UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from to

Commission file number 1-13883

CALIFORNIA WATER SERVICE GROUP

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**77-0448994** (I.R.S. Employer identification No.)
1720 North First Street, San Jose, CA. (Address of principal executive offices)	**95112** (Zip Code)

408-367-8200

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. Common shares outstanding as of August 1, 2013 47,734,035

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PART I FINANCIAL INFORMATION

Item 1.

FINANCIAL STATEMENTS

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

CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(In thousands, except per share data)

	June 30, 2013	December 31, 2012
ASSETS		
Utility plant:		
Utility plant	$ 2,160,706	$ 2,096,363
Less accumulated depreciation and amortization	(670,452)	(639,307)
Net utility plant	1,490,254	1,457,056
Current assets:		
Cash and cash equivalents	38,668	38,790
Receivables: net of allowance for doubtful accounts of $714 for both periods presented		
Customers	41,493	29,958
Regulatory balancing accounts	25,560	34,020
Other	14,335	11,943
Unbilled revenue	24,750	15,394
Materials and supplies at weighted average cost	5,720	5,874
Taxes, prepaid expenses and other assets	13,550	10,585
Total current assets	164,076	146,564
Other assets:		
Regulatory assets	353,910	344,419
Goodwill	2,615	2,615
Other assets	47,752	45,270
Total other assets	404,277	392,304
	$ 2,058,607	$ 1,995,924
CAPITALIZATION AND LIABILITIES		
Capitalization:		

Common stock, $.01 par value; 68,000,000 shares authorized, 47,734,035 and 41,908,218 outstanding in 2013 and 2012, respectively	$	477	$	419
Additional paid-in capital		327,628		221,013
Retained earnings		250,375		252,280
Total common stockholders equity		578,480		473,712
Long-term debt, less current maturities		430,705		434,467
Total capitalization		1,009,185		908,179
Current liabilities:				
Current maturities of long-term debt		48,040		46,783
Short-term borrowings		28,815		89,475
Accounts payable		57,158		47,199
Regulatory balancing accounts		4,717		5,018
Accrued interest		4,608		4,705
Accrued expenses and other liabilities		52,872		49,887
Total current liabilities		196,210		243,067
Unamortized investment tax credits		2,180		2,180
Deferred income taxes, net		167,611		158,846
Pension and postretirement benefits other than pensions		248,003		244,901
Regulatory and other liabilities		88,578		92,593
Advances for construction		186,202		187,584
Contributions in aid of construction		160,638		158,574
Commitments and contingencies				
	$	2,058,607	$	1,995,924

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

(In thousands, except per share data)

For the three months ended		June 30, 2013		June 30, 2012
Operating revenue	$	154,555	$	143,552
Operating expenses:				
Operations:				
Water production costs		59,645		52,678
Administrative and general		23,155		22,167
Other operations		17,030		17,729
Maintenance		4,188		4,605
Depreciation and amortization		14,491		13,712
Income taxes		9,548		9,062
Property and other taxes		5,715		3,977
Total operating expenses		133,772		123,930
Net operating income		20,783		19,622
Other income and expenses:				
Non-regulated revenue		3,215		4,051
Non-regulated expenses, net		(3,240)		(3,695)
Income tax benefit (expense) on other income and expenses		16		(138)
Net other (expense) income		(9)		218
Interest expense:				
Interest expense		7,803		7,821
Less: capitalized interest		(539)		(946)
Net interest expense		7,264		6,875
Net income	$	13,510	$	12,965
Earnings per share				
Basic	$	0.28	$	0.31
Diluted	$	0.28	$	0.31
Weighted average shares outstanding				
Basic		47,729		41,911
Diluted		47,760		41,911
Dividends declared per share of common stock	$	0.16000	$	0.15750

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

(In thousands, except per share data)

For the six months ended	June 30, 2013	June 30, 2012
Operating revenue	$ 265,999	$ 260,301
Operating expenses:		
Operations:		
Water production costs	101,342	91,630
Administrative and general	48,436	45,185
Other operations	32,675	41,555
Maintenance	8,321	10,365
Depreciation and amortization	29,120	27,663
Income taxes	8,402	9,090
Property and other taxes	11,150	8,584
Total operating expenses	239,446	234,072
Net operating income	26,553	26,229
Other income and expenses:		
Non-regulated revenue	6,737	8,187
Non-regulated expenses, net	(5,657)	(5,794)
Income tax (expense) on other income and expenses	(435)	(961)
Net other income	645	1,432
Interest expense:		
Interest expense	15,840	15,460
Less: capitalized interest	(1,079)	(1,849)
Net interest expense	14,761	13,611
Net income	$ 12,437	$ 14,050
Earnings per share		
Basic	$ 0.28	$ 0.34
Diluted	$ 0.28	$ 0.34
Weighted average shares outstanding		
Basic	45,004	41,877
Diluted	45,034	41,877
Dividends declared per share of common stock	$ 0.32000	$ 0.31500

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

(In thousands)

For the six months ended :		June 30, 2013		June 30, 2012
Operating activities				
Net income	$	12,437	$	14,050
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		30,088		28,554
Change in value of life insurance contracts		(504)		(1,635)
Other changes in noncurrent assets and liabilities		1,350		(1,658)
Changes in operating assets and liabilities:				
Receivables		(19,686)		(20,701)
Accounts payable		8,787		8,879
Other current assets		(3,889)		(5,108)
Other current liabilities		8,193		9,716
Net cash provided by operating activities		36,776		32,097
Investing activities:				
Utility plant expenditures		(66,190)		(61,984)
Purchase of life insurance		(1,608)		(1,357)
Change in restricted cash and other changes		1,079		6
Net cash used in investing activities		(66,719)		(63,335)
Financing activities:				
Short-term borrowings		32,615		62,635
Repayment of short-term borrowings		(93,275)		(22,000)
Proceeds from long-term debt		48		123
Repayment of long-term debt		(2,553)		(1,645)
Advances and contributions in aid of construction		5,006		2,760
Refunds of advances for construction		(3,512)		(3,835)
Issuance of common stock		110,688		
Common stock issuance cost		(4,853)		
Dividends paid		(14,343)		(13,187)
Net cash provided by financing activities		29,821		24,851
Change in cash and cash equivalents		(122)		(6,387)
Cash and cash equivalents at beginning of period		38,790		27,203
Cash and cash equivalents at end of period	$	38,668	$	20,816
Supplemental information				
Cash paid for interest (net of amounts capitalized)	$	14,383	$	13,143
Cash paid for income taxes	$		$	
Supplemental disclosure of non-cash activities:				
Accrued payables for investments in utility plant	$	9,492	$	8,998
Utility plant contribution by developers	$	6,809	$	8,710

See Accompanying Notes to Unaudited Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP

Notes to Unaudited Condensed Consolidated Financial Statements

June 30, 2013

(Amounts in thousands, except share and per share amounts)

Note 1. Organization and Operations and Basis of Presentation

California Water Service Group (the Company) is a holding company that provides water utility and other related services in California, Washington, New Mexico and Hawaii through its 100% owned subsidiaries. California Water Service Company (Cal Water), Washington Water Service Company (Washington Water), New Mexico Water Service Company (New Mexico Water), and Hawaii Water Service Company, Inc. (Hawaii Water) provide regulated utility services under the rules and regulations of their respective state s regulatory commissions (jointly referred to herein as the Commissions). CWS Utility Services and HWS Utility Services LLC provide non-regulated water utility and utility-related services.

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

Basis of Presentation

The unaudited interim financial information has been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X promulgated by the Securities and Exchange Commission (SEC) and therefore do not contain all of the information and footnotes required by GAAP and the SEC for annual financial statements. The condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements for the year ended December 31, 2012, included in its annual report on Form 10-K as filed with the SEC on February 28, 2013.

The preparation of the Company s condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet dates and the reported amounts of revenues and expenses for the periods presented. These include, but are not limited to, estimates and assumptions used in determining the Company s regulatory asset and liability balances based upon probability assessments of regulatory recovery, revenues earned but not yet billed, asset retirement obligations, allowance for doubtful accounts, pension and other employee benefit plan liabilities, and income tax-related assets and liabilities. Actual results could differ from these estimates.

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

Due to the seasonal nature of the water business, the results for interim periods are not indicative of the results for a 12-month period. Revenue and income are generally higher in the warm, dry summer months when water usage and sales are greater. Revenue and income are lower in the winter months when cooler temperatures and rainfall curtail water usage and sales.

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

Note 2. Summary of Significant Accounting Policies

Revenue

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

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

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For metered customers, Cal Water recognizes revenue from rates which are designed and authorized by the California Public Utilities Commission (CPUC). Under the Water Revenue Adjustment Mechanism (WRAM), Cal Water records the adopted level of volumetric revenues, which would include recovery of cost of service and a return on investments, as established by the CPUC for metered accounts (adopted volumetric revenues). In addition to volumetric-based revenues, the revenue requirements approved by the CPUC include service charges, flat rate charges, and other items not subject to the WRAM. The adopted volumetric revenue considers the seasonality of consumption of water based upon historical averages. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as a component of revenue with an offsetting entry to a regulatory asset or liability balancing account (tracked individually for each Cal Water district) subject to certain criteria under the accounting for regulated operations being met. The variance amount may be positive or negative and represents amounts that will be billed or refunded to customers in the future.

Cost-recovery rates are designed to permit full recovery of certain costs 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. There is no markup for return or profit for cost-recovery expenses and they are generally recognized when expenses are incurred.

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

The change to deferred net WRAM and MCBA balances during the six months ended June 30, 2013 was:

	Operating Revenues	Operating Costs	Income Before Income Taxes
Net WRAM and MCBA deferral as of December 31, 2012	$ 882	$ 719	$ 163
Less: reversal of prior year deferral during the six months ended June 30, 2013	(415)	(317)	(98)
Add: net WRAM and MCBA deferral during the six months ended June 30, 2013	800	687	113
Net amount during the six months ended June 30, 2013	385	370	15
Net WRAM and MCBA deferral as of June 30, 2013	$ 1,267	$ 1,089	$ 178

The change to deferred net WRAM and MCBA balances during the six months ended June 30, 2012 was:

	Operating Revenues	Operating Costs	Income Before Income Taxes
Net WRAM and MCBA deferral as of December 31, 2011	$ 12,864	$ 10,492	$ 2,372
Less: reversal of prior year deferral during the six months ended June 30, 2012	(9,486)	(7,736)	(1,750)
Add: net WRAM and MCBA deferral during the six months ended June 30, 2012	462	377	85
Net amount during the six months ended June 30, 2012	(9,024)	(7,359)	(1,665)
Net WRAM and MCBA deferral as of June 30, 2012	$ 3,840	$ 3,133	$ 707

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The net WRAM and MCBA under- or overcollected balances are:

		June 30, 2013		December 31, 2012
Net short-term regulatory balancing accounts (receivable)	$	25,560	$	34,020
Net long-term regulatory assets (receivable)		18,644		12,051
Total regulatory assets	$	44,204	$	46,071
Net short-term regulatory balancing accounts (liability)	$	196	$	371
Net long-term regulatory liability		183		119
Total payable	$	379	$	490

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. Unearned revenue liability was $1.6 million and $1.7 million as of June 30, 2013 and December 31, 2012, respectively. This liability is included in accrued expenses and other liabilities on the condensed consolidated balance sheets.

Cash and Cash Equivalents

Cash equivalents include highly liquid investments with maturities of three months or less. Cash and cash equivalents was $38.7 million and $38.8 million as of June 30, 2013 and December 31, 2012, respectively. Restricted cash is included in taxes, prepaid expenses and other assets and was $1.2 million and $2.3 million as of June 30, 2013 and December 31, 2012, respectively.

Adoption of New Accounting Standards

On February 1, 2013, the Financial Accounting Standards Board issued an accounting standards update (ASU) for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The ASU will impact the Company s recognition, measurement, and disclosure requirements for guarantees on third party debt of its 100%-owned subsidiaries. The ASU effective date for the Company s interim and annual reporting is January 1, 2014. The Company is reviewing its contracts to determine if there are any of these arrangements and the impact, if any, on the Company s condensed consolidated financial statements.

Note 3. Stock-based Compensation

Equity Incentive Plan

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

During the six months ended June 30, 2013 and 2012, the Company granted annual Restricted Stock Awards (RSAs) of 70,557 and 98,422 shares, respectively, of common stock to officers and directors of the Company and no RSAs were cancelled. Employee RSAs granted in 2013 vest over 36 months and RSAs granted in 2012 vest over 48 months. Director RSAs generally vest at the end of 12 months. During the first six months of 2013 and 2012, the shares granted were valued at $20.62 and $17.96 per share, respectively, based upon the fair market value of the Company s common stock on the date of grant.

On March 1, 2013, the Company granted performance-based Restricted Stock Unit Awards (RSUs) of 50,267 shares of common stock to officers. Each award reflects a target number of shares that may be issued to the award recipient. The awards may be earned upon the completion of the three-year performance period ending February 28, 2016. Whether RSUs are earned at the end of the performance period will be determined based on the achievement of certain performance objectives set by the Board of Director Compensation Committee in connection with the issuance of the RSUs. The performance objectives are based on the Company s business plan covering the performance period. The performance objectives include achieving the budgeted return on equity, budgeted investment in utility plant, customer service standards, and water quality standards. Depending on the results achieved during the three-year performance period, the actual number of shares that a grant recipient receives at the end of the performance period may range from 0% to 200% of the target shares granted, provided that the grantee is continuously employed by the Company through the vesting date. If prior to the vesting date employment is terminated by reason of death, disability or normal retirement, then a pro rata portion of this award will vest. RSUs are not included in diluted shares for financial reporting until earned. The RSUs are recognized as expense ratably over the three year performance period using a fair market value of $20.62 per share and an estimate of RSUs earned during the performance period.

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The Company has recorded compensation costs for the RSAs and RSUs which are included in operating expense in the amount of $0.8 million and $0.6 million for the six months ended June 30, 2013 and June 30, 2012, respectively. The Company has recorded compensation costs for the RSAs and RSUs in operating expense in the amount of $0.5 million and $0.4 million for the three months ended June 30, 2013 and June 30, 2012, respectively.

Note 4. Equity

The Company s changes in equity for the six months ended June 30, 2013 were as follows:

		Total Stockholders Equity
Balance at December 31, 2012	$	473,712
Common stock issued, net		105,835
Share-based compensation expense		839
Common stock dividends declared		(14,343)
Net income		12,437
Balance at June 30, 2013	$	578,480

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

Note 5. Earnings Per Share Calculations

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

A total of 333,856 shares of Stock Appreciation Rights were vested and outstanding and all were dilutive as of June 30, 2013 and anti-dilutive as of June 30, 2012 as shown in the tables below.

	Three months Ended June 30			
		2013		2012
Net income available to common stockholders	$	13,510	$	12,965
Weighted average common shares, basic		47,729		41,911
Dilutive common stock appreciation rights (treasury method)		31		
Shares used for dilutive computation		47,760		41,911

Net income per share - basic	$	0.28	$	0.31
Net income per share - diluted	$	0.28	$	0.31

	Six months Ended June 30			
	2013		2012	
Net income available to common stockholders	$	12,437	$	14,050
Weighted average common shares, basic		45,004		41,877
Dilutive common stock appreciation rights (treasury method)		30		
Shares used for dilutive computation		45,034		41,877
Net income per share - basic	$	0.28	$	0.34
Net income per share - diluted	$	0.28	$	0.34

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Note 6. Pension Plan and Other Postretirement Benefits

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

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

Cash payments by the Company related to pension plans and other postretirement benefit plans were $17.8 million for the six months ended June 30, 2013 compared to $15.8 million for the six months ended June 30, 2012. The 2013 estimated cash contribution to the pension plans is $31.3 million and to the other postretirement benefit plans is $9.6 million.

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

	Three months Ended June 30			
	Pension Plan		Other Benefits	
	2013	2012	2013	2012
Service cost	$ 4,658	$ 3,709	$ 1,695	$ 1,330
Interest cost	4,063	3,864	1,109	1,005
Expected return on plan assets	(3,565)	(2,886)	(598)	(448)
Recognized net initial APBO (1)	N/A	N/A	2	69
Amortization of prior service cost	1,541	1,570	20	29
Recognized net actuarial loss	2,224	2,075	916	822
Net periodic benefit cost	$ 8,921	$ 8,332	$ 3,144	$ 2,807

	Six months Ended June 30			
	Pension Plan		Other Benefits	
	2013	2012	2013	2012
Service cost	$ 9,316	$ 7,725	$ 3,390	$ 2,747
Interest cost	8,126	7,643	2,218	1,972
Expected return on plan assets	(7,130)	(5,779)	(1,196)	(916)
Recognized net initial APBO (1)	N/A	N/A	4	138
Amortization of prior service cost	3,082	3,141	40	58
Recognized net actuarial loss	4,448	4,001	1,832	1,586
Net periodic benefit cost	$ 17,842	$ 16,731	$ 6,288	$ 5,585

(1) APBO - Accumulated postretirement benefit obligation

Note 7. Short-term and Long-term Borrowings

On June 29, 2011, the Company and Cal Water entered into Syndicated Credit Facilities, 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 12-months unless otherwise authorized by the CPUC. The proceeds from the revolving credit facilities may be used for working capital purposes, including the short-term financing of capital projects. The base loan rate may vary from LIBOR plus 72.5 basis points to LIBOR plus 95 basis points, depending on the Company s total capitalization ratio. Likewise, the unused commitment fee may vary from 8 basis points to 12.5 basis points based on the same ratio.

Both short-term unsecured credit agreements contain affirmative and negative covenants and events of default customary for credit facilities of this type including, among other things, limitations and prohibitions relating to additional indebtedness, liens, mergers, and asset sales. Also, these unsecured credit agreements contain financial covenants governing the Company and its subsidiaries consolidated total capitalization ratio and interest coverage ratio. As of June 30, 2013, the Company and Cal Water have met all borrowing covenants for both credit agreements.

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As of June 30, 2013 and December 31, 2012, the outstanding borrowings on the Company lines of credit were $8.8 million and $64.5 million, respectively, and the outstanding borrowings on the Cal Water lines of credit were $20.0 million and $25.0 million. For the six months ended June 30, 2013, the average borrowing rate was 2.3% compared to 1.6% for the same period last year.

Note 8. Income Taxes

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

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

During 2012, the Company filed an application for a change in accounting method (section 481 adjustment) with the Internal Revenue Service (IRS) to implement the new repairs and maintenance deduction. The new deduction is for qualified tangible property placed into service during 2012 and prior years. The new tax regulations allow the Company to deduct a significant amount of costs previously capitalized for book and tax purposes. The 2012 repairs and maintenance deductions resulted in a federal net operating loss (NOL) of $26.0 million and a state NOL of $55.7 million. The NOL carry-forward amounts are more likely than not to be recovered and therefore require no valuation allowance. The NOL carry-forward does not begin to expire until 2033.

The American Taxpayer Relief Act of 2012 provided the Company with additional 50% first-year bonus depreciation for assets placed in service from December 31, 2012 to December 31, 2013. The federal income tax bonus deduction was estimated at $3.1 million in 2012. The 2012 estimate will be finalized when the Company files its 2012 tax returns during the third quarter of 2013.

The IRS is presently auditing the Company s 2010 and 2011 federal income tax returns. It is uncertain when the IRS will complete its audit. The Company believes that the final resolution of the IRS audit will not have a material adverse impact on its financial condition, cash flows, or results of operations.

Note 9. Regulatory Assets and Liabilities

During 2011, the CPUC issued a decision regarding the $34.2 million of litigation proceeds previously received by Cal Water during 2008 which is being used to replace infrastructure damaged by the gasoline additive Methyl tert-butyl ether (MTBE). The decision requires use of these proceeds for costs incurred as a result of MTBE contamination with any related benefits to be provided to Cal Water customers. Such usage includes transfer of the amount to contributions in aid of construction (CIAC) for remediation or replacement project costs once complete. Usage of the proceeds is reported to the CPUC through an Advice Letter or General Rate Case filing. As of December 31, 2012, $22.4 million of the proceeds was recorded as CIAC. Cal Water used $1.2 million of the proceeds to replace damaged infrastructure during the second quarter of 2013. The remaining balance of $10.6 million at June 30, 2013 is included in regulatory and other liabilities.

During 2011, Cal Water added balancing accounts for its pension plans and conservation program. Both balancing account effective dates were January 1, 2011. The pension plans balancing account is a two-way balancing account that tracks the differences between actual expenses and adopted rate recovery which will result in either a regulatory asset or liability. The conservation program is a one-way balancing account that tracks the differences between actual expenses and adopted rate recovery which may result in a regulatory liability if actual conservation expenses are less than adopted over the three year period ending December 31, 2013. As of June 30, 2013 and December 31, 2012, the pension balancing account was a regulatory asset of $3.7 million and $2.4 million, respectively. The conservation balancing account was a regulatory liability of $6.8 million and $6.5 million as of June 30, 2013 and December 31, 2012, respectively.

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Note 10. Commitment and Contingencies

Commitments

The Company has significant commitments to lease certain office spaces and water systems and to purchase water from water wholesalers. These commitments are described in Form 10-K for the year ended December 31, 2012. As of June 30, 2013, there were no significant changes from December 31, 2012.

Contingencies

Groundwater Contamination

The Company has undertaken litigation against third parties to recover past and future costs related to ground water contamination in our service areas. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. The Company records gain contingencies as a regulatory liability when the net litigation proceeds are received. The Commission s general policy requires all proceeds from contamination litigation to be used first to pay transactional expenses, then to make ratepayers whole for water treatment costs to comply with the Commission s water quality standards. The Commission allows for a risk-based consideration of contamination proceeds which exceed the costs of the remediation described above and may result in some sharing of proceeds with the shareholder, determined on a case by case basis. The Commission has authorized various memorandum accounts that allow the Company to track significant litigation costs to request recovery of these costs in future filings and uses of proceeds to comply with Commission s general policy.

Other Legal Matters

From time to time, the Company is involved in various disputes and litigation matters that arise in the ordinary course of business. The status of each significant matter is reviewed and assessed for potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount of the range of loss can be estimated, a liability is accrued for the estimated loss in accordance with the accounting standards for contingencies. Legal proceedings are subject to uncertainties, and the outcomes are difficult to predict. Because of such uncertainties, accruals are based on the best information available at the time. While the outcome of these disputes and litigation matters cannot be predicted with any certainty, management does not believe when taking into account existing reserves the ultimate resolution of these matters will materially affect the Company s financial position, results of operations, or cash flows. The Company recognized a liability of $1.0 million and $1.1 million for all known legal matters as of June 30, 2013 and December 31, 2012, respectively. The cost of litigation is expensed as incurred and any settlement is first offset against such costs. Any settlement in excess of the cost to litigate is accounted for on a case by case basis, dependant on the nature of the settlement.

Note 11. Fair Value of Financial Assets and Liabilities

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

Level 1 -	Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. The types of assets and liabilities included in Level 1 are highly liquid and actively traded instruments with quoted prices.
Level 2 -	Pricing inputs are other than quoted prices in active markets, but are either directly or indirectly observable as of the reporting date. The types of assets and liabilities included in Level 2 are typically either comparable to actively traded securities or contracts, or priced with discounted cash flow or option pricing models using highly observable inputs.
Level 3 -	Significant inputs to pricing have little or no observability as of the reporting date. The types of assets and liabilities included in Level 3 are those valued with models requiring significant management judgment or estimation.

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Specific valuation methods include the following:

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

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

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

	June 30, 2013				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long -term debt, including current maturities	$ 478,745	$	$ 571,083	$	$ 571,083
Advances for construction	186,202		71,801		71,801
Total	$ 664,947	$	$ 642,884	$	$ 642,884

	December 31, 2012				
		Fair Value			
	Cost	Level 1	Level 2	Level 3	Total
Long -term debt, including current maturities	$ 481,250	$	$ 613,211	$	$ 613,211
Advances for construction	187,584		70,914		70,914
Total	$ 668,834	$	$ 684,125	$	$ 684,125

Note 12. Condensed Consolidating Financial Statements

On April 17, 2009, Cal Water issued $100 million aggregate principal amount of 5.875% First Mortgage Bonds due 2019, and on November 17, 2010, Cal Water issued $100 million aggregate principal amount of 5.500% First Mortgage Bonds due 2040. All of the guarantees are full and unconditional, and all of the guarantees are joint and several.

The following tables present the condensed consolidating balance sheets as of June 30, 2013 and December 31, 2012, the condensed consolidating statements of income for the three and six months ended June 30, 2013 and 2012 and the condensed consolidating statements of cash flow for the six months ended June 30, 2013 and 2012 of (i) California Water Service Group, the guarantor of the first mortgage bonds and the parent company; (ii) California Water Service Company, the issuer of the first mortgage bonds and a 100% owned subsidiary of California Water Service Group; and (iii) the other 100% owned subsidiaries of California Water Service Group.

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CALIFORNIA WATER SERVICE GROUP

CONDENSED CONSOLIDATING BALANCE SHEET

As of June 30, 2013

(In thousands)

	Parent Company	Cal Water	All Other Subsidiaries	Consolidating Adjustments	Consolidated
ASSETS					
Utility plant:					
Utility plant	$ 1,079	$ 1,984,718	$ 182,106	$ (7,197)	$ 2,160,706
Less accumulated depreciation and amortization	(136)	(636,860)	(35,015)	1,559	(670,452)
Net utility plant	943	1,347,858	147,091	(5,638)	1,490,254
Current assets:					