2006-2007), Hitachi Global Storage (2005), Abbot Laboratories (1998-2004), and Symantec (1998-2001).	40

- (1) Holds the same position with California Water Service Company, CWS Utility Services, Hawaii Water Service Co., Inc., and New Mexico Water Service Company; Chief Executive Officer of Washington Water Service Company.
- (2) Holds the same position with California Water Service Company, CWS Utility Services, Hawaii Water Service Company, Inc., New Mexico Water Service Company, and Washington Water Service Company.

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**Item 1A. Risk Factors.**

If any of the following risks actually occur, our financial condition and results of operations could be materially and adversely affected.

**Risks Related to Our Regulatory Environment**

*Our business is heavily regulated by state and federal regulatory agencies and our financial viability depends upon our ability to recover costs from our customers through rates that must be approved by state public utility commissions.*

California Water Service Company, New Mexico Water Service Company, Washington Water Service Company and Hawaii Water Service Company, Inc., are regulated public utilities which provide water and water related service to our customers. The rates that we charge our water customers are subject to the jurisdiction of the regulatory commissions in the states in which we operate. These Commissions may set water and water related rates for each operating district independently because the systems are not interconnected. The Commissions authorize us to charge rates which they consider to be sufficient to recover normal operating expenses, to provide funds for adding new or replacing water infrastructure, and to allow us to earn what the Commissions consider to be a fair and reasonable return on invested capital.

Our revenues and consequently our ability to meet our financial objectives are dependent upon the rates we are authorized to charge our customers by the commissions and our ability to recover our costs in these rates. Our management uses forecasts, models and estimates in order to set rates that will provide a fair and reasonable return on our invested capital. While our rates must be approved by the commissions, no assurance can be given that our forecasts, models and estimates will be correct or that the commissions will agree with our forecasts, models and estimates. If our rates are set too low, our revenues may be insufficient to cover our operating expenses, capital expenditure requirements and desired dividend levels.

We periodically file rate increase applications with the commissions. The ensuing administrative and hearing process may be lengthy and costly. The decisions of the commissions are beyond our control and we can provide no assurances that our rate increase requests will be granted by the commissions. Even if approved, there is no guarantee that approval will be given in a timely manner or at a sufficient level to cover our expenses and provide a reasonable return on our investment. If the rate increase decisions are delayed, our earnings may be adversely affected.

*Our evaluation of the probability of recovery of regulatory assets is subject to adjustment by regulatory agencies and any such adjustment could adversely affect our results of operations.*

Regulatory decisions may also impact prospective revenues and earnings, affect the timing of the recognition of revenues and expenses and may overturn past decisions used in determining our revenues and expenses. Our 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. Current accounting procedures allow us to defer certain costs if we believe it is probable that we will be allowed to recover those costs by future rate increases. If a commission determined that a portion of our assets were not recoverable in customer rates, we may suffer an asset impairment which would require a write down in such asset's valuation which would be recorded through operations.

If our assessment as to the probability of recovery through the ratemaking process is incorrect, the associated regulatory asset or liability would be adjusted to reflect the change in our assessment or any regulatory disallowances. A change in our evaluation of the probability of recovery of regulatory assets or a regulatory disallowance of all or a portion of our cost could have a material adverse effect on our financial results.

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***Regulatory agencies may disagree with our valuation and characterization of certain of our assets.***

If we determine that assets are no longer used or useful for utility operations, we may remove them from our rate base and subsequently sell those assets. If the commission disagrees with our characterization, we could be subjected to penalties. Furthermore, there is a risk that the commission could determine that appreciation in property value should be awarded to the ratepayers rather than our stockholders.

***Changes in laws, rules and policies of regulatory agencies can significantly affect our business.***

Regulatory agencies may change their rules and policies for various reasons, including changes in the local political environment. In some states, regulators are elected by popular vote or are appointed by elected officials, and the results of elections may change the long-established rules and policies of an agency dramatically. For example, in 2001 regulation regarding recovery of increases in electrical rates changed in California. For over 20 years prior to 2001, the CPUC allowed recovery of electric rate increases under its operating rules. However, in 2003, the CPUC reinstated its policy to allow utilities to adjust their rates for rate changes by the power companies. The original decision by the commission to change its policy, as well as its subsequent decision to reinstate that policy, affected our business.

We rely on policies and regulations promulgated by the various state commissions in order to recover capital expenditures, maintain favorable treatment on gains from the sale of real property, offset certain production and operating costs, recover the cost of debt, maintain an optimal equity structure without over-leveraging, and have financial and operational flexibility to engage in non-regulated operations. If any of the commissions with jurisdiction over us implements policies and regulations that do not allow us to accomplish some or all of the items listed above, our future operating results may be adversely affected.

In addition, legislatures may repeal, relax or tighten existing laws, or enact new laws that impact the regulatory agencies with jurisdiction over our business or affect our business directly. If changes in existing laws or the implementation of new laws limit our ability to accomplish some or all of our business objectives, our future operating results may be adversely affected.

***We expect environmental regulation to increase, resulting in higher operating costs in the future.***

Our water and wastewater services are governed by various federal and state environmental protection, health and safety laws, and regulations. These provisions establish criteria for drinking water and for discharges of water, wastewater and airborne substances. The Environmental Protection Agency promulgates numerous nationally applicable standards, including maximum contaminant levels (MCLs) for drinking water. We believe we are currently in compliance with all of the MCLs promulgated to date but we can give no assurance that we will continue to comply with all water quality requirements. If we violate any federal or state regulations or laws governing health and safety, we could be subject to substantial fines or otherwise sanctioned.

Environmental laws are complex and change frequently. They tend to become more stringent over time. As new or stricter standards are introduced, they could increase our operating costs. Although we would likely seek permission to recover these costs through rate increases, we can give no assurance that the commissions would approve rate increases to enable us to recover these additional compliance costs.

We are required to test our water quality for certain chemicals and potential contaminants on a regular basis. If the test results indicate that we exceed allowable limits, we may be required either to commence treatment to remove the contaminant or to develop an alternate water source. Either of these results may be costly, and there can be no assurance that the commissions would approve rate increases to enable us to recover these additional compliance costs.

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***New and more stringent water quality regulations could increase our operating costs.***

We are subject to water quality standards set by federal, state and local authorities that have the power to issue new regulations. Compliance with new regulations that are more stringent than current regulations could increase our operating costs.

On July 1, 2014, the California Department of Public Health (CDPH) changed the water quality standard for chromium-6 in our water supply. The new standard requires us to have 10 parts per billion or less of chromium-6 in our California water supply. We have two districts where every well does not comply with the new standard. The new standard is expected to restrict water supply significantly increase capital spending and operation expenses in the impacted districts. The commission authorized a memorandum account in 2014 to track all costs associated with compliance with the new chromium-6 standard. Although we would likely seek permission to recover additional costs of compliance through rate increases, we can give no assurance that the CPUC would approve rate increases to enable us to recover these additional compliance costs.

***Legislation regarding climate change may impact our operations.***

Future legislation regarding climate change may restrict our operations or impose new costs on our business. Our operations depend on power provided by other public utilities and, in emergencies, power generated by our portable and fixed generators. If future legislation limits emissions from the power generation process, our cost of power may increase. Any increase in the cost of power will be passed along to our California rate payers through the MCBA or included in our cost of service paid by our rate payers as requested in our general rate case filings. While recovery of these costs is not guaranteed, we would expect recovery in the regulatory process.

The Low Carbon Fuel Standard Program, which went into effect January 1, 2011, requires diesel engines to use low carbon fuel such as biodiesel or other alternatives. This may increase the operating cost of our generators and vehicles.

We maintain a fleet of vehicles to provide service to our customers, including a number of heavy duty diesel vehicles that we retrofitted prior to the end of 2010 to meet California emission standards. If future legislation further impacts the cost to operate the fleet or the fleet acquisition cost in order to meet certain emission standards, it will increase our cost of service and our rate base. Any increase in fleet operating costs associated with meeting emission standards will be included in our cost of service paid by our rate payers as requested in our general rate case filings. While recovery of these costs is not guaranteed, we would expect recovery in the regulatory process.

Starting January 1, 2010, under the California Environmental Quality Act (CEQA), all capital projects of a certain type (primarily wells, tanks, major pipelines and treatment facilities) will require mitigation of green house gas emissions. The cost to prepare the CEQA documentation and permit will add an estimated ten thousand dollars to such capital projects. This cost will be included in our capital cost and added to our rate base, which will be requested to be paid for by our rate payers. Any increase in the operating cost of the facilities will also be included in our cost of service paid by our rate payers as requested in our general rate case filings. While recovery of these costs is not guaranteed, we would expect recovery in the regulatory process.

Cap and trade regulations were implemented in 2012 with the goal of reducing emissions to 1990 levels by the year 2020. While recovery of these costs is not guaranteed, we would expect recovery in the regulatory process.

***We are party to a toxic contamination lawsuit which could result in our paying damages not covered by insurance.***

We have been and may be in the future, party to water contamination lawsuits, which may not be fully covered by insurance.

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The number of environmental and product-related lawsuits against other water utilities have increased in frequency in recent years. If we are subject to additional environmental or product-related lawsuits, we might incur significant legal costs and it is uncertain whether we would be able to recover the legal costs from ratepayers or other third parties. In addition, if current California law regarding California Public Utilities Commission's preemptive jurisdiction over regulated public utilities for claims about compliance with California Department of Health Services and United States Environmental Protection Agency water quality standards changes, our legal exposure may be significantly increased.

**Risks Related to Our Business Operations**

***Wastewater operations entail significant risks.***

While wastewater collection and treatment is not presently a major component of our revenues, wastewater collection and treatment involve many risks associated with damage to the surrounding environment. If collection or treatment systems fail or do not operate properly, untreated or partially treated wastewater could discharge onto property or into nearby streams and rivers, causing property damage or injury to aquatic life, or even human life. Liabilities resulting from such damage could materially and adversely affect our results of operations and financial condition.

***Demand for our water is subject to various factors and is affected by seasonal fluctuations.***

Demand for our water during the warmer, dry months is generally greater than during cooler or rainy months due primarily to additional requirements for water in connection with irrigation systems, swimming pools, cooling systems and other outside water use. Throughout the year, and particularly during typically warmer months, demand will vary with temperature and rainfall levels. If temperatures during the typically warmer months are cooler than normal, or if there is more rainfall than normal, the demand for our water may decrease. Under the WRAM mechanism, lower water usage in our California operations impacts our cash flows in the year of usage, but results in higher cash flows in the following years.

In addition, governmental restrictions on water usage during drought conditions may result in a decreased demand for our water, even if our water reserves are sufficient to serve our customers during these drought conditions. The Commissions for our non-California operations may not allow surcharges to collect lost revenues caused by customers' conservation during the drought. Regardless of whether we may surcharge our customers during a conservation period, they may use less water even after a drought has passed because of conservation patterns developed during the drought. Furthermore, our customers may wish to use recycled water as a substitute for potable water. If rights are granted to others to serve our customers recycled water, there will likely be a decrease in demand for our water.

Finally, changes in prevailing weather patterns due to climate change may affect customer demand. If increased ambient temperatures affect our service areas, water used for irrigation and cooling may increase. If rainfall patterns change, our customers may change their patterns of water use including the amount of outdoor irrigation and the type of landscape they install. Government agencies may also mandate changes to customer irrigation or landscape patterns in response to changes in weather and climate.

***The adequacy of our water supplies depends upon a variety of factors beyond our control. Interruption in the water supply may adversely affect our earnings.***

We depend on an adequate water supply to meet the present and future needs of our customers. Whether we have an adequate supply varies depending upon a variety of factors, many of which are partially or completely beyond our control, including:

the amount of rainfall;

the amount of water stored in reservoirs;

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underground water supply from which well water is pumped;

availability from water wholesalers;

changes in the amount of water used by our customers;

water quality;

legal limitations on water use such as rationing restrictions during a drought;

changes in prevailing weather patterns and climate; and

population growth.

We purchase our water supply from various governmental agencies and others. Water supply availability may be affected by weather conditions, funding and other political and environmental considerations. In addition, our ability to use surface water is subject to regulations regarding water quality and volume limitations. If new regulations are imposed or existing regulations are changed or given new interpretations, the availability of surface water may be materially reduced. A reduction in surface water could result in the need to procure more costly water from other sources, thereby increasing our water production costs and adversely affecting our operating results.

There is strong scientific consensus that human activity including carbon emissions is changing the chemical and thermodynamic characteristics of the atmosphere and the earth's overall climate. Because scientific efforts have been global in nature, and because climate modeling has not yet been predictive on a local scale, there is tremendous uncertainty over the timing, extent, and types of impacts global climate change may have in our service areas. In addition, studies of tree ring data show long periods of drought conditions have occurred in the historical record in California but prior to our operation. Thus, we include potential climate change risks in our water supply planning activities. We also periodically review the climate change plans of our wholesalers to determine whether alternative supplies may be necessary in the future. However, we can give no assurance that replacement water supplies will be available at a reasonable cost or a cost acceptable to our customers and Commissions.

We have entered into long-term water supply agreements, which commit us to making certain minimum payments whether or not we purchase any water. Therefore, if demand is insufficient to use our required purchases we would have to pay for water we did not receive.

From time to time, we enter into water supply agreements with third parties and our business is dependent upon such agreements in order to meet regional demand. For example, we have entered into a water supply contract with the San Francisco Public Utilities Commission that expires on June 30, 2034. We can give no assurance that the San Francisco Public Utilities Commission, or any of the other parties from whom we purchase water, will renew our contracts upon expiration, or that we will not be subject to significant price increases under any such renewed contracts.

The parties from whom we purchase water maintain significant infrastructure and systems to deliver water to us. Maintenance of these facilities is beyond our control. If these facilities are not adequately maintained or if these parties otherwise default on their obligations to supply water to us, we may not have adequate water supplies to meet our customers' needs.

If we are unable to access adequate water supplies we may be unable to satisfy all customer demand which could result in rationing. Rationing may have an adverse effect on cash flow from operations. We can make no guarantee that we will always have access to an adequate supply of water that will meet all required quality standards. Water shortages may affect us in a variety of ways. For example, shortages could:

adversely affect our supply mix by causing us to rely on more expensive purchased water;



adversely affect operating costs;

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increase the risk of contamination to our systems due to our inability to maintain sufficient pressure; and

increase capital expenditures for building 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.

We may or may not be able to recover increased operating and construction costs on a timely basis, or at all, for our regulated systems through the ratemaking process. Although we can give no assurance, we may also be able to recover certain of these costs from third parties that may be responsible, or potentially responsible, for groundwater contamination.

***Changes in water supply costs impact our operations.***

The cost to obtain water for delivery to our customers varies depending on the sources of supply, wholesale suppliers' prices, the quality of water required to be treated and the quantity of water produced to fulfill customer water demand. Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of the supply from wholesale suppliers; and other districts obtain the supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. On average, slightly more than half of the water we deliver to our customers is pumped from wells or received from a surface supply with the remainder purchased from wholesale suppliers. Water purchased from suppliers usually costs us more than surface supplied or well pumped water. The cost of purchased water for delivery to customers represented 34.5% and 35.9% of our total operating costs in 2014 and 2013, respectively.

Wholesale water suppliers may increase their prices for water delivered to us based on factors that affect their operating costs. Purchased water rate increases are beyond our control. In California, effective July 1, 2008, our ability to recover increases in the cost of purchased water changed with the adoption of the MCBA. With this change, actual purchased water costs are compared to authorized purchased water costs with variances, netted against variance in purchased power, pump tax, and metered revenue, recorded to revenue. The balance in the MCBA will be collected in the future by billing the net WRAM and MCBA accounts receivable balances over 12, 18, and up to 36 month periods, which may have a short-term negative impact on cash flow.

***Dependency upon adequate supply of electricity and certain chemicals could adversely affect our results of operations.***

Purchased electrical power is required to operate the wells and pumps needed to supply water to our customers. Although there are back-up power generators to operate a number of wells and pumps in emergencies, an extended interruption in power could impact the ability to supply water. In the past, California has been subject to rolling power blackouts due to insufficient power supplies. There is no assurance we will not be subject to power blackouts in the future. Additionally, we require sufficient amounts of certain chemicals in order to treat the water we supply. There are multiple sources for these chemicals but an extended interruption of supply could adversely affect our ability to adequately treat our water.

Purchased power is a significant operating expense. During 2014 and 2013, purchased power expense represented 6.4% and 6.3% of our total operating costs, respectively. These costs are beyond our control and can change unpredictably and substantially as occurred in California during 2001 when rates paid for electricity increased 48%. As with purchased water, purchased power costs are included in the MCBA. Cash flows between rate filings may be adversely affected until the commission authorizes a rate change but earnings will be minimally impacted. Cost of chemicals used in the delivery of water is not an element of the MCBA and therefore variances in quantity or cost could impact the results of operations.

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***Our ability to generate new operating contracts or renewal of existing operating contracts is affected by local politics.***

Our revenue and non-regulated revenue growth depends upon our ability to generate new as well as renew operating contracts with cities, other agencies and municipal utility districts. As our services are sold in a political environment, there is exposure to changing trends and municipal preferences. Terrorist acts have affected some political viewpoints relative to outsourcing of water or wastewater utility services. Municipalities own and municipal employees operate the majority of water and wastewater systems. Significant marketing and sales efforts are spent demonstrating the benefits of contract operations to elected officials and municipal authorities. The existing political environment means decisions affecting our business are based on many factors, not just economic factors.

***Our business requires significant capital expenditures that are dependent on our ability to secure appropriate funding. If we are unable to obtain sufficient capital or if the rates at which we borrow increase, there would be a negative impact on our results of operations.***

The water utility business is capital-intensive. We invest significant funds to add or replace property, plant and equipment. In addition, water shortages may adversely affect us by causing us to rely on more purchased water. This could cause increases in capital expenditures needed to build pipelines to secure alternative water sources. In addition, we require capital to grow our business through acquisitions. We fund our short-term capital requirements from cash received from operations and funds received from developers. We also borrow funds from banks under short-term bank lending arrangements. We seek to meet our long-term capital needs by raising equity through common or preferred stock issues or issuing debt obligations. We cannot give any assurance that these sources will continue to be adequate or that the cost of funds will remain at levels permitting us to earn a reasonable rate of return. In the event we are unable to obtain sufficient capital, our expansion efforts could be curtailed, which may affect our growth and may affect our future results of operations.

Our ability to access the capital markets is affected by the ratings of certain of our debt securities. Standard & Poor's Rating Agency issues a rating on California Water Service Company's ability to repay certain debt obligations. The credit rating agency could downgrade our credit rating based on reviews of our financial performance and projections or upon the occurrence of other events that could impact our business outlook. Lower ratings by the agency could restrict our ability to access equity and debt capital. We can give no assurance that the rating agency will maintain ratings which allow us to borrow under advantageous conditions and at reasonable interest rates. A future downgrade by the agency could also increase our cost of capital by causing potential investors to require a higher interest rate due to a perceived risk related to our ability to repay outstanding debt obligations.

While the majority of our debt is long term at fixed rates, we do have interest rate exposure in our short-term borrowings which have variable interest rates. We are also subject to interest rate risks on new financings. However, if interest rates were to increase on a long-term basis, our management believes that customer rates would increase accordingly, subject to approval by the appropriate commission. We can give no assurance that the commission would approve such an increase in customer rates.

We are obligated to comply with specified debt covenants under certain of our loan and debt agreements. Failure to maintain compliance with these covenants could limit future borrowing, and we could face increased borrowing costs, litigation, acceleration of maturity schedules, and cross default issues. Such actions by our creditors could have a material adverse effect on our financial condition and results of operations.

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***Our inability to access the capital or financial markets could affect our ability to meet our liquidity needs at reasonable cost and our ability to meet long-term commitments. Changes in economic conditions in our markets could affect our customers' ability to pay for water services. Any of these could adversely affect our results of operations, cash flows and financial condition.***

We rely on our current credit facilities to fund short-term liquidity needs if internal funds are not available from operations. Specifically, given the seasonal fluctuations in demand for our water we commonly draw on our credit facilities to meet our cash requirements at times in the year when demand is relatively low. We also may occasionally use letters of credit issued under our revolving credit facilities. Disruptions in the capital and credit markets could adversely affect our ability to draw on our credit facilities. Our access to funds under our credit facilities is dependent on the ability of our banks to meet their funding commitments.

Many of our customers and suppliers also have exposure to risks that could affect their ability to meet payment and supply commitments. We operate in geographic areas that may be particularly susceptible to declines in the price of real property, which could result in significant declines in demand for our products and services. In the event that any of our significant customers or suppliers, or a significant number of smaller customers and suppliers, are adversely affected by these risks, we may face disruptions in supply, significant reductions in demand for our products and services, inability of customers to pay invoices when due, and other adverse effects that could negatively affect our financial condition, results of operations and/or cash flows.

Our operations and certain contracts for water distribution and treatment depend on the financial capability of state and local governments, and other municipal entities such as water districts. Major disruptions in the financial strength or operations of such entities, such as liquidity limitations, bankruptcy or insolvency, could have an adverse effect on our ability to conduct our business and/or enforce our rights under contracts to which such entities are a party.

***We are a holding company that depends on cash flow from our subsidiaries to meet our obligations and to pay dividends on our common stock.***

As a holding company, we conduct substantially all of our operations through our subsidiaries and our only significant assets are investments in those subsidiaries. 94% of our revenues are derived from the operations of California Water Service Company. As a result, we are dependent on cash flow from our subsidiaries, and California Water Service Company in particular, to meet our obligations and to pay dividends on our common stock.

We can make dividend payments only from our surplus (the excess, if any, of our net assets over total paid-in capital) or if there is no surplus, the net profits for the current fiscal year or the fiscal year before which the dividend is declared. In addition, we can pay cash dividends only if after paying those dividends we would be able to pay our liabilities as they become due. Owners of our capital stock cannot force us to pay dividends and dividends will only be paid if and when declared by our board of directors. Our board of directors can elect at any time, and for an indefinite duration, not to declare dividends on our capital stock.

Our subsidiaries are separate and distinct legal entities and generally have no obligation to pay any amounts due on California Water Service Group's debt or to provide California Water Service Group with funds for dividends. Although there are no contractual or regulatory restrictions on the ability of our subsidiaries to transfer funds to us, the reasonableness of our capital structure is one of the factors considered by state and local regulatory agencies in their ratemaking determinations. Therefore, transfer of funds from our subsidiaries to us for the payment of our obligations or dividends may have an adverse effect on ratemaking determinations. Furthermore, our right to receive cash or other assets upon the liquidation or reorganization of a subsidiary is generally subject to the prior claims of creditors of that subsidiary. If we are unable to obtain funds from our subsidiaries in a timely manner, we may be unable to meet our obligations or pay dividends.

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***An important element of our growth strategy is the acquisition of water and wastewater systems. Risks associated with potential acquisitions, divestitures or restructurings may adversely affect us.***

We may seek to acquire or invest in other companies, technologies, services or products that complement our business. The execution of our growth strategy may expose us to different risks than those associated with our utility operations. We can give no assurance that we will succeed in finding attractive acquisition candidates or investments, or that we would be able to reach mutually agreeable terms with such parties. In addition, as consolidation becomes more prevalent in the water and wastewater industries, the prices for suitable acquisition candidates may increase to unacceptable levels and limit our ability to grow through acquisitions. If we are unable to find acquisition candidates or investments, our ability to grow may be limited.

Acquisition and investment transactions may result in the issuance of our equity securities that could be dilutive if the acquisition or business opportunity does not develop in accordance with our business plan. They may also result in significant write-offs and an increase in our debt. The occurrence of any of these events could have a material adverse effect on our business, financial condition and results of operations.

Any of these transactions could involve numerous additional risks, including one or more of the following:

problems integrating the acquired operations, personnel, technologies or products with our existing businesses and products;

liabilities inherited from the acquired companies' prior business operations;

diversion of management time and attention from our core business to the acquired business;

failure to retain key technical, management, sales and other personnel of the acquired business;

difficulty in retaining relationships with suppliers and customers of the acquired business; and

difficulty in getting required regulatory approvals.

In addition, the businesses and other assets we acquire may not achieve the sales and profitability expected. The occurrence of one or more of these events may have a material adverse effect on our business. There can be no assurance that we will be successful in overcoming these or any other significant risks encountered.

***We may not be able to increase or sustain our recent growth rate, and we may not be able to manage our future growth effectively.***

We may be unable to continue to expand our business or manage future growth. To successfully manage our growth and handle the responsibilities of being a public company, we believe we must effectively:

hire, train, integrate and manage additional qualified engineers for engineering design and construction activities, new business personnel, and financial and information technology personnel;

retain key management, augment our management team, and retain qualified and certified water and wastewater system operators;

implement and improve additional and existing administrative, financial and operations systems, procedures and controls;

expand and upgrade our technological capabilities; and

manage multiple relationships with our customers, regulators, suppliers and other third parties.

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If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities, satisfy customer requirements, execute our business plan or respond to competitive pressures.

***We have a number of large-volume commercial and industrial customers and a significant decrease in consumption by one or more of these customers could have an adverse effect on our operating results and cash flows.***

Our billed revenues will decrease, and such decrease may be material, if a significant business or industrial customer terminates or materially reduces its use of our water. Approximately \$136.4 million, or 22.8%, of our 2014 water utility revenues was derived from business and industrial customers. If any of our large business or industrial customers in California reduce or cease its consumption of our water, the impact to net operating income would be minimal to our operations due to the WRAM and MCBA, but could impact our cash flows. In Hawaii, we serve a number of large resorts which if their water usage was reduced or ceased could have a material impact to our Hawaii operation. The delay between such date and the effective date of the rate relief may be significant and could adversely affect our operating results and cash flows.

***Our operating cost and costs of providing services may rise faster than our revenues.***

Our ability to increase rates over time is dependent upon approval of such rate increases by state commissions, or in the case of the City of Hawthorne and the City of Commerce, the City Council, which may be inclined, for political or other reasons, to limit rate increases. However, our costs are subject to market conditions and other factors, which may increase significantly. The second largest component of our operating costs after water production is made up of salaries and wages. These costs are affected by the local supply and demand for qualified labor. Other large components of our costs are general insurance, workers compensation insurance, employee benefits and health insurance costs. These costs may increase disproportionately to rate increases authorized by state commissions and may have a material adverse effect on our future results of operations.

***Our non-regulated activities operate in a competitive market.***

While a majority of our business is regulated, our non-regulated activities participates in a competitive market. We compete with several larger companies whose size, financial resources, customer base and technical expertise may restrict our ability to compete successfully for certain operations and maintenance contracts. Due to the nature of our contract operations business, and to the very competitive nature of the market, we must accurately estimate the cost and profitability of each project while, at the same time, maintaining prices at a level low enough to compete with other companies. Our inability to achieve this balance could adversely impact our results of operations.

***Demand for our stock may fluctuate due to circumstances beyond our control.***

We believe that stockholders invest in public utility stocks, in part, because they seek reliable dividend payments. If there is an over-supply of stock of public utilities in the market relative to demand by such investors, the trading price of our securities could decrease. Additionally, if interest rates rise above the dividend yield offered by our equity securities, demand for our stock, and consequently its market price, may also decrease. A decline in demand for our stock may have a negative impact on our ability to finance capital projects.

***The price of our common stock may be volatile and may be affected by market conditions beyond our control.***

The trading price of our common stock may fluctuate in the future because of the volatility of the stock market and a variety of other factors, many of which are beyond our control. Factors that could cause fluctuations in the trading price of our common stock include: regulatory developments; general economic

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conditions and trends; price and volume fluctuations in the overall stock market from time to time; actual or anticipated changes or fluctuations in our results of operations; actual or anticipated changes in the expectations of investors or securities analysts; actual or anticipated developments in our competitors' businesses or the competitive landscape generally; litigation involving us or our industry; and major catastrophic events or sales of large blocks of our stock.

Equity markets in general can experience extreme price and volume fluctuations. Such price and volume fluctuations may continue to adversely affect the market price of our common stock for reasons unrelated to our business or operating results.

***Adverse investment returns and other factors may increase our pension liability and pension funding requirements.***

A substantial number of our employees are covered by a defined benefit pension plan. At present, the pension plan is underfunded because our projected pension benefit obligation exceeds the aggregate fair value of plan assets. Under applicable law, we are required to make cash contributions to the extent necessary to comply with minimum funding levels imposed by regulatory requirements. The amount of such required cash contribution is based on an actuarial valuation of the plan. The funded status of the plan can be affected by investment returns on plan assets, discount rates, mortality rates of plan participants, pension reform legislation and a number of other factors. There can be no assurance that the value of our pension plan assets will be sufficient to cover future liabilities. Although we have made contributions to our pension plan in recent years, it is possible that we could incur a pension liability adjustment, or could be required to make additional cash contributions to our pension plan, which would reduce the cash available for business and other needs.

***Work stoppages and other labor relations matters could adversely affect our operating results.***

At December 31, 2014, 708 of our 1,105 total employees were union employees. Most of our unionized employees are represented by the Utility Workers Union of America, AFL-CIO, except certain engineering and laboratory employees who are represented by the International Federation of Professional and Technical Engineers, AFL-CIO.

We believe our labor relations are good, but in light of rising costs for healthcare and pensions, contract negotiations in the future may be difficult. Furthermore, changes in applicable law or regulations could have an adverse effect on management's negotiating position with respect to our currently unionized employees and/or employees that decide to unionize in the future. We are subject to a risk of work stoppages and other labor relations matters as we negotiate with the unions to address these issues, which could affect our results of operations and financial condition. We can give no assurance that issues with our labor forces will be resolved favorably to us in the future or that we will not experience work stoppages.

***We depend significantly on the services of the members of our management team, and the departure of any of those persons could cause our operating results to suffer.***

Our success depends significantly on the continued individual and collective contributions of our management team. The loss of the services of any member of our management team could have a material adverse effect on our business as our management team has knowledge of our industry and customers and would be difficult to replace.

***Our operations are geographically concentrated in California and this lack of diversification may negatively impact our operations.***

Although we own facilities in a number of states, over 94% of our operations are located in California. As a result, we are largely subject to weather, political, water supply, labor, utility cost, regulatory and economic risks affecting California.



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We are also affected by the real property market in California. In order to grow our business, we may need to acquire additional real estate or rights to use real property owned by third parties, the cost of which tends to be higher and more volatile in California relative to other states. The value of our assets in California may decline if there is a decline in the California real estate market which results in a significant decrease in real property values.

***The effects of natural disasters, terrorist activity, pandemics, or poor water quality or contamination to our water supply may result in disruption in our services and litigation which could adversely affect our business, operating results and financial condition.***

We operate in areas that are prone to earthquakes, fires, mudslides and other natural disasters. A significant seismic event or other natural disaster in California where our operations are concentrated could adversely impact our ability to deliver water and adversely affect our costs of operations. A major disaster could damage or destroy substantial capital assets. The California Public Utilities Commission has historically allowed utilities to establish a catastrophic event memorandum account as another possible mechanism to recover costs. However, we can give no assurance that the CPUC or any other commission would allow any such cost recovery mechanism in the future.

Our water supplies are subject to contamination, including contamination from the development of naturally-occurring compounds, chemicals in groundwater systems, pollution resulting from man-made sources, such as MTBE, sea water incursion and possible terrorist attacks. If our water supply is contaminated, we may have to interrupt the use of that water supply until we are able to substitute the flow of water from an uncontaminated water source. In addition, we may incur significant costs in order to treat the contaminated source through expansion of our current treatment facilities, or development of new treatment methods. If we are unable to substitute water supply from an uncontaminated water source, or to adequately treat the contaminated water source in a cost-effective manner, there may be an adverse effect on our revenues, operating results and financial condition. The costs we incur to decontaminate a water source or an underground water system could be significant and could adversely affect our business, operating results and financial condition and may not be recoverable in rates. We could also be held liable for consequences arising out of human exposure to hazardous substances in our water supplies or other environmental damage. For example, private plaintiffs have the right to bring personal injury or other toxic tort claims arising from the presence of hazardous substances in our drinking water supplies. Our insurance policies may not be sufficient to cover the costs of these claims.

We operate a dam. If the dam were to fail for any reason, we would lose a water supply and flooding likely would occur. Whether or not we were responsible for the dam's failure, we could be sued. We can give no assurance that we would be able to successfully defend such a suit.

In light of the threats to the nation's health and security ensuing in the wake of the September 11, 2001 terrorist attacks, we have taken steps to increase security measures at our facilities and heighten employee awareness of threats to our water supply. We have also tightened our security measures regarding the delivery and handling of certain chemicals used in our business. We have and will continue to bear increased costs for security precautions to protect our facilities, operations and supplies. These costs may be significant. Despite these tightened security measures, we may not be in a position to control the outcome of terrorist events should they occur.

We depend upon our skilled and trained workforce to ensure water delivery. Were a pandemic to occur, we can give no assurance that we would be able to maintain sufficient manpower to ensure uninterrupted service in all of the districts that we serve.

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***We retain certain risks not covered by our insurance policies.***

We evaluate our risks and insurance coverage annually. Our evaluation considers the costs, risks and benefits of retaining versus insuring various risks as well as the availability of certain types of insurance coverage. Furthermore, we are also affected by increases in prices for insurance coverage; in particular, we have been, and will continue to be, affected by rising health insurance costs. Retained risks are associated with deductible limits, partial self-insurance programs and insurance policy coverage ceilings. If we suffer an uninsured loss, we may be unable to pass all, or any portion, of the loss on to customers because our rates are regulated by regulatory commissions. Consequently, uninsured losses may negatively affect our financial condition, liquidity and results of operations. There can be no assurance that we will not face uninsured losses pertaining to the risks we have retained.

***We rely on our information technology ("IT") and a number of complex business systems to assist with the management of our business and customer and supplier relationships, and a disruption of these systems could adversely affect our business.***

Our IT systems are an integral part of our business, and a serious disruption of our IT systems could significantly limit our ability to manage and operate our business efficiently, which, in turn, could cause our business and competitive position to suffer and adversely affect our results of operations. We depend on our IT systems to bill customers, process orders, provide customer service, manage construction projects, manage our financial records, track assets, remotely monitor certain of our plants and facilities and manage human resources, inventory and accounts receivable collections. Our IT systems also enable us to purchase products from our suppliers and bill customers on a timely basis, maintain cost-effective operations and provide service to our customers. Some of our mission and business critical IT systems are older, such as our SCADA (Supervisory Control and Data Acquisition) system. Although we do not believe that our IT systems are at a materially greater risk of cyber security incidents than other similar organizations, our IT systems remain vulnerable to damage or interruption from:

power loss, computer systems failures, and internet, telecommunications or data network failures;

operator negligence or improper operation by, or supervision of, employees;

physical and electronic loss of customer data due to security breaches, cyber attacks, misappropriation and similar events;

computer viruses;

intentional security breaches, hacking, denial of services actions, misappropriation of data and similar events; and

Earthquakes, floods, fires, mudslides and other natural disasters.

These events may result in physical and/or electronic loss of customer or financial data, security breaches, misappropriation and other adverse consequences. In addition, the lack of redundancy for certain of our IT systems, including billing systems, could exacerbate the impact of any of these events on us.

In addition, we may not be successful in developing or acquiring technology that is competitive and responsive to the needs of our business, and we might lack sufficient resources to make the necessary upgrades or replacements of our outdated existing technology to allow us to continue to operate at our current level of efficiency.

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***The accuracy of our judgments and estimates about financial and accounting matters will impact our operating results and financial condition.***

We make certain estimates and judgments in preparing our financial statements regarding, among others:

the useful life of intangible rights;

the number of years to depreciate certain assets;

amounts to set aside for uncollectible accounts receivable, inventory obsolescence and uninsured losses;

our legal exposure and the appropriate accrual for claims, including medical claims and workers' compensation claims;

future costs and assumptions for pensions and other post-retirement benefits;

regulatory recovery of deferred items;

possible tax uncertainties; and

projected collections of WRAM and MCBA receivables.

The quality and accuracy of those estimates and judgments will have an impact on our operating results and financial condition.

In addition, we must estimate unbilled revenues and costs as of the end of each accounting period. If our estimates are not accurate, we will be required to make an adjustment in a future period. Accounting rules permit us to use expense balancing accounts and memorandum accounts that include input cost changes to us that are different from amounts incorporated into the rates approved by the commissions. These accounts result in expenses and revenues being recognized in periods other than in which they occurred.

***Our controls and procedures may fail or be circumvented.***

Management regularly reviews and updates our internal control over financial reporting, disclosure controls and procedures, and corporate governance policies and procedures. Any system of controls and procedures, however well designed and operated, is based in part on certain assumptions and can provide only reasonable, not absolute, assurances that the objectives of the system are met. Any failure or circumvention of our controls and procedures or failure to comply with regulations related to controls and procedures could result in lack of compliance with contractual agreements, misstatements in our financial statements in amounts that could be material or could cause investors to lose confidence in our reported financial information, either of which could have a negative effect on the trading price of our stock and may negatively affect our ability to raise future capital.

Further, if we or our independent registered public accounting firm discover a material weakness in our internal control over financial reporting, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price. In addition, non-compliance with Section 404 of the Sarbanes-Oxley Act of 2002 could subject us to a variety of administrative sanctions, including the suspension or delisting of our common stock from the New York Stock Exchange and the inability of registered broker-dealers to make a market in our common stock, which would further reduce our stock price.

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*We may be required to adopt International Financial Reporting Standards (IFRS), or other accounting or financial reporting standards, the ultimate adoption of which could negatively impact our business, financial condition or results of operations.*

We could be required to adopt IFRS or other accounting or financial reporting standards different from Generally Accepted Accounting Principles (GAAP) in the United States of America, which is currently applicable to our accounting and financial reporting. In 2008 the SEC released a proposed roadmap for the adoption of IFRS. The Financial Accounting Standards Board and the International Accounting Standards Board are currently working together to replace current GAAP with a convergence of GAAP and IFRS accounting standards. Under GAAP we are subject to the accounting procedures for accounting for the effects of certain types of regulation, which, among other things, allows us to defer certain costs if we believe it is probable that we will be allowed to recover those costs by future rate increases. Currently, IFRS does not contain provisions equivalent to the current GAAP accounting procedures. In 2014, the IASB issued IFRS 14 which basically allows for an adopter of IFRS to continue using regulatory accounting standards from its prior GAAP while the IASB works out its own regulatory accounting standard. The implementation and adoption of new accounting or financial reporting standards could affect our reported performance, which in turn could favorably or unfavorably impact our business, financial condition or results of operations. Furthermore, the transition to and application of new accounting or financial reporting standards could result in increased administrative costs.

*Municipalities, water districts and other public agencies may condemn our property by eminent domain action.*

State statutes allow municipalities, water districts and other public agencies to own and operate water systems. These agencies are empowered to condemn properties already operated by privately owned public utilities. However, whenever a public agency constructs facilities to extend a utility system into the service area of a privately owned public utility, such an act constitutes the taking of property and requires reimbursement to the utility for its loss. If a public agency were to acquire our utility property by eminent domain action, we would be entitled to just compensation for our loss, but we would no longer have access to the condemned property nor would we be entitled to any portion of revenue generated from the use of such asset going forward.

**Item 1B. Unresolved Staff Comments.**

None.

**Item 2. Properties.**

Our physical properties consist of offices and water facilities to accomplish the production, storage, treatment, and distribution of water. These properties are located in or near the geographic service areas listed above in Item 1, "Business Geographical Service Areas and Number of Customers at Year-end." Our headquarters, which houses accounting, engineering, information systems, human resources, purchasing, regulatory, water quality, and executive staff, is located in San Jose, California.

The real properties owned are held in fee simple title. Properties owned by Cal Water are subject to the lien of an Indenture of Mortgage and Deed of Trust dated April 17, 2009 (the California Indenture), securing Cal Water's first mortgage bonds, of which \$408.1 million was outstanding at December 31, 2014. The California Indenture contains certain restrictions common to such types of instruments regarding the disposition of property and includes various covenants and restrictions. At December 31, 2014, our California utility was in compliance with the covenants of the California Indenture.

Cal Water owns 626 wells and operates 5 leased wells. There are 432 owned storage tanks with a capacity of 271 million gallons, 2 leased storage tanks with a capacity of 0.4 million gallons, 29 managed storage tanks with a capacity of 20.8 million gallons, and 3 reservoirs with a capacity of 220 million gallons.

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Cal Water owns and operates 6 surface water treatment plants with a combined capacity of 46 million gallons per day. There are 5,771 miles of supply and distribution mains in the various systems.

Hawaii Water owns 21 wells and manages 5 irrigation wells. There are 24 storage tanks with a storage capacity of 20 million gallons. There are 70 miles of supply and distribution lines. Hawaii Water operates 5 wastewater treatment facilities with a combined capacity to process approximately 1.8 million gallons per day. There are 26 miles of sewer collection mains.

Washington Water owns 342 wells and manages 114 wells. There are 128 owned storage tanks and 35 managed storage tanks with a storage capacity of 10 million gallons. There are 330 miles of supply and distribution lines.

New Mexico Water owns 17 wells. There are 12 storage tanks with a storage capacity of 4 million gallons. There are 134 miles of supply and distribution lines. New Mexico operates 2 waste water treatment facilities with a combined capacity to process 0.5 million gallons per day. There are 34 miles of sewer collection mains.

Washington Water has long-term bank loans that are secured primarily by utility plant owned by Washington Water. New Mexico Water has a short-term loan that is secured by utility plant owned by New Mexico Water.

In the leased City of Hawthorne and City of Commerce systems or in systems that are operated under contract for municipalities or private companies, title to the various properties is held exclusively by the municipality or private company.

### **Item 3. *Legal Proceedings.***

Information with respect to this item may be found under the subheading "Commitments and Contingencies" in Note 14 to the consolidated Financial Statements in Item 8, which is incorporated herein by reference.

### **Item 4. *Mine Safety Disclosures.***

Not applicable.

Table of Contents**PART II****Item 5. Market for Registrant's Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

Our common stock is traded on the New York Stock Exchange under the symbol "CWT." At December 31, 2014, there were 47,806,190 common shares outstanding. There were 2,174 common stockholders of record as of February 09, 2015.

During 2014, we paid a cash dividend of \$0.6500 per common share, or \$0.1625 per quarter. During 2013, we paid a cash dividend of \$0.6400 per common share, or \$0.1600 per quarter. On January 28, 2015, our Board of Directors declared a quarterly cash dividend of \$0.1675 per common share payable on February 20, 2015, to stockholders of record on February 9, 2015. This represents our 48<sup>th</sup> consecutive year of increasing the annual dividend and marks the 280<sup>th</sup> consecutive quarterly dividend.

We presently intend to pay quarterly cash dividends in the future consistent with past practices, subject to our earnings and financial condition, restrictions set forth in our debt instruments, regulatory requirements and such other factors as our Board of Directors may deem relevant.

During 2014 and 2013, the common stock market price range and dividends per share for each quarter were as follows:

<b>2014</b>	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
Common stock market price range:				
High	\$ 24.60	\$ 24.37	\$ 24.78	\$ 26.37
Low	21.63	20.33	22.41	21.98
Dividends paid per common share	0.1625	0.1625	0.1625	0.1625

<b>2013</b>	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
Common stock market price range:				
High	\$ 21.22	\$ 20.84	\$ 22.34	\$ 23.43
Low	18.42	18.54	18.87	19.65
Dividends paid per common share	0.1600	0.1600	0.1600	0.1600

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**Five-Year Performance Graph**

The following performance graph compares the changes in the cumulative shareholder return on California Water Service Group's common stock with the cumulative total return on the Robert W. Baird Water Utility Index and the Standard & Poor's 500 Index during the last five years ended December 31, 2014. The comparison assumes \$100 was invested on December 31, 2009, in California Water Service Group's common stock and in each of the forgoing indices and assumes reinvestment of dividends.

*Performance Graph Data*

The following descriptive data is supplied in accordance with Rule 304(d) of Regulations S-T:

	2009	2010	2011	2012	2013	2014
<b>California Water Service Group</b>	100	105	106	110	143	157
<b>S &amp; P 500</b>	100	115	117	136	180	205
<b>RW Baird Water Utility Index</b>	100	120	138	166	195	241

An initial \$10,000 investment in the common stock of California Water Service Group on December 31, 2009 including reinvestment of dividends would be worth \$15,700 at the end of the 5-year period ending December 31, 2014.

**Item 6. Selected Financial Data.**

The following selected consolidated financial data should be read in conjunction with our Consolidated Financial Statements and the Notes thereto and the information contained in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Historical results are not necessarily indicative of future results.

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**FIVE YEAR FINANCIAL REVIEW**

	2014	2013	2012	2011	2010
	(Dollars in thousands, except common share and other data)				
<b>Summary of Operations</b>					
Operating revenue					
Residential	\$ 406,322	\$ 406,824	\$ 394,736	\$ 375,703	\$ 335,833
Business	111,438	111,529	106,674	100,050	90,992
Industrial	24,957	26,290	25,467	24,612	20,733
Public authorities	30,810	31,067	29,568	28,278	23,904
Other	16,766	17,553	26,567	(3,033)	11,666
MCBA net adjustment to increase (reduce) adopted revenue	7,206	(9,160)	(23,046)	(23,796)	(22,729)
<b>Total operating revenue</b>	<b>597,499</b>	<b>584,103</b>	<b>559,966</b>	<b>501,814</b>	<b>460,399</b>
Operating expenses	515,652	510,098	486,123	434,647	398,586
Interest expense, other income and expenses, net	25,109	26,751	25,015	29,455	24,157
<b>Net income</b>	<b>\$ 56,738</b>	<b>\$ 47,254</b>	<b>\$ 48,828</b>	<b>\$ 37,712</b>	<b>\$ 37,656</b>
<b>Common Share Data</b>					
Earnings per share diluted	\$ 1.19	\$ 1.02	\$ 1.17	\$ 0.90	\$ 0.90
Dividend paid	0.650	0.640	0.630	0.615	0.595
Dividend payout ratio	55%	63%	54%	68%	66%
Book value per share	\$ 13.11	\$ 12.54	\$ 11.30	\$ 10.76	\$ 10.45
Market price at year-end	24.61	23.07	18.35	18.26	18.64
Common shares outstanding at year-end (in thousands)	47,806	47,741	41,908	41,817	41,667
Return on average common stockholders' equity	9.3%	8.8%	10.6%	8.5%	9.0%
Long-term debt interest coverage	4.29	3.42	3.45	3.11	3.59
<b>Balance Sheet Data</b>					
Net utility plant	\$ 1,590,431	\$ 1,515,831	\$ 1,457,056	\$ 1,381,119	\$ 1,294,297
Total assets	2,187,351	1,959,855	1,995,924	1,854,587	1,692,066
Long-term debt including current portion	425,840	434,050	481,250	488,165	481,561
Capitalization ratios:					
Common stockholders' equity	59.5%	58.0%	49.6%	48.0%	47.5%
Preferred stock					
Long-term debt	40.5%	42.0%	50.4%	52.0%	52.5%
<b>Other Data</b>					
Estimated water production (million gallons)					
Wells and surface supply	61,848	64,161	66,184	64,100	65,288
Purchased	56,434	62,202	59,708	56,253	56,654
<b>Total estimated water production</b>	<b>118,282</b>	<b>126,363</b>	<b>125,892</b>	<b>120,353</b>	<b>121,942</b>
Metered customers	472,500	464,800	458,400	451,900	438,600
Flat-rate customers	33,600	38,100	42,300	47,600	59,300
<b>Customers at year-end**</b>	<b>506,100</b>	<b>502,900</b>	<b>500,700</b>	<b>499,500</b>	<b>497,900</b>



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New customers added	3,200	2,200	1,200	1,600	3,200
Revenue per customer	\$ 1,181	\$ 1,161	\$ 1,118	\$ 1,005	\$ 925
Utility plant per customer	4,628	4,401	4,187	3,925	3,706
Employees at year-end	1,105	1,125	1,131	1,132	1,127

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Includes customers of the City of Hawthorne and City of Commerce

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**Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations.***

**Overview**

In 2014 and 2013, net income was \$56.7 million and \$47.3 million, respectively. Diluted earnings per share increased \$0.17 to \$1.19 or 16.7% from 2013 to 2014. Net income increased \$9.5 million mostly due to incremental revenue with the approval of our 2012 GRC in California and reductions to administrative and general, other operations, net interest, and property tax expenses. We achieved these cost reductions primarily because we operated within our budget in 2014. The increase to net income was partially offset by increases in employee wages, income tax, maintenance, and depreciation and amortization expenses and a reduction to other income.

In 2013 and 2012, net income was \$47.3 million and \$48.8 million, respectively. Diluted earnings per share decreased \$0.15 to \$1.02 or 13% from 2012 to 2013. The weighted average number of common shares outstanding used in the diluted earnings per share calculation increased to 46,417,000 shares in 2013 compared to 41,892,000 shares in 2012 mostly due to the sale of 5,750,000 shares of common stock on March 26, 2013. The \$1.5 million decrease in net income was primarily attributable to cost increases for employee wages and benefits, water production costs, depreciation on plant placed into service during 2012, and property taxes. The decrease in net income was also due to the reversal of 2011 deferred WRAM revenues of \$12.9 million and associated costs of \$10.5 million that we recognized in 2012, a \$0.6 million decrease in the unrealized pre-tax gain on our benefit plan insurance investments in 2013, and higher net interest expenses mostly due to a reduction in capital project spending in 2013. In 2013, the Company recorded a tax benefit of \$4.9 million for state enterprise zone credits and state repairs deductions, which compared to a tax benefit of \$6.2 million in 2012 for state repairs deductions. The 2013 cost increases were partially offset by cost reductions to other operations, maintenance expenses, and income taxes.

We plan to continue to seek rate relief to recover our operating cost increases and receive reasonable returns on invested capital. We expect to fund our long-term capital needs through a combination of debt, common stock offerings, and cash flow from operations.

**Critical Accounting Policies and Estimates**

We maintain our accounting records in accordance with accounting principles generally accepted in the United States of America and as directed by the Commissions to which our operations are subject. The process of preparing financial statements requires the use of estimates on the part of management. The estimates used by management are based on historic experience and an understanding of current facts and circumstances. A summary of our significant accounting policies is listed in Note 2 of the Notes to Consolidated Financial Statements. The following sections describe those policies where the level of subjectivity, judgment, and variability of estimates could have a material impact on the financial condition, operating performance, and cash flows of the business.

**Revenue Recognition**

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 we operate. The revenue requirements are intended to provide the Company a reasonable opportunity to recover its cost of service and earn a return on investments.

For metered customers, Cal Water recognizes revenue from rates which are designed and authorized by the CPUC. Under the Water Revenue Adjustment Mechanism (WRAM), Cal Water records the adopted level of volumetric revenues, which would include recovery of cost of service and a return on

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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 allowed to be recovered by the commissions. 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. 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. Cost-recovery expenses are generally recognized when the expenses are incurred with no markup for return or profit.

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 the deferred net balances are interest bearing at the current 90 day commercial paper rate. At the end of the 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 and 18 months. Cal Water defers any net WRAM and MCBA revenues and associated costs whenever the net receivable balances are estimated to be collected more than 24 months after the respective reporting period in which it was recorded. The deferred net WRAM and MCBA revenue 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 unbilled balances. Deferred revenues and associated costs are recorded in future periods as the collection becomes within 24 months of the respective reporting 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 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. Our unearned revenue liability was \$1.5 million as of December 31, 2014 and 2013. This liability is included in "other accrued liabilities" on our consolidated balance sheets.

**Regulated Utility Accounting**

Because we operate extensively in a regulated business, we are subject to the accounting standards for regulated utilities. The Commissions in the states in which we operate establish rates that are designed to permit the recovery of the cost of service and a return on investment. We capitalize and record regulatory assets for costs that would otherwise be charged to expense if it is probable that the incurred costs will be recovered in future rates. Regulatory assets are amortized over the future periods that the costs are expected to be recovered. If costs expected to be incurred in the future are currently being recovered through rates, we record those expected future costs as regulatory liabilities. In addition, we record regulatory liabilities when the Commissions require a refund to be made to our customers over future periods.

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Determining probability requires significant judgment by management and includes, but is not limited to, consideration of testimony presented in regulatory hearings, proposed regulatory decisions, final regulatory orders, and the strength or status of applications for rehearing or state court appeals. We also record a regulatory asset when a mechanism is in place to recover current expenditures and historical experience indicates that recovery of incurred costs is probable, such as the regulatory assets for pension benefits; and deferred income tax.

If we determine that a portion of our assets used in utility operations is not recoverable in customer rates, we would be required to recognize the loss of the assets disallowed.

**Goodwill Accounting and Evaluation for Impairment**

In November of 2014 and 2013, we performed annual impairment tests of the remaining goodwill balance of \$2.6 million by comparing the fair value of Hawaii Water, the reporting unit, with its carrying amount, including goodwill and no impairment was recorded. Our analysis considered the approval of future rate case proceedings for the various operations of Hawaii Water based on historical rate of return filings allowed by the Hawaii Public Utilities Commission. To the extent the approved rate of return filings allowed by the Hawaii Public Utilities Commission are less than expected an impairment of the recorded goodwill may occur.

**Income Taxes**

We account for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. We measure deferred tax assets and liabilities 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. We recognize the effect on the deferred tax assets and liabilities of a change in tax rate in the period that includes the enactment date. We must also assess the likelihood that deferred tax assets will be recovered in future taxable income and, to the extent recovery is not probable, a valuation allowance would be recorded. In management's view, a valuation allowance was not required at December 31, 2014 or December 31, 2013.

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 the Company permission 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. The commission requires flow-through accounting for state deferred taxes.

During 2012, we filed an application for a change in tax accounting method with the Internal Revenue Service (IRS) to implement tangible property regulations specifically in regards to repairs and maintenance deductions. In September 2013, the U.S. Department of the Treasury (U.S. Treasury) and IRS issued the final tangible property regulations for repairs and maintenance deductions with an effective date of January 1, 2014. In August 2014, the U.S. Treasury and IRS issued the final regulations regarding dispositions of tangible property 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 filed a tax accounting method change on its 2013 tax return for the repair and maintenance of linear assets within the guidance of the tangible property regulations.

In 2013, we recorded \$4.0 million net of any unrecognized tax benefit of State of California enterprise zone (EZ) credits for sales and use taxes and hiring incentives for the period from 2008 to 2013 based on an analysis of all district operations. The Company filed amended state income tax returns for tax years 2008, 2009, 2010, and 2011. Unused State of California EZ credits can carry-forward ten years. The Company has a carry-forward California EZ credits at \$2.3 million net of any unrecognized tax benefit.

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The American Taxpayer Relief Act of 2012 was enacted on January 2, 2013, and extended the termination date of additional 50 percent first-year bonus depreciation (bonus depreciation) by one year. As a result, qualified property placed in service through the end of 2013 was eligible for bonus depreciation. On December 19, 2014, President Obama signed in to law the Tax Increase Prevention Act of 2014, which, among other provisions, retroactively extended the application of bonus depreciation to qualified property placed in service through the end of 2014.

The Company's total federal net operating loss (NOL) carry-forward was \$43.8 million and state NOL carry-forward was \$49.9 million net of any unrecognized tax benefit as of December 31, 2014. 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. As of December 31, 2014 we had unrecognized tax benefits of approximately \$7.9 million. Included in the balance of unrecognized tax benefits is approximately \$1.6 million of tax benefits that, if recognized, would result in an adjustment to the Company's effective tax rate. The Company does not expect its unrecognized tax benefits to change significantly within the next twelve months.

The State of Hawaii Department of Taxation is presently auditing the Company's 2010, 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. The State of California Franchise Tax Board is presently auditing the Company's 2008 through 2011 enterprise zone 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.

**Pension Benefits**

We incur costs associated with our pension and postretirement health care benefits plans. To measure the expense of these benefits, our management must estimate compensation increases, mortality rates, future health cost increases and discount rates used to value related liabilities and to determine appropriate funding. Different estimates used by our management could result in significant variances in the cost recognized for pension benefit plans. The estimates used are based on historical experience, current facts, future expectations, and recommendations from independent advisors and actuaries. We use an investment advisor to provide advice in managing the plan's investments. We anticipate any increases in funding for the pension benefits plans will be recovered in future rate filings, thereby mitigating the financial impact. We believe it is probable that future costs will be recovered in future rates and therefore have recorded a regulatory asset in accordance with generally accepted accounting principles.

**Workers' Compensation and Other Claims**

We are self-insured for a portion of workers' compensation and other claims. Excess amounts are covered by insurance policies. For workers' compensation, we work with an independent actuary firm to estimate the discounted liability associated with claims submitted and claims not yet submitted based on historical data. These estimates could vary significantly from actual claims paid, which could impact earnings and cash flows. For other claims, management estimates the cost incurred but not yet paid using historical information. Actual costs could vary from these estimates. Management believes actual costs incurred would be allowed in future rates, mitigating the financial impact.

Table of Contents**Results of Operations*****Operating Revenue***

Operating revenue in 2014 was \$597.5 million, an increase of \$13.4 million, or 2.3%, over 2013. Operating revenue in 2013 was \$584.1 million, an increase of \$24.1 million, or 4.3%, over 2012. The estimated sources of changes in operating revenue were:

	2014	2013	2012
	Dollars in millions		
Rate increases(1)	\$ 2.2	\$ 13.6	\$ 28.9
Net change due to actual versus adopted results, usage, and other(2)	16.6	8.4	14.0
Health care balancing account(5)	1.1		
Conservation balancing account(3)	(2.7)	0.3	(2.2)
Pension balancing account(3)	(4.3)	0.6	4.3
Deferral of net WRAM and MCBA revenue(4)	(1.7)	(0.3)	12.0
New customers	2.2	1.5	1.2
Net change	\$ 13.4	\$ 24.1	\$ 58.2

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- (1) Rate increases result from GRCs, escalation rate increase filings and offset filings.
- (2) The net change due to actual versus adopted results, usage, and other is mainly due to the net effect of WRAM. The usage by existing customers can materially change based upon current weather patterns and is influenced both by temperature and rainfall; however, the impact of weather on net operating income has been minimized with the adoption of WRAM and MCBA for California regulated customers for 2014, 2013, and 2012.
- (3) The pension and conservation balancing accounts is the difference between actual expenses and adopted rate recovery for all year reported above.
- (4) The deferral of net WRAM and MCBA revenue is the net receivable balances that are expected to be collected from ratepayers beyond 24 months following the end of the accounting period in which these revenues were recorded. Early in 2012, Cal Water received CPUC decision 12-04-048, which decreased the amortization periods of Cal Water's receivables and resulted in the recognition in 2012 of \$12.0 million WRAM revenue that was deferred in 2011. In 2014 and 2013, the net WRAM revenue deferral was \$1.7 million and \$0.3 million, respectively.
- (5) The health care balancing account is the difference between actual health care expenses and adopted rate recovery. The health care balancing account was authorized by the CPUC in the 2012 GRC in California, effective January 1, 2014.

***Water Production Expenses***

Water production expenses, which consist of purchased water, purchased power, and pump taxes, comprise the largest segment of total operating expenses. Water production costs accounted for 43.4%, 44.3%, and 41.6%, of total operating costs in 2014, 2013, and 2012, respectively. The rates charged for wholesale water supplies, electricity, and pump taxes are established by various public agencies. As such, these rates are beyond our control.

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The table below provides the amount of increases and percent changes in water production costs during the past two years:

	2014			2013			2012		
	Amount	Change	% Change	Amount	Change	% Change	Amount	Change	% Change
<b>Dollars in millions</b>									
Purchased water	\$ 177.9	\$ (5.2)	(2.8)%	\$ 183.1	\$ 21.8	13.5%	\$ 161.3	\$ 18.7	13.2%
Purchased power	33.1	0.9	2.8%	32.2	1.2	3.8%	31.0	0.9	3.2%
Pump taxes	12.9	2.1	19.4%	10.8	0.5	4.4%	10.3	1.2	13.2%
Total water production expenses	\$ 223.9	\$ (2.2)	(1.0)%	\$ 226.1	\$ 23.5	11.5%	\$ 202.6	\$ 20.8	11.5%

The principal factors affecting water production expenses are the quantity, price and source of the water. Generally, water from wells costs less than water purchased from wholesale suppliers.

The table below provides the amounts, percentage change, and source mix for the respective years:

	2014		2013		2012	
	MG	% of Total	MG	% of Total	MG	% of Total
<b>Millions of gallons (MG)</b>						
<b>Source:</b>						
Wells	57,866	48.9%	58,435	46.3%	59,932	47.6%
% change from prior year	(1.0)%		(2.5)%		4.4%	
Purchased	56,434	47.7%	62,202	49.2%	59,708	47.4%
% change from prior year	(9.3)%		4.2%		6.0%	
Surface	3,982	3.4%	5,727	4.5%	6,252	5.0%
% change from prior year	(30.5)%		(8.4)%		(6.2)%	
Total	118,282	100.0%	126,364	100.0%	125,892	100.0%
% change from prior year	(6.4)%		0.4%		4.6%	

Purchased water expenses are affected by changes in quantities purchased, supplier prices, and cost differences between wholesale suppliers. The MCBA mechanism is designed to recover all incurred purchase water expenses.

For 2014, the \$5.2 million decrease in purchased water is due to 1.0% decrease in purchased quantities. On an overall blended basis, wholesale water rates increased 7.9% on a cost-per-million-gallon basis in 2014. Purchased water expense for 2014 was partially offset by lease water rights credits of \$0.7 million.

For 2013, the \$21.8 million increase in purchased water is due to wholesaler water rate increases between 3% and 12% and a 4% increase in purchased quantities. On an overall blended basis, wholesale water rates increased 8% on a cost-per-million-gallon basis in 2013. Purchased water expense for 2013 was partially offset by lease water rights credits of \$1.0 million.

For 2012, the \$18.7 million increase in purchased water is due to wholesaler water rate increases between 3% and 12% and a 6% increase in purchased quantities. On an overall blended basis, wholesale water rates increased 7% on a cost-per-million-gallon basis in 2012. Purchased water expense for 2012 was partially offset by lease water rights credits of \$0.9 million.

Purchased power expenses are affected by the quantity of water pumped from wells and moved through the distribution system, rates charged by electric utility companies, and rate structures applied to usage during peak and non-peak times of the day or season. In 2014, 2013, and 2012 purchased power expense increased \$0.9 million, or 2.8%, \$1.2 million, or 3.8%, and \$0.9 million or 3.2% respectively, primarily due

to power supplier rate increases.



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Changes in climate change regulations could increase the cost of purchased power which in turn would result in an increase in the rates our power suppliers charge us. Any change in pricing of our purchased power in California would be recovered from our rate payers by the MCBA. Any change in power costs in other states would be requested to be recovered by the rate payers in those states. The impact of such legislation, is dependent upon the enacted date, the factors that impact our suppliers cost structure, and their ability to pass the costs to us in their approved tariffs. These items are not known at this time.

***Administrative and General Expenses***

Administrative and general expenses include payroll related to administrative and general functions, all employee benefits charged to expense accounts, insurance expenses, legal fees, expenses associated with being a public company, and general corporate expenses.

During 2014, administrative and general expenses decreased \$0.7 million or 0.7%, as compared to 2013. The decrease was mostly due to decreases in employee pension benefit costs which were partially offset by increases to health care costs, outside service fees, and business insurance costs. Employee pension benefit expenses are fully recovered in rates and are tracked in a balancing account, such that revenues are recovered on a dollar-for-dollar basis up to the amounts authorized in the 2012 GRC. Employee and retiree medical expenses are recovered in rates up to 85% of adopted values and are tracked in a balancing account as authorized in the 2012 GRC.

During 2013, administrative and general expenses increased \$4.1 million, or 4.4%, as compared to 2012. The increase was due primarily to increases in employee payroll costs, health care, pension and other employee benefit costs. These increases were partially offset by a reduction to outside service costs.

***Other Operations Expenses***

The components of other operations expenses include payroll, material and supplies, and contract service costs of operating the regulated water systems, including the costs associated with water transmission and distribution, pumping, water quality, meter reading, billing, operations of district offices, and water conservation programs.

During 2014, other operating expenses decreased \$3.9 million, or 5.6%, compared to 2013. The decrease was mostly due to a \$5.8 million reduction in the timing of conservation program expenses and was partially offset by increased wage costs and other water operation costs. Wage increases became effective January 1, 2014. Conservation program expenses are fully recovered in rates and are tracked in a balancing account, such that revenues are recovered on a dollar-for-dollar basis up to the amounts authorized in the 2012 GRC.

During 2013, other operating expenses decreased \$7.4 million, or 9.6%, compared to 2012 mainly due to \$10.5 million of MCBA costs from the recording of the 2011 deferred WRAM revenues and associated costs recorded during 2012 and the decrease was partially offset by \$2.6 million of increased conservation program expenses in 2013 compared to 2012. Conservation program expenses are fully recovered in rates for 2011, 2012, and 2013, and are tracked in a balancing account, such that revenues are recovered on a dollar-for-dollar basis up to the amounts authorized in the 2009 GRC.

***Maintenance***

Maintenance expenses increased \$2.5 million, or 14.3%, in 2014, compared to 2013 due to increased costs for repairs of groundwater treatment facilities, transmission and distribution mains, pumping equipment, and wells.

Maintenance expenses decreased \$1.8 million, or 9.3%, in 2013, compared to 2012 due to decreased costs for repairs of mains, services, meters, hydrants, and other structures.

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***Depreciation and Amortization***

Depreciation and amortization increased \$2.9 million in 2014, or 5.0%, mostly due to 2013 capital additions.

Depreciation and amortization increased \$3.7 million in 2013 due to capital additions from 2012.

Our capital expenditures in California will be impacted by certain California environmental legislation passed in prior years. The CEQA permitting process involved in certain capital projects has increased the administrative cost of certain projects. California emission controls are expected to increase the cost of vehicle acquisitions. Certain existing vehicles will also have to be retrofitted to comply with the current legislation. The costs will be recovered via depreciation expense by our rate payers upon the filing of future general rate cases.

***Income Taxes***

For 2014, income taxes increased \$7.7 million as compared to 2013. The increase was mostly due to an increase in net operating income and a decrease in tax benefits as compared to the prior year. Income tax on other income and expenses in 2014 decreased \$0.2 million mostly due to an increase in corporate development costs as compared to the prior year.

For 2013, income taxes decreased \$1.0 million as compared to 2012. The decrease was mostly due to an increase in tax benefits in 2013 compared to 2012.

The tax rate is affected by tax benefits and the flow through method of accounting for income taxes which resulted from differences between federal tax depreciation and book depreciation on pre-1982 assets, as well as California depreciation differences on all assets and tangible property regulation deductions. The flow through method of accounting is described in the Summary of Significant Accounting Policies in the Notes to Consolidated Financial Statements. We anticipate the reversal of federal tax depreciation differences on pre-1982 assets to continue in future years but to a lesser extent due to the removal of pre-1982 assets from service; however, the net effect of flow-through accounting on our tax provision is uncertain due to the offsetting flow-through of state tax depreciation, which continues to increase with capital additions.

***Property and Other Taxes***

For 2014, property and other taxes decreased \$0.8 million, or 3.6% from 2013. The decrease was mostly due to a reduction in our assessed property values which was partially offset by taxes on utility plant placed in service during 2013 and increased payroll and franchise taxes.

For 2013, property and other tax expenses increased \$2.3 million, or 11.9% from 2012. The increase was primarily due to increased property taxes for utility plant placed in service during 2012, increased payroll taxes, and increased franchise taxes.

***Non-Regulated Revenue and Expense, Net***

The major components of non-regulated income are revenue and operating expenses related to the following activities:

operating and maintenance services (O&M) and meter reading and billing services;

antenna site leases;

design and construction services;

billing of optional third-party insurance program to our residential customers;

interest income;



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selling surplus property;

change in cash surrender value of life insurance; and

non-regulated and new business expenses.

Revenues from antenna site leases to telecommunication companies were \$2.0 million in 2014, 2013, and 2012. Revenues from the billing and marketing contract with Home Serve USA were \$2.1 million in 2014, 2013, and 2012. Changes to the cash surrender value (CSV) of life insurance contracts associated with our benefit plans also impact non-regulated expenses. There was an unrealized gain of \$1.0 million in 2014, an unrealized gain of \$1.9 million in 2013, and an unrealized loss of \$2.5 million in 2012. The CSV is determined in part by the market of certain underlining funds, the value of which reflects the changes in the stock market.

In 2014, non-regulated income net of expenses decreased \$0.3 million, or 12.8%, compared to 2013. The decrease was mostly due to an increase in corporate development costs and lower unrealized gains on our benefit plan insurance investments.

In 2013, non-regulated income net of expenses decreased \$1.0 million, or 33%, compared to 2012. The decrease was primarily due to a lower unrealized gain on the life insurance contracts associated with our benefit plans during 2013 and an increase in corporate development costs.

***Gain on Sale of Non-Utility Property***

For 2014, 2013, and 2012, there were no significant non-utility property sales. Earnings and cash flow from these transactions are sporadic and may or may not continue in future periods, depending upon market conditions. The Company has other non-utility properties that may be marketed in the future based on real estate market conditions.

***Interest Expenses***

In 2014, net interest expense, decreased \$1.9 million compared to 2013. The decrease was mostly due to \$40.0 million of first mortgage bonds maturing during the fourth quarter of 2013 which was partially offset by an increase in short term borrowings and a decrease in capitalized interest charged to construction projects.

In 2013, interest expense increased \$0.7 million compared to 2012. This increase was attributable to decreased capitalized interest charged to construction projects during 2013, which was partially offset by decreased financing costs on the Company's short-term lines of credit.

**Rates and Regulation**

The following is a summary of 2014 rate filings. California decisions and resolutions may be found on the CPUC website at [www.cpuc.ca.gov](http://www.cpuc.ca.gov).

Type of Filing	Decision/Resolution	Approval Date	Increase (Decrease) Annual Revenue	CA District/ Subsidiary
<b>GRC and Offset Filings</b>				
2014 Expense Offset	AL 2129-2134	Jul 2014	\$ 6.6 million	6 districts
2012 GRC Decision(1)	AL 2136	Sep 2014	\$ (8.8) million	All districts

(1) The rate design in the 2012 California GRC shifted revenue from metered net WRAM/MCBA revenue to service charge, flat and other revenue. Adopted metered net WRAM/MCBA revenue decreased \$13.3 million while the adopted service charge, flat and other revenue increased by \$34.0 million. The decrease in metered net WRAM/MCBA revenue is based on a reduced quantity



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sales forecast due to forecasted decreases in customer usage in 2014, 2015 and 2016 as a result of water conservation programs.

The estimated impact of current and prior year rate changes on operating revenues compared to prior years is listed in the following table:

	2014	2013	2012
	<b>Dollars in millions</b>		
General Rate Case (GRC)(a)	\$ (4.0)	\$ 1.2	\$ 3.8
Step rate increases		9.2	8.5
Offset (purchased water/pump taxes)	6.1	9.2	17.1
Balancing accounts, net		0.2	0.2
Other rate (decreases) increases	0.1	(6.2)	(0.7)
Total rate increases	\$ 2.2	\$ 13.6	\$ 28.9

(a)

Includes rate changes for the Cal Water 2012 GRC decision in 2014, Cal Water 2009 GRC decision in 2013 and 2012, and Hawaii Water GRC decisions in 2014, 2013, and 2012.

### Water Supply

Our source of supply varies among our operating districts. Certain districts obtain all of their supply from wells; some districts purchase all of their supply from wholesale suppliers; and other districts obtain supply from a combination of wells and wholesale suppliers. A small portion of supply comes from surface sources and is processed through Company-owned water treatment plants. To the best of management's knowledge, we are meeting water quality, environmental, and other regulatory standards for all company-owned systems.

California's normal weather pattern yields little precipitation between mid-spring and mid-fall. The Washington Water service areas receive precipitation in all seasons, with the heaviest amounts during the winter. New Mexico Water's rainfall is heaviest in the summer monsoon season. Hawaii Water receives precipitation throughout the year, with the largest amounts in the winter months. Water usage in all service areas is highest during the warm and dry summers and declines in the cool winter months. Rain and snow during the winter months replenish underground water aquifers and fill reservoirs, providing the water supply for subsequent delivery to customers. Management believes that supply pumped from underground aquifers and purchased from wholesale suppliers will be adequate to meet customer demand during 2015 and beyond. However, water rationing may be required in future periods, if declared by the state or local jurisdictions. Long-term water supply plans are developed for each of our districts to help assure an adequate water supply under various operating and supply conditions. Some districts have unique challenges in meeting water quality standards, but management believes that supplies will meet current standards using current treatment processes.

### Liquidity and Capital Resources

#### *Cash flow from Operations*

During 2014, we generated cash flow from operations of \$128.1 million, compared to \$124.2 million during 2013, and \$131.9 million during 2012. In general, cash flow from operations is primarily generated by net income, non-cash expenses for depreciation and amortization, deferred income taxes, regulatory liabilities, other current liabilities, changes of prepaid income taxes, and the amortization periods allowed by the commission to recover MCBA and other incurred costs. Cash generated by operations varies during the year due to customer billings, timing of contributions to our benefit plans, and timing of estimated tax payments.

The increase during 2014 compared to 2013 was mostly due a \$6.0 million refund for 2013 calendar year federal and state income tax payments, higher billing rates in 2014 due to the Cal Water 2012 GRC decision, timing collections from customers, and the timing of liability payments also impacted the increase.



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The decrease during 2013 compared to 2012 was primarily due to income tax payments of \$7.7 million in 2013 compared to an income tax refund of \$5.3 million in 2012. The decrease was partially offset by higher billing rates in 2013 due to the Cal Water 2009 GRC decision. The timing of the collection from customers, the timing of employee pensions and other benefit payments, and the timing of liability payments also impacted the decrease.

The water business is seasonal. Billed revenue is lower in the cool, wet winter months when less water is used compared to the warm, dry summer months when water use is highest. This seasonality results in the possible need for short-term borrowings under the bank lines of credit in the event cash is not sufficient to cover operating and capital costs during the winter period. The increase in cash flow during the summer allows short-term borrowings to be paid down. Customer water usage can be lower than normal in years when more than normal precipitation falls in our service areas or temperatures are lower than normal, especially in the summer months. The reduction in water usage reduces cash flow from operations and increases the need for short-term bank borrowings. In addition, short-term borrowings are used to finance capital expenditures until long-term financing is arranged.

***Investing Activities***

During 2014 and 2013, we used \$132.0 million and \$123.0 million, respectively, of cash for capital expenditures, both company-funded and developer-funded. The 2015 budget estimated capital expenditures between \$125 million and \$145 million. Annual expenditures fluctuate each year due to the availability of construction resources and our ability to obtain construction permits in a timely manner.

***Financing Activities***

During 2014, the Company borrowed \$117.3 million and paid down \$85.0 million on our unsecured revolving credit facilities to fund capital expenditures and general corporate purposes. Also, the Company added \$12.3 million of advances and contributions in aid of construction, which was reduced by refunds to developers of \$6.6 million. There was \$0.5 million of new debt added to long-term debt during 2014. The Company did not issue Company common stock or first mortgage bonds in 2014. The uncollected interim rates receivable balance was \$26.9 million as of December 31, 2014 and was financed with our unsecured revolving credit facilities.

During 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of approximately \$105.6 million, net of \$5.1 million of 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. Also, the Company borrowed \$70.6 million on our bank lines of credit, repaid \$113.3 million of short-term borrowings, and added \$10.6 million of advances and contributions in aid of construction, which was reduced by refunds to developers of \$6.9 million.

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.



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Likewise, the unused commitment fee may vary from 8 basis points to 12.5 basis points based on the same ratio.

The undercollected WRAM and MCBA receivable balances were \$47.1 million and \$46.3 million as of December 31, 2014 and 2013, respectively. The increase of \$0.8 million to the undercollected net WRAM and MCBA receivable balances during 2014 was due to timing of when cost-offset filings were authorized and when water production cost increases occurred in 2014. The undercollected net WRAM and MCBA receivable balances were primarily financed by Cal Water with short-term and long-term financing arrangements to meet operational cash requirements. Interest on the undercollected net WRAM and MCBA receivable balances, the interest recoverable from ratepayers, is limited to the current 90-day commercial paper rate which is significantly lower than Cal Water's short and long-term financing rates.

Bond principal and other long-term debt payments were \$8.7 million during 2014, compared to \$47.2 million during 2013. The decrease in 2014 compared to 2013 was primarily due to the \$40.0 million repayment of series MMM and NNN during 2013. Bond principal and other long-term debt payments were \$47.2 million during 2013 compared to \$7.0 million during 2012. The increase in 2013 compared to 2012 was primarily due to the repayment of series MMM and NNN during 2013 and to a lesser affect for repayments on series GGG and HHH.

At the January 2015 meeting, the Board of Directors declared the quarterly dividend, increasing it for the 48<sup>th</sup> consecutive year. The quarterly dividend was raised from \$0.1625 to \$0.1675 per common share, or an annual rate of \$0.67 per common share. Dividends have been paid for 70 consecutive years. The annual dividends paid per common share in 2014, 2013, and 2012 were \$0.65, \$0.64, and \$0.63, respectively. Earnings not paid as dividends are reinvested in the business for the benefit of stockholders. The dividend payout ratio was 55% in 2014, 63% in 2013 and 54% in 2012, for an average of 57% over the three-year period. Our long-term targeted dividend payout ratio is 60%.

***Short-Term Financing***

Short-term liquidity is provided by the bank lines of credit described above and by internally generated funds. Long-term financing is accomplished through the use of both debt and equity. As of December 31, 2014, there were short-term borrowings of \$79.1 million outstanding on our unsecured revolving line of credit compared to \$46.8 million outstanding on our original unsecured revolving line of credit as of December 31, 2013. The increase during 2014 was mostly due to financing of capital expenditures and general corporate purposes. As of December 31, 2013, there were short-term borrowings of \$46.8 million outstanding on our unsecured revolving line of credit compared to \$89.5 million outstanding on our original unsecured revolving line of credit as of December 31, 2012. The decrease during 2013 was mostly due to the repayment of the outstanding borrowings from the net cash proceeds of the Company's common stock public offerings on March 26, 2013.

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

California Water Service Group and subsidiaries which it designates may borrow up to \$100 million under its short-term credit facility. California Water Service Company may borrow up to \$300 million under its credit facility; however, all borrowings need to be repaid within twelve months unless otherwise authorized by the CPUC.

Both short-term 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

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capitalization ratio not to exceed 66.7% and interest coverage ratio of three or more. As of December 31, 2014, the Company's total capitalization ratio was 56.4% (trade payable is included as debt for this calculation) and interest ratio was four and three fourths. In summary, we have met all of the covenant requirements and are eligible to use the full amounts of these credit agreements.

There was \$0.5 million of new debt added to long-term debt during 2014, and we made principal payments on Cal Water's first mortgage bonds and other long-term debt of \$8.7 million during 2014. There was \$0.1 million of new debt added to long-term debt during 2013, and we made principal payments on Cal Water's first mortgage bonds and other long-term debt of \$47.2 million during 2013. Long-term financing, which includes first mortgage bonds, senior notes, other debt securities, and common stock, has typically been used to replace short-term borrowings and fund capital expenditures. Internally generated funds, after making dividend payments, provide positive cash flow, but have not been at a level to meet the needs of our capital expenditure requirements. Management expects this trend to continue given our capital expenditures plan for the next five years. Some capital expenditures are funded by payments received from developers for contributions in aid of construction or advances for construction. Funds received for contributions in aid of construction are non-refundable, whereas funds classified as advances in construction are refundable. Management believes long-term financing is available to meet our cash flow needs through issuances in both debt and equity instruments.

***Long-Term Financing***

On January 7, 2010, Cal Water filed an application for additional financing authority with the CPUC. This request was approved on September 23, 2010, and the CPUC decision authorizes Cal Water to issue \$350 million of debt and common stock to finance capital projects and operations. In November 2010, Cal Water issued \$100 million of first mortgage bonds in accordance with the CPUC decision.

In 2013 the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of approximately \$105.6 million, net of \$5.1 million of 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 future periods, management anticipates funding our capital needs through a relatively balanced approach between long term debt and equity.

Additional information regarding the bank borrowings and long-term debt is presented in Notes 7 and 8 in the Notes to Consolidated Financial Statements.

***Off-Balance Sheet Transactions***

We do not utilize off-balance-sheet financing or utilize special purpose entity arrangements for financing. We do not have equity ownership through joint ventures or partnership arrangements.

***Contractual Obligations***

The contractual obligations presented in the table below represent our estimates of future payments under fixed contractual obligations and commitments. Changes in our business needs, cancellation provisions and changes in interest rates, as well as action by third parties and other factors, may cause

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these estimates to change. Therefore, our actual payments in future periods may vary from those presented in the table below. The following table summarizes our contractual obligations as of December 31, 2014.

	Total	Less than 1 Year	1 - 3 Years	3 - 5 Years	After 5 Years
	(In thousands)				
Long-term debt(*)	\$ 417,105	\$ 6,318	\$ 32,599	\$ 121,041	\$ 257,147
Interest payments	312,151	25,487	50,020	42,656	193,988
Advances for construction	182,284	7,587	14,708	14,655	145,334
Pension and post retirement benefits(**)	272,651	8,791	21,417	27,253	215,190
Capital lease obligations(***)	11,936	1,109	2,218	2,264	6,345
Facility leases	5,753	893	987	783	3,090
System leases	3,028	845	1,690	493	
Water supply contracts	531,429	21,045	42,261	44,212	423,911
<b>TOTAL</b>	<b>\$ 1,736,337</b>	<b>\$ 72,075</b>	<b>\$ 165,900</b>	<b>\$ 253,357</b>	<b>\$ 1,245,005</b>

\* Excludes capital lease obligations as reported below.

\*\* Pension and post retirement benefits include \$1.8 million of short-term pension obligations.

\*\*\* Capital lease obligations represent total cash payments to be made in the future and include interest expense of \$3.2 million.

Our contractual obligations are summarized in the table above. For pension and post retirement benefits other than pension obligations see Note 11 of the Notes to the consolidated Financial Statements. Long-term debt payments include annual sinking fund payments on first mortgage bonds, maturities of long-term debt, and annual payments on other long-term obligations. Advances for construction represent annual contract refunds to developers for the cost of water systems paid for by the developers. The contracts are non-interest bearing, and refunds are generally on a straight-line basis over a 40-year period. System and office leases include obligations associated with leasing water systems and rents for office space.

There are three capital leases; the most significant was the City of Hawthorne water system. In 2011, we entered into a 15-year capital lease agreement to operate the City of Hawthorne water system. The system, which is located near the Hermosa Redondo district, serves about half of Hawthorne's population. The lease agreement required us to make an up-front \$8.1 million lease payment to the city that is being amortized over the lease term. Additionally, annual lease payments of \$0.9 million are made to the city and shall be increased or decreased each year on July 1, by the same percentage that the rates charged to customers served by the water system increased or decreased, exclusive of pass-through increases or decreases in the cost of water, power, and city-imposed fees, compared to the rates in effect on July 1 of the prior year, provided, that in no event will the annual lease payment be less than \$0.9 million. Under the lease, we are responsible for all aspects of system operation and capital improvements, although title to the system and system improvements reside with the city. In exchange, we receive all revenue from the water system, which was \$7.8 million, \$7.7 million, and \$7.6 million in 2014, 2013, and 2012, respectively. At the end of the lease, the city is required to reimburse us for the unamortized value of capital improvements made during the term of the lease.

Cal Water has water supply contracts with wholesale suppliers in 14 of its operating districts and for the two leased systems in Hawthorne and Commerce. For each contract, the cost of water is established by the wholesale supplier and is generally beyond our control. The amount paid annually to the wholesale suppliers is charged to purchased water expense on our statement of income. Most contracts do not require minimum annual payments and vary with the volume of water purchased.

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We have a contract with the Santa Clara Valley Water District, which contains minimum purchase obligations. The contract payment varies with the volume of water purchased above the minimum purchase levels. Management plans to continue to purchase and use at least the minimum quantity of water that is required to purchase under this contract in the future. Total paid to Santa Clara Valley Water District was \$5.5 million in 2014, \$7.4 million in 2013, and \$6.2 million in 2012.

The water supply contract with Stockton East Water District (SEWD) expires on April 1, 2035, requires a fixed, annual payment and does not vary during the year with the quantity of water delivered by the district. Due to the fixed price arrangement, we utilize as much water as possible from SEWD in order to minimize the cost of operating Company-owned wells used to supplement SEWD deliveries. The total paid under the contract was \$8.7 million in 2014, \$10.0 million in 2013, and \$6.6 million in 2012. Pricing under the contract varies annually. Estimated annual contractual obligations in the above table are based on the same payment level as 2014. Future cost increases by SEWD are expected to be offset by a decline in the allocation of costs to us as more of these costs are expected to be allocated to other SEWD customers due to growth within their service areas.

On September 21, 2005, we entered into an agreement with Kern County Water Agency (Agency) to obtain treated water for our operations. The term of the agreement is to January 1, 2035, or until the Agency's bonds are repaid. The Agency's bonds are described below. Under the terms of the agreement, we were obligated to purchase approximately 19,000 acre feet of treated water in 2014 and an incrementally higher volume of water for each subsequent year until 2018, when we are obligated to purchase 20,500 acre feet of treated water per year. We are obligated to pay a capital facilities charge and a treated water charge regardless of whether we can use the water in our operation, and we are obligated for these charges even if the Agency cannot produce an adequate amount to supply the 20,500 acre feet in the year. This agreement supersedes a prior agreement with Kern County Water Agency for the supply of 11,500 acre feet of water per year. Total expense, under the prior agreement, was \$6.7 million in 2014, \$6.3 million in 2013, and \$6.3 million in 2012.

Three other parties, including the City of Bakersfield, are also obligated to purchase a total of 32,500 acre feet per year under separate agreements with the Agency. Further, the Agency has the right to proportionally reduce the water supply provided to all of the participants if it cannot produce adequate supplies. The participation of all parties in the transaction for expansion of the Agency's facilities, including its water purification plant, purchase of the water, and payment of interest and principal on the bonds being issued by the Agency to finance the transaction, is required as a condition to the obligation of the Agency to proceed with expansion of the Agency's facilities. If any of the other parties does not use its allocation in a given year, that party is still obligated to pay its contracted amount.

The Agency has issued bonds to fund the project and will use the payments of the capital facilities charges by us and the other contracted parties to meet the Agency's obligations to pay interest and repay principal on the bonds. If any of the parties were to default on making payments of the capital facilities charge, then the other parties are obligated to pay for the defaulting party's share on a pro-rata basis. If there is a payment default by a party and the remaining parties have to make payments, they are also entitled to a pro-rata share of the defaulting party's water allocation.

We expect to use all of its entitled water in our operations every year. If additional treated water is available, all parties have an option to purchase this additional treated water, subject to the Agency's right to allocate the water among the parties. If we were to pay for and receive additional amounts of water due to a default of another participating party, we believe we could use this additional water in our operations without incurring substantial increases in incremental costs.

The total obligation of all parties, excluding us, is approximately \$82.4 million to the Agency. Based on the credit worthiness of the other participants, which are government entities, our management believes it to be highly unlikely that we would be required to assume any other parties' obligations under the

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contract due to their default. If a party defaults, we would receive entitlement to the additional water for assuming the additional obligation.

We pay a capital facilities charge and charges related to treated water that together total \$7.7 million annually, which equates to \$378 dollars per acre foot. Total treated water charge for 2014 was \$2.8 million. As treated water is being delivered, we will also be obligated for our portion of the operating costs; that portion is currently estimated to be \$14 dollars per acre foot. The actual amount will vary due to variations from estimates, inflation, and other changes in the cost structure. Our overall estimated cost of \$378 dollars per acre foot is less than the estimated cost of procuring untreated water (assuming water rights could be obtained) and then providing treatment.

***Capital Requirements***

Capital requirements consist primarily of new construction expenditures for expanding and replacing utility plant facilities and the acquisition of water systems. They also include refunds of advances for construction.

Company-funded and developer-funded utility plant expenditures were \$132.0 million, \$123.0 million, and \$127.7 million in 2014, 2013, and 2012, respectively. A majority of capital expenditures was associated with mains and water treatment equipment.

For 2015, the Company is estimating its capital expenditures to be between \$125 million and \$145 million. We expect our annual capital expenditure to increase during the next five years due to increasing needs to replace and maintain infrastructure.

Management expects developer-funded expenditures in 2015. These expenditures will be financed by developers through refundable advances for construction and non-refundable contributions in aid of construction. Developers are required to deposit the cost of a water construction project with us prior to our commencing construction work, or the developers may construct the facilities themselves and deed the completed facilities to us. Funds are generally received in advance of incurring costs for these projects. Advances are normally refunded over a 40-year period without interest. Future payments for advances received are listed under contractual obligations above. Because non-company-funded construction activity is solely at the discretion of developers, we cannot predict the level of future activity. The cash flow impact is expected to be minor due to the structure of the arrangements.

***Capital Structure***

Common stockholders' equity was \$626.6 million at December 31, 2014 compared to \$598.8 million at December 31, 2013. The Company issued additional long-term debt of \$0.5 million in 2014. The Company did not sell shares of its common stock in 2014.

Common stockholders' equity was \$598.8 million at December 31, 2013 compared to \$473.7 million as of December 31, 2012. In 2013, the Company sold 5,750,000 shares of its common stock in an underwritten public offering for cash proceeds of \$105.6 million, net of underwriting discounts and commissions and offering expenses. The Company did not incur additional long-term debt in 2013.

Total capitalization, including the current portion of long-term debt, at December 31, 2014, was \$1,052 million and \$1,033 million at December 31, 2013. In future periods, the Company intends to issue common stock and long-term debt to finance our operations. The capitalization ratios will vary depending upon the method we choose to finance our operations.

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At December 31, capitalization ratios were:

	2014	2013
Common equity	59.5%	58.0%
Long-term debt	40.5%	42.0%

The return (from both regulated and non-regulated operations) on average common equity was 9.3% in 2014 compared to 8.8% in 2013.

***Acquisitions***

In 2014, 2013, and 2012 there were no significant acquisitions.

***Real Estate Program***

We own real estate. From time to time, certain parcels are deemed no longer used or useful for water utility operations. Most surplus properties have a low cost basis. We developed a program to realize the value of certain surplus properties through sale or lease of those properties. The program will be ongoing for a period of several years. Property sales produced pretax gains of less than \$0.1 million in 2014, 2013 and 2012. As sales are dependent on real estate market conditions, future sales, if any, may or may not be at prior year levels.

**Item 7A. *Quantitative and Qualitative Disclosures about Market Risk.***

We do not participate in hedge arrangements, such as forward contracts, swap agreements, options, or other contractual agreements to mitigate the impact of market fluctuations on our assets, liabilities, production, or contractual commitments. We operate only in the United States and, therefore, are not subject to foreign currency exchange rate risks.

**Interest Rate Risk**

We are subject to interest rate risk, although this risk is lessened because we operate in a regulated industry. If interest rates were to increase, management believes customer rates would increase accordingly, subject to Commission approval in future GRC filings. The majority of our debt is long-term at a fixed rate. Interest rate risk does exist on short-term borrowings within our credit facilities, as these interest rates are variable. We also have interest rate risk on new financing, as higher interest cost may occur on new debt if interest rates increase.

Over the next 12 months, approximately \$6.6 million of the \$425.8 million of existing long-term debt instruments will mature or require sinking fund payments. Applying a hypothetical 10 percent increase in the rate of interest charged on those borrowings would not have a material effect on our earnings.

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**Item 8. *Financial Statements and Supplementary Data.***

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
California Water Service Group  
San Jose, California

We have audited the accompanying consolidated balance sheets of California Water Service Group and subsidiaries (the "Company") as of December 31, 2014 and 2013, and the related consolidated statements of income, common stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2014. We also have audited the Company's internal control over financial reporting as of December 31, 2014, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of California Water Service Group and subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2014, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2014, based on the criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/S/ DELOITTE & TOUCHE LLP

San Francisco, California  
February 26, 2015



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	<b>December 31,</b>	
	<b>2014</b>	<b>2013</b>
	<b>(In thousands, except per share data)</b>	
<b>ASSETS</b>		
Utility plant:		
Land	\$ 42,181	\$ 42,208
Depreciable plant and equipment	2,191,194	2,043,414
Construction work in progress	90,328	109,474
Intangible assets	18,768	18,232
<b>Total utility plant</b>	<b>2,342,471</b>	<b>2,213,328</b>
Less accumulated depreciation and amortization	(752,040)	(697,497)
<b>Net utility plant</b>	<b>1,590,431</b>	<b>1,515,831</b>
Current assets:		
Cash and cash equivalents	19,587	27,506
Receivables: net of allowance for doubtful accounts of \$697 and \$668 in 2014 and 2013, respectively		
Customers	25,803	31,468
Regulatory balancing accounts	53,199	30,887
Other	14,136	18,700
Unbilled revenue	23,740	17,034
Materials and supplies at weighted average cost	6,041	5,571
Taxes, prepaid expenses, and other assets	11,618	8,324
<b>Total current assets</b>	<b>154,124</b>	<b>139,490</b>
Other assets:		
Regulatory assets	390,331	251,681
Unamortized debt premium and expense	4,640	5,114
Goodwill	2,615	2,615
Other	45,210	45,124
<b>Total other assets</b>	<b>442,796</b>	<b>304,534</b>
	<b>\$ 2,187,351</b>	<b>\$ 1,959,855</b>
<b>CAPITALIZATION AND LIABILITIES</b>		
Capitalization:		
Common stock, \$0.01 par value; 68,000 shares authorized, 47,806 and 47,741, outstanding in 2014 and 2013, respectively	\$ 478	\$ 477
Additional paid-in capital	330,558	328,364
Retained earnings	295,590	269,915
<b>Total common stockholders' equity</b>	<b>626,626</b>	<b>598,756</b>
Long-term debt, less current maturities	419,233	426,142
<b>Total capitalization</b>	<b>1,045,859</b>	<b>1,024,898</b>
Current liabilities:		
Current maturities of long-term debt	6,607	7,908
Short-term borrowings	79,115	46,815
Accounts payable	59,395	55,087

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Regulatory balancing accounts	6,126	1,827
Accrued other taxes	4,059	3,575
Accrued interest	4,194	4,245
Other accrued liabilities	58,210	47,127
<b>Total current liabilities</b>	<b>217,706</b>	<b>166,584</b>
Unamortized investment tax credits	2,032	2,106
Deferred income taxes	214,842	183,245
Regulatory liabilities	36,447	34,251
Pension and postretirement benefits other than pension	270,865	145,451
Advances for construction	182,284	183,393
Contributions in aid of construction	170,484	167,723
Other long-term liabilities	46,832	52,204
Commitments and contingencies		
	\$ 2,187,351	\$ 1,959,855