AMERICAN STATES WATER CO
Form 10-K
March 13, 2009
Table of Contents

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

FOR ANNUAL AND TRANSITION REPORTS

PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

(Mark One)

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

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	Registrant, State of Incorporation Address, Zip Code and Telephone Number	IRS Employer Identification No.
001-14431	**American States Water Company** (Incorporated in California) 630 E. Foothill Boulevard, San Dimas, CA 91773-1212 (909) 394-3600	95-4676679
001-12008	**Golden State Water Company** (Incorporated in California) 630 E. Foothill Boulevard, San Dimas, CA 91773-1212 (909) 394-3600	95-1243678

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

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

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

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

American States Water Company	Yes o No x
Golden State Water Company	Yes o No x

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

American States Water Company	Yes o No x
Golden State Water Company	Yes o No x

Indicate by check mark whether Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

American States Water Company	Yes x No o

Golden State Water Company	Yes x No o

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. x

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

American States Water Company

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

Golden State Water Company

Large accelerated filer o	Accelerated filer o	Non-accelerated filer x	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)

American States Water Company	Yes o No x
Golden State Water Company	Yes o No x

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

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

Documents Incorporated by Reference:

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

Table of Contents

AMERICAN STATES WATER COMPANY
and

GOLDEN STATE WATER COMPANY

FORM 10-K

INDEX

Table of Contents

PART I

Item 1. Business

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

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

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

General

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

Competition

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

Employee Relations

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

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

Table of Contents

Forward-Looking Information

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

Table of Contents

Item 1A Risk Factors

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

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

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

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

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

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

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

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

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

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

Table of Contents

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

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

Additional Risks Associated with our Public Utility Operations

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

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

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

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

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

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

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

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

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

Table of Contents

Water shortages may:

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

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

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

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

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

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

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

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

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

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

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

Table of Contents

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

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

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

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

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

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

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

Changes in electricity prices also affected the unrealized gains and losses on our block forward purchased power contracts that qualify as derivative instruments as we adjusted the asset or liability on these contracts to reflect the fair market value of the contracts at the end of each month. These unrealized gains and losses have been reflected in earnings prior to January 1, 2009.

We have filed an application with the CPUC to review our new purchased power contracts, effective after December 31, 2008. In this filing, we also requested the CPUC s authorization of a memorandum account to track the changes in the fair market value of the contracts resulting in unrealized gains and losses. If this application is approved, unrealized gains and losses on these purchased power contracts will not impact earnings.

Our assets are subject to condemnation

Municipalities and other government subdivisions may, in certain circumstances, seek to acquire certain of our assets through eminent domain proceedings. It is generally our practice to contest these proceedings which may be costly and may divert the attention of management from the operation of our business. If a municipality or other government subdivision succeeds in acquiring our assets, there is a risk that we will not receive adequate compensation for the assets acquired or be able to recover all charges associated with divesting these assets.

Table of Contents

Additional Risks Associated with our Contracted Services

We derive revenues from contract operations primarily from the operation and maintenance of water and/or wastewater systems at military bases and the construction of water and wastewater improvements to the infrastructure on these bases. As a result, these operations are subject to risks that are different than those of our public utility operations.

Our operations and maintenance contracts on military bases create certain risks that are different from that of our regulated utility operations

We have entered into contracts to provide water and/or wastewater services at military bases pursuant to 50-year contracts, subject to termination, in whole or in part, for the convenience of the U.S. government. In addition, the U.S. government may stop work under the terms of the contracts, delay performance of our obligations under the contracts or modify the contracts at its convenience.

Our contract pricing was based on a number of assumptions, including assumptions about prices and availability of labor, equipment and materials. We may be unable to recover all costs if any of these assumptions are inaccurate or if all costs that we may incur in connection with performing the work were not considered. Our operations and maintenance contracts are also subject to periodic price adjustments at the time of price redetermination or in connection with requests for equitable adjustments or other changes permitted by the terms of the contracts. The contract price for each of these contracts is subject to redetermination two years after commencement of operations and every three years thereafter to the extent provided in each of the contracts. Prices are also subject to equitable adjustment based upon changes in circumstances and changes in wages and fringe benefits to the extent provided in each of the contracts.

We have experienced delays in the redetermination of prices following completion of the first two years of operation under our operation and maintenance contracts in effect for more than two years. We have also experienced delays in obtaining a final equitable adjustment of prices for the significantly higher infrastructure at certain of the bases than that described by the U.S. government in its request for proposal. These delays have negatively impacted our results of operations and cash flows. Further delays will impact our future earnings and cash flows.

We are required to record all costs incurred under these types of contracts as these costs are incurred. As a result, we have been recording losses associated with unanticipated conditions that we have encountered at Fort Bliss and our two new bases in North Carolina and South Carolina. We will reverse previously recorded costs as, and to the extent that, our requests for equitable adjustments are approved.

We are subject to audits, cost review and investigations by contracting oversight agencies. During the course of an audit, the oversight agency may disallow costs. Such cost disallowances may result in adjustments to previously reported revenues.

Payment under these contracts is subject to appropriations by Congress. We may experience delays in receiving payment or delays in redetermination of prices or other price adjustments due to cancelled or delayed appropriations specific to our projects or reductions in government spending for the military generally or military base operations. Appropriations and the timing of payment may be influenced by, among other things, the state of the economy, competing political priorities, budget constraints, the timing and amount of tax receipts and the overall level of government expenditures for the military generally or military base operations specifically.

In addition, we must maintain the proper management of water and wastewater facilities, employ state-certified and other qualified employees to support the operation of these facilities and otherwise comply with contract requirements.

Table of Contents

Risks associated with the collection, treatment and disposal of wastewater are different, in some respects, from that of our water utility operations

The wastewater collection, treatment and disposal operations of our subsidiaries providing water and/or wastewater services on military bases are subject to substantial regulation and involve significant environmental risks. If collection or sewage systems fail, overflow or do not operate properly, untreated wastewater or other contaminants could spill onto nearby properties or into nearby streams and rivers, causing damage to persons or property, injury to aquatic life and economic damages, which may not be recoverable in fees. This risk is most acute during periods of substantial rainfall or flooding, which are common causes of sewer overflow and system failure. Liabilities resulting from such damage could adversely and materially affect our business, results of operations and financial condition. In the event that we are deemed liable for any damage caused by overflow, our losses might not be covered by insurance policies or we may find it difficult to secure insurance for this business in the future at acceptable rates.

Our contracts for the construction of infrastructure improvements on military bases create risks that are different, in some respects, from that of our operations and maintenance contracts

We have entered into contracts for the construction of infrastructure improvements to water and wastewater systems at military bases. Many of these contracts are fixed-price contracts. Under fixed-price contracts, we benefit from cost savings and earnings, but are generally unable to recover any cost overruns to the approved contract price. Under extenuating circumstances, the U.S. government has approved increased cost change orders.

We recognize revenues from these types of contracts using the percentage-of-completion method of accounting. This accounting practice results in our recognizing contract revenues and earnings ratably over the contract term in proportion to our incurrence of contract costs. The earnings or losses recognized on individual contracts are based on periodic estimates of contract revenues, costs and profitability as the construction projects progress.

We establish prices for these types of fixed-price contracts based, in part, on cost estimates that are subject to a number of assumptions, including assumptions regarding future economic conditions. If these estimates prove inaccurate or circumstances change, cost overruns could have a material adverse effect on our contracted business operations and results of operations for contracted services.

We may be adversely affected by disputes with the U.S. government regarding our performance of contract services on military bases

If there is a dispute with the U.S. government regarding performance under these contracts or the amounts owed to us, the U.S. government may delay, reject or withhold payment, or assert its right to offset damages against amounts owed to us. If we are unable to collect amounts owed to us on a timely basis or the U.S. government asserts its offset rights, profits and cash flows will be adversely affected.

If we fail to comply with the terms of one or more of our U.S. government contracts, other agreements with the U.S. government or U.S. government regulations and statutes, we could be suspended or barred from future U.S. government contracts for a period of time and be subject to possible damages, fines and penalties and damage to our reputation in the water and wastewater industry.

We depend, to some extent, upon subcontractors to assist us in the performance of contracted services on military bases

We rely, to some extent, on subcontractors to assist us in the operation and maintenance of the water and wastewater systems at a number of military bases, subject to our existing contracts with the U.S. government. The failure of any of these subcontractors to perform services for us in accordance with the terms of our contracts with the U.S. government could result in the termination of our contracts to provide water and/or wastewater services at these bases, a loss of revenues or increases in costs to correct as a result of a subcontractor s performance failures. We are able to mitigate these risks, in part, by obtaining, and requiring our subcontractors to obtain, performance bonds.

We are also required to make a good faith effort to achieve our small business subcontracting plan goals pursuant to U.S. government regulation. If we fail to use good faith efforts to meet these goals, the U.S. government may assess damages against us at the end of the contract or, in some cases, at the end of each price redetermination period. The U.S. government has the right to offset claimed damages against any amounts owed to us.

We also rely on third-party manufacturers as well as third-party subcontractors to complete our construction projects. To the extent that we cannot engage subcontractors or acquire equipment or materials, our ability to complete a project in a timely fashion or at a profit may be impaired. If the amount of costs we incur for these projects exceeds the amount we have estimated in our bid, we could experience losses in the performance of these contracts. In addition, if a

Table of Contents

subcontractor or manufacturer is unable to deliver its services, equipment or materials according to the negotiated terms for any reason, including the deterioration of its financial condition, we may be required to purchase the services, equipment or materials from another source at a higher price. This may reduce the profit to be realized or result in a loss on a project for which the services, equipment or materials were needed.

If these subcontractors fail to perform services to be provided to us or fail to provide us with the proper equipment or materials, we may be penalized for their failure to perform.

We continue to incur costs associated with the expansion of our contract activities

We continue to incur additional costs in connection with the expansion of our contract operations associated with the preparation of bids and the negotiation of the terms of new contracts for contract operations on military bases and compliance with regulatory requirements associated with our water marketing efforts. Our ability to recover these costs and to earn a profit on our contract operations will depend upon the extent to which we are successful in obtaining new contracts on military bases and satisfying regulatory requirements associated with our water marketing efforts and recovering these costs and other costs from new contract revenues.

Other Risks

Our business requires significant capital expenditures

The utility business is capital intensive. On an annual basis, we spend significant sums of money for additions to, or replacement of, our property, plant and equipment at our California and Arizona utilities. We obtain funds for these capital projects from operations, contributions by developers and others and advances from developers (which are repaid over a period of time at no interest). We also periodically borrow money or issue equity for these purposes. In addition, we have a syndicated bank credit facility that is partially used for these purposes. We cannot provide 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.

Our subsidiaries providing water and wastewater services on military bases also expect to incur significant capital expenditures. To the extent that the U.S. government does not reimburse us for these expenditures as the work is performed, the U.S. government will repay us over time with interest. However, if there is a dispute with the U.S. government regarding performance under these contracts or the amounts owed to us, the U.S. government may delay, reject or withhold payment, or assert its right to offset damages against amounts owed to us. If we are unable to collect amounts owed to us on a timely basis or the U.S. government asserts its offset rights, profits and cash flows will be adversely affected.

We may be adversely impacted by the current financial crisis

Due to recent capital market events, there has been a decline in the fair value of the assets in our pension and postretirement benefit plans since December 31, 2007. This decline in market value will significantly increase our pension and post-retirement benefit plan expenses in 2009. To the extent that this decline in market value continues or is not reversed and is not offset by changes in the discount rate, pension and postretirement benefit plan expenses may also increase in subsequent years, negatively impacting earnings. If market conditions do not improve, we will also need to increase our cash contributions to these plans in 2009 and subsequent years. We include increases in pension and postretirement cost in each general rate case filed by our public utilities for possible recovery. However, we estimate the amount of expenses expected to be incurred during future years in California. We may not recover overages from those estimates in rates, which may adversely affect our financial condition, results of operations, cash flow and liquidity. In March 2009, we filed an advice letter with the CPUC requesting authorization to establish a Pension Costs Memorandum Account. If this account is approved, we will track the difference between the pension costs authorized by the CPUC and included in customer rates, and our actual pension costs. We will not record the amounts in this account as a regulatory asset until they are reviewed and approved by the CPUC. If approved by the CPUC, we will then establish a regulatory asset with a corresponding increase to earnings. Until then, we expect that our earnings will be negatively affected by increasing pension costs.

We obtain funds from external sources to finance our on-going capital expenditures. Access to external financing on reasonable terms depends, in part, on conditions in the debt and equity markets. When business and market conditions deteriorate we may no longer have access to the capital markets on reasonable terms. Our ability to obtain funds is dependent upon our ability to access the capital markets by issuing debt or equity to third parties or obtaining funds from our revolving credit facility. If the current financial turmoil continues for an extended period of time, it may become necessary for us to seek funds on unattractive terms. Moreover, we also have goodwill at CCWC and ASUS that may be adversely impacted if economic conditions worsen.

We anticipate a loss of customers and an increase in charge-offs as a result of rising unemployment, residential foreclosure and business failures. We also anticipate a reduction in water usage due to the loss of income and the decline in

Table of Contents

wealth of customers in our services areas. Our ability to collect amounts owed to us by other third parties could also be adversely impacted by the current financial crisis.

We are unable to predict at this time how we may otherwise be impacted by this financial crisis.

Our failure to comply with the restrictive covenants in our long-term debt agreements and credit facility could trigger prepayment obligations

Our failure to comply with the restrictive covenants under our long-term debt agreements could result in an event of default, which, if not cured or waived, could result in us being required to repay or refinance these borrowings before their due dates on less favorable terms. If we are forced to repay or refinance these borrowings on less favorable terms, our results of operations and financial condition could be adversely affected by increased costs and interest rates.

We are a holding company that depends on cash flow from GSWC to meet our financial obligations and to pay dividends on our common shares

As a holding company, our subsidiaries conduct substantially all operations and our only significant assets are investments in our subsidiaries. This means that we are dependent on distributions of funds from our subsidiaries to meet our debt service obligations and to pay dividends on our common shares. More than 90% of our earnings are derived from the operations of GSWC. Moreover, none of our other subsidiaries has paid any dividends to us during the past three years. As a result, we are largely dependent on cash flow from GSWC to meet our financial obligations and to pay dividends on our common shares.

Our subsidiaries are separate and distinct legal entities and generally have no obligation to pay any amounts due on our debt. Our subsidiaries only pay dividends if and when declared by the subsidiary board. Moreover, GSWC is obligated to give first priority to its own capital requirements and to maintain a capital structure consistent with that determined to be reasonable by the CPUC in its most recent decision on capital structure, in order that ratepayers not be adversely affected by the holding company structure. Furthermore, our right to receive cash or other assets in the unlikely event of liquidation or reorganization of GSWC is generally subject to the prior claims of creditors of that subsidiary. If we are unable to obtain funds from GSWC in a timely manner, we may be unable to meet our financial obligations, make additional investments or pay dividends.

A disruption of our information technology systems could adversely affect our business

We depend on our information technology, or 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 allow us to purchase products from our suppliers and bill customers on a timely basis, maintain cost-effective operations and provide service to our customers. A serious disruption of these systems could adversely affect our business and our ability to provide service to our customers.

Our IT systems are vulnerable to damage or interruption from:

- power loss, computer systems failures and internet, telecommunications or data network failures;
- user negligence or improper operation by, or supervision of, employees;
- physical and electronic loss of customer data or security breaches, misappropriation and similar events;
- computer viruses;
- intentional acts of vandalism and similar events; and
- hurricanes, fires, floods, earthquakes and other natural disasters.

Such damages or interruptions may result in physical and electronic loss of customer or financial data, security breaches, misappropriation and similar events.

Table of Contents

Our operations are geographically concentrated in California

Although we operate water and wastewater facilities in a number of states, our operations are concentrated in California, particularly southern California. As a result, our financial results are largely subject to political, water supply, labor, utility cost and regulatory risks, economic conditions and other economic risks affecting California. California has been particularly hard hit by the current economic crisis. California is raising taxes in order to balance the state budget and jobs may be lost to other states which are perceived as having a more business friendly climate, thereby exacerbating the impact of the financial crisis in California. Consequently, we anticipate a loss of GSWC customers and an increase in charge-offs as a result of rising unemployment, residential foreclosure and business failures in California.

We operate in areas subject to natural disasters or that may be the target of terrorist activities

We operate in areas that are prone to earthquakes, fires, mudslides and other natural disasters. While we maintain insurance policies to help reduce our financial exposure, a significant seismic event in southern California, where our operations are concentrated, or other natural disasters in California could adversely impact our ability to deliver water and adversely affect our costs of operations. The CPUC has historically allowed utilities to establish a catastrophic event memorandum account as another possible mechanism to recover these costs.

Terrorists could seek to disrupt service to our customers by targeting our assets. We have invested in additional security for facilities throughout our regulated service areas to mitigate the risks of terrorist activities. We also may be prevented from providing water and/or wastewater services at the military bases we serve in times of military crisis affecting these bases.

Item 1B Unresolved Staff Comments

None.

Table of Contents

Item 2 - Properties

Electric Properties

GSWC s electric properties are all located in the Big Bear area of San Bernardino County, California. As of December 31, 2008, GSWC owned and operated 29 miles of overhead 34.5 kilovolt (kv) transmission lines, 1 mile of underground 34.5 kv transmission lines, 176.4 miles of 4.16 kv or 2.4 kv distribution lines, 53 miles of underground cable, 13 sub-stations and a natural gas-fueled 8.4 MW peaking generation facility. GSWC also has franchises, easements and other rights of way for the purpose of constructing and using poles, wires and other appurtenances for transmitting electricity.

Water Properties

As of December 31, 2008, GSWC s physical properties consisted of water transmission and distribution systems which included 2,727 miles of pipeline together with services, meters and fire hydrants and approximately 430 parcels of land, generally less than 1 acre each, on which are located wells, pumping plants, reservoirs and other water utility facilities, including four surface water treatment plants. GSWC also has franchises, easements and other rights of way for the purpose of constructing and using pipes and appurtenances for transmitting and distributing water.

As of December 31, 2008, GSWC owned 248 wells, of which 208 are active operable wells equipped with pumps with an aggregate production capacity of approximately 219.3 million gallons per day. GSWC has 56 connections to the water distribution facilities of the MWD, and other municipal water agencies. GSWC s storage reservoirs and tanks have an aggregate capacity of approximately 109 million gallons. GSWC owns no dams in its customer service areas. The following table provides, in greater detail, selected water utility plant of GSWC for each of its water regions:

	Pumps		Distribution Facilities			Reservoirs	
Region	**Well**	**Booster**	**Mains***	**Services**	**Hydrants**	**Tanks**	**Capacity***
Region I	72	119	535	55,694	4,015	46	35,327
Region II	50	68	972	100,573	8,680	25	20,095
Region III	126	198	1,220	98,215	10,445	81	53,425(**1**)
Total	248	385	2,727	254,482	23,140	152	108,847

* Reservoir capacity is measured in thousands of gallons. Mains are in miles.

(1) GSWC has additional reservoir capacity in its Claremont system, through an exclusive right to use all of one 8 million gallon reservoir, one-half of another 8 million gallon reservoir, and one-half of a treatment plant s capacity, all owned by Three Valleys Municipal Water District.

As of December 31, 2008, CCWC s physical properties consisted of water transmission and distribution systems, which included 184 miles of pipeline, together with services, meters, fire hydrants, wells, reservoirs with a combined storage capacity of 7.55 million gallons and other water utility facilities including a surface water treatment plant, which treats water from the CAP.

<u>Adjudicated and Other Water Rights</u>

<u>GSWC</u>

GSWC owns numerous water rights in California, as shown in the table below. Water rights are divided between groundwater and surface water, and groundwater rights are further subject to classification as either adjudicated or unadjudicated rights. Adjudicated rights have been subjected to comprehensive litigation in the courts, are typically quantified and are actively managed for optimization and sustainability of the resource. Unadjudicated groundwater rights have not been quantified and are not subject to predetermined limitations, but are measured by maximum historical usage. Surface water rights are quantified and managed by the State Water Resources Control Board, unless they originated prior to 1914, in which case they resemble unadjudicated groundwater rights. A total of 118,109 acre-feet per year (AFY) of water rights are owned by GSWC as follows:

	Groundwater		**Surface Water**	
Region	**Adjudicated Rights (AFY)**	**Unadjudicated Rights (AFY)**	**Water Rights (AFY)**	**Totals (AFY)**
Region I	10,248	20,113	10,134	40,495
Region II	23,942	1,771		25,713
Region III	27,490	23,010	1,401	51,901
Total	61,680	44,894	11,535	118,109

Table of Contents

CCWC

CCWC has an assured water supply designation, by decision and order of the Arizona Department of Water Resources (ADWR). Pursuant to a decision issued by ADWR on April 7, 2004, CCWC has demonstrated the physical, legal and continuous availability of CAP water and groundwater, in an aggregate volume of 11,759 acre-feet per year for a minimum of 100 years. The 11,759 acre-feet is comprised of existing CAP allocation of 8,909 acre-feet per year, 350 acre-feet per year groundwater allowance, incidental recharge credits of 500 acre-feet per year, and a Central Arizona Groundwater Replenishment District contract of 2,000 acre-feet per year.

ASUS

In August 2004, Natomas and ASUS entered into a contract under which ASUS acts as the exclusive agent for marketing water that has become temporarily surplus to the internal needs of Natomas, to third parties outside the Natomas service area, and that arises under water rights permits and contracts owned or controlled by Natomas. On January 31, 2006, ASUS and Natomas entered into a water purchase and sale agreement under which ASUS agreed to acquire 5,000 acre-feet of permanent Sacramento River water diversion rights from Natomas. Pursuant to the terms of this agreement, Natomas agreed to sell, transfer and convey to ASUS, in perpetuity, water rights and entitlements to divert from the Sacramento River up to 5,000 acre-feet of water per year for consumptive use, subject to certain regulatory approvals. Terms of the acquisition, among other things, include a base price of $2,500 per acre-foot of water, with payments contingent on achieving specific milestones and events over a 10-year period. After first determining whether a need for the water exists in Sutter County, ASUS may use the water rights acquired from Natomas to serve existing GSWC s customers, to re-sell to other beneficial users, or to pursue and serve expanded service territories.

Pursuant to a marketing services agreement, ASUS agreed to attempt to arrange for the sale and transfer of Natomas temporarily surplus water for beneficial use beyond the Natomas service area. Natomas agreed to pay to ASUS a commission of 16% of the lease or sale price for any such water successfully marketed by ASUS. At the same time that the water purchase agreement was completed, Natomas and ASUS also entered into a settlement agreement that released Natomas from previously established reimbursement obligations under prior agreements. In accordance with the marketing agreement, Natomas shareholders voted in December 2007 to approve the sale of 8,000 to 10,000 acre-feet of Natomas Central Valley Project water to the City of Folsom, subject to certain regulatory and environmental approvals. The base price to be paid by Folsom is $4,000 per acre-foot.

Office Buildings

Registrant s general headquarters are housed in a single-story office building located in San Dimas, California. The land and the building are owned by GSWC. GSWC also owns and/or leases certain facilities housing regional, district and customer service offices. CCWC owns its primary office space in Fountain Hills, Arizona. ASUS leases an office facility in Costa Mesa, California. ASUS subsidiary, ONUS, leases a service center located in North Carolina.

Mortgage and Other Liens

As of December 31, 2008, GSWC had no mortgage debt outstanding, encumbrances or liens securing indebtedness.

As of December 31, 2008, substantially all of the utility plant of CCWC was pledged to secure its Industrial Development Authority Bonds, which among other things, restricts CCWC s ability to incur debt and make liens, sell, lease or dispose of assets, or merge with another corporation, and pay dividends.

As of December 31, 2008, neither AWR nor ASUS or any of its subsidiaries had any mortgage debt or liens securing indebtedness, outstanding. However, under the terms of certain debt of AWR and GSWC, AWR and GSWC are prohibited from issuing any secured debt, without providing equal and ratable security to the holders of this existing debt.

Table of Contents

Condemnation of Properties

The laws of the State of California and the State of Arizona provide for the acquisition of public utility property by governmental agencies through their power of eminent domain, also known as condemnation, where doing so is necessary and in the public interest. In addition, however, the laws of California provide: (i) that the owner of utility property may contest whether the condemnation is actually necessary and in the public interest, and (ii) that the owner is entitled to receive the fair market value of its property if the property is ultimately taken.

Although the City of Claremont, California (the City) located in GSWC s Region III, has not initiated the formal condemnation process pursuant to California law, the City has expressed various concerns to GSWC about the rates charged by GSWC and the effectiveness of the CPUC s rate-setting procedures. The City hired a consultant to perform an appraisal of the value of GSWC s water system serving the City. The value was estimated in 2004 by the City s consultant at $40 to $45 million. GSWC disagrees with the consultant s valuation assessment. As of December 31, 2008, management believes that the fair market value of the Claremont water system exceeds the $40.9 million recorded net book value and also exceeds the consultant s estimates of its value. The Claremont City Council held a project priorities workshop in April 2007. The council members agreed that the acquisition of GSWC s water system was to remain a priority and authorized staff to obtain updated appraisals for the value of the water systems. Requests for proposals have been sent to consulting firms by the City. In meetings held in February and June of 2008, the Claremont City Council stated that they had decided to authorize additional studies of the acquisition of GSWC s water system and plans to move forward on this matter.

The Town of Apple Valley abandoned its activities related to a potential condemnation of GSWC s water system serving the Town in 2007. Except for the City of Claremont and the Town of Apple Valley, Registrant has not been, within the last three years, involved in activities related to the potential condemnation of any of its water customer service areas or in its BVES customer service area. No formal condemnation proceedings have been filed against any of the Registrant s service areas during the past three years.

Item 3 - Legal Proceedings

Water Quality-Related Litigation:

Perchlorate and/or Volatile Organic Compounds (VOC) have been detected in five wells servicing GSWC s South San Gabriel System. GSWC filed suit in federal court, along with two other affected water purveyors (San Gabriel Valley Water Company and City of Monterey Park), and the San Gabriel Basin Water Quality Authority (WQA), against some of those allegedly responsible for the contamination of two of these wells. The lawsuit was filed on August 14, 2002 in the United States District Court for the Central District of California. Some of the other potential defendants settled with GSWC, other water purveyors and the WQA (the Water Entities), on VOC related issues prior to the filing of the lawsuit. In response to the filing of the lawsuit, the Potentially Responsible Party (PRP) defendants filed motions to dismiss the suit or strike certain portions of the suit. The judge issued a ruling on April 1, 2003 granting in part and denying in part the PRP s motions. A key ruling of the court was that the water purveyors, including GSWC, by virtue of their ownership of wells contaminated with hazardous chemicals are themselves PRPs under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA).

GSWC has, pursuant to permission of the court, amended its suit to claim certain affirmative defenses as an innocent party under CERCLA. Registrant is presently unable to predict the outcome of this ruling on its ability to fully recover from the PRPs future costs associated with the treatment of these wells. In this same suit, the PRPs have filed cross-complaints against the Water Entities, the MWD, the Main San Gabriel Basin Watermaster and others on the theory that they arranged for and did transport contaminated water into the Main San Gabriel Basin for use by GSWC and the other two affected water purveyors and for other related claims.

On August 29, 2003, the US Environmental Protection Agency (EPA) issued Unilateral Administrative Orders (UAO) against 41 parties deemed responsible for polluting the groundwater in that portion of the San Gabriel Valley from which these two impacted wells draw water. GSWC was not named as a party to the UAO. The UAO requires that these parties remediate the contamination. The judge in the lawsuit has appointed a special master to oversee mandatory settlement discussions between the PRPs and the Water Entities. EPA is also conducting settlement discussions with several PRPs regarding the UAO. The Water Entities and EPA are working to coordinate their settlement discussions under the special master in order to arrive at a complete resolution of all issues affecting the lawsuit and the UAO. Settlements with a number of the PRPs are being finalized; however, Registrant is presently unable to predict the ultimate outcome of these settlement discussions.

Table of Contents

Santa Maria Groundwater Basin Adjudication:

In 1997, the Santa Maria Valley Water Conservation District (plaintiff) filed a lawsuit against multiple defendants, including GSWC, the City of Santa Maria, and several other public water purveyors. The lawsuit was filed on July 14, 1997 in the Santa Clara County Superior Court: *Santa Maria Valley Water Conservation District v. City of Santa Maria, et al* (Lead Case No. CV 770214; consolidated with Case Nos.: CV 784900, 784921, 784926, 785509, 785511, 785515, 785522, 785936, 786791, 787150, 787151, 787152).

The plaintiff s lawsuit sought an adjudication of the Santa Maria Groundwater Basin (the Basin). A stipulated settlement of the lawsuit has been reached, subject to CPUC approval. The settlement, among other things, if approved by the CPUC, would preserve GSWC s historical pumping rights and secure supplemental water rights for use in case of drought or other reductions in the natural yield of the Basin. GSWC, under the stipulation, has a right to 10,000 acre-feet of groundwater replenishment provided by the Twitchell Project, a storage and flood control reservoir project operated by the Santa Maria Valley Conservation District. A monitoring and annual reporting program has been established to allow the parties to responsibly manage the Basin and to respond to shortage conditions. If severe water shortage conditions are found over a period of five years, the management area engineer will make findings and recommendations to alleviate such shortages. In the unlikely case that the Basin experiences severe shortage conditions, the court has the authority to limit GSWC s groundwater production to 10,248 acre-feet per year, based on developed water in the Basin.

On February 11, 2008, the court issued its final judgment, which approves and incorporates the stipulation. The judgment awards GSWC prescriptive rights to groundwater against the non-stipulating parties. In addition, the judgment grants GSWC the right to use the Basin for temporary storage and to recapture 45 percent of the return flows that are generated from its importation of State Water Project water. Pursuant to this judgment, the court retains jurisdiction over all of the parties to make supplemental orders or to amend the judgment as necessary. On March 20, 2008, the non-stipulating parties filed notices of appeal. Registrant is unable to predict the outcome of the appeal.

Other Litigation:

Two former officers of GSWC filed a lawsuit against both AWR and GSWC alleging among other things, wrongful termination and retaliation against the former officers. The lawsuits were filed on November 15, 2007 in the Los Angeles Superior Court: *Conway, et al. v. Golden State Water Company, et al.*, Case No. BC380721. Management believes that the allegations are without merit and intends to vigorously defend against them. Based on management s understanding of all the claims, management does not believe that the ultimate resolution of this matter will have a material adverse effect on GSWC s financial position, results of operations, or cash flows.

Registrant is also subject to ordinary routine litigation incidental to its business. Management believes that rate recovery, proper insurance coverage and reserves are in place to insure against property, general liability and workers compensation claims incurred in the ordinary course of business. Management is unable to predict an estimate of the loss, if any, resulting from any pending suits or administrative proceedings.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders through the solicitation of proxies or otherwise during the fourth quarter of the fiscal year covered by this report.

Table of Contents

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Stock Performance Graph

The graph below compares American States Water Company s cumulative five-year total shareholder return on Common Shares with the cumulative total returns of the S & P 500 index and a customized peer group of six companies that includes: Artesian Resources Corp., California Water Service, Connecticut Water, Middlesex Water Company, SJW Corp. and Southwest Water Company. The graph tracks the performance of a $100 investment in our Common Shares, in the index and in the peer group (with the reinvestment of all dividends) from December 31, 2003 to December 31, 2008.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among American States Water Company, The S&P 500 Index
And A Peer Group

*$100 invested on 12/31/03 in stock & index-including reinvestment of dividends.
Fiscal year ending December 31.

	12/03	12/04	12/05	12/06	12/07	12/08
American States Water Company	**100.00**	**107.96**	**132.08**	**169.83**	**169.71**	**152.85**
S&P 500	**100.00**	**110.88**	**116.33**	**134.70**	**142.10**	**89.53**
Peer Group	**100.00**	**120.84**	**130.87**	**156.80**	**149.59**	**143.44**

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

Table of Contents

Market Information Relating to Common Shares

Common Shares of American States Water Company are traded on the New York Stock Exchange (NYSE) under the symbol AWR. The intra-day high and low NYSE prices on the Common Shares for each quarter during the past two years, as reported by the Wall Street Journal s website, were:

	Stock Prices	
	High	**Low**
2008		
First Quarter	$ 40.25	$ 31.78
Second Quarter	38.77	33.09
Third Quarter	42.00	33.03
Fourth Quarter	39.50	27.00
2007		
First Quarter	$ 41.12	$ 35.36
Second Quarter	38.84	33.57
Third Quarter	44.84	35.06
Fourth Quarter	46.14	36.77

The closing price of the Common Shares of American States Water Company on the NYSE as reported on the Wall Street Journal s website on March 11, 2009 was $30.60.

Approximate Number of Holders of Common Shares

As of March 11, 2009, there were 3,024 holders of record of the 17,317,982 outstanding Common Shares of American States Water Company. AWR owns all of the authorized and outstanding Common Shares of GSWC, CCWC and ASUS. ASUS owns all of the outstanding stock of the Military Utility Privatization Subsidiaries.

Frequency and Amount of Any Dividends Declared and Dividend Restrictions

For the last two years, AWR has paid dividends on its Common Shares on or about March 1, June 1, September 1 and December 1. The following table lists the amount of dividends paid on Common Shares of American States Water Company:

	2008	**2007**
First Quarter	$ 0.250	$ 0.235
Second Quarter	$ 0.250	$ 0.235
Third Quarter	$ 0.250	$ 0.235

Fourth Quarter	$	0.250	$	0.250
Total	$	1.000	$	0.955

AWR s ability to pay dividends is subject to the requirement in the Company s $115 million revolving credit facility for AWR to maintain compliance with all covenants described in footnote (15) to the table in the section entitled *Contractual Obligations, Commitments and Off Balance Sheet Arrangements* included in Part II, Item 7 in Management s Discussion and Analysis of Financial Condition and Results of Operation. GSWC s maximum ability to pay dividends is restricted by certain Note Agreements to the sum of $21 million plus 100% of consolidated net income from certain dates plus the aggregate net cash proceeds received from capital stock offerings or other instruments convertible into capital stock from various dates. Under the most restrictive of the Note Agreements, $237.3 million was available from GSWC to pay dividends to AWR as of December 31, 2008. GSWC is also prohibited under the terms of a senior note issued in October 2005 from paying dividends if, after giving effect to the dividend, its total indebtedness to capitalization ratio (as defined) would be more than .6667 to 1. GSWC would have to issue additional debt of $290.2 million to invoke this covenant as of December 31, 2008.

The ability of AWR, ASUS and GSWC to pay dividends is also restricted by California law. Under restrictions of the California tests, approximately $125.0 million of AWR s retained earnings was available to pay dividends to common shareholders at December 31, 2008. Approximately $129.8 million was available from the retained earnings of GSWC at December 31, 2008 to pay dividends to AWR. At December 31, 2008, ASUS was unable to pay dividends to AWR under the California tests due to cumulative losses.

Table of Contents

CCWC is subject to contractual restrictions on its ability to pay dividends. CCWC s maximum ability to distribute dividends is limited to maintenance of no more than 55% debt in its capital structure for the quarter immediately preceding the distribution. The ability of CCWC to pay dividends is also restricted under Arizona law. Under restrictions of the Arizona tests, approximately $2.6 million was available to pay dividends to AWR at December 31, 2008. See footnote (6) to the table in the section entitled *Contractual Obligations and Other Commitments* included in Part II, Item 7 in Management s Discussion and Analysis of Financial Conditions and Results of Operation for additional information regarding CCWC s debt.

AWR paid $17.3 million in common dividends to shareholders for the year ended December 31, 2008, as compared to $16.3 million for the year ended December 31, 2007. GSWC paid dividends of $13.2 million and $17.2 million to AWR in 2008 and 2007, respectively. CCWC and ASUS did not pay any dividends to AWR in 2008 or 2007.

Securities Authorized for Issuance under Equity Compensation Plans

We have made stock awards to our executive officers and managers under the 2000 Stock Incentive Plan (the 2000 Employee Plan) and the 2008 Stock Incentive Plan (the 2008 Employee Plan). We have also made stock awards to our non-employee directors under the 2003 Non-Employee Directors Stock Plan (the Directors Plan). We provide information regarding the securities which have been issued and which are available for issuance under these plans in the table set forth below as of December 31, 2008. This table does not include any common shares that may be issued under our 401(k) plan.

Plan category	(a)(1) Number of securities to be issued upon exercise of outstanding options, warrants and rights		(b) Weighted-average exercise price of outstanding options, warrants and rights	(c)(1) Number of securities remaining available for future issuance under equity Compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	541,452	$	30.65	1,379,980
Equity compensation plans not approved by security holders				
Total	541,452	$	30.65	1,379,980

(1) Amounts shown are for options granted only. At December 31, 2008, there were 32,184 restricted stock units outstanding that had been granted to employees under the 2000 Employee Plan and 45,618 restricted stock units outstanding that had been granted to directors under the Directors Plan. Each restricted stock unit was issued with dividend equivalent rights until the restricted stock unit vests or is terminated earlier pursuant to the term of the grant. We may not grant restricted stock units with respect to more than 118,000 of our common shares under the Directors Plan.

21

Table of Contents

Other Information

The shareholders of AWR have approved the material features of all equity compensation plans under which AWR directly issues equity securities. AWR did not directly issue any unregistered equity securities during 2008.

The following table provides information about Company repurchases of its Common Shares during the fourth quarter of 2008:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased under the Plans or Programs (3)
October 1 - 31, 2008	28	$ 36.79		NA
November 1 - 30, 2008	10,438	$ 33.45		NA
December 1 - 31, 2008	223	$ 30.86		NA
TOTAL	10,689(2)	$ 33.41		NA

(1) None of the Common Shares was purchased pursuant to any publicly announced stock repurchase program.

(2) Of this amount, 10,350 Common Shares were acquired on the open market for employees pursuant to the Company s 401(k) Plan. The remainder of the Common Shares were acquired on the open market for participants in the Company s Common Share Purchase and Dividend Reinvestment Plan.

(3) None of these plans contain a maximum number of Common Shares that may be purchased in the open market under the plans.

Table of Contents

Item 6. Selected Financial Data

AMERICAN STATES WATER COMPANY (AWR):

(in thousands, except per share amounts)	2008(3)	2007(3)	2006(3)	2005	2004
Income Statement Information					
Total Operating Revenues	$ 318,718	$ 301,370	$ 268,629	$ 238,128	$ 229,090
Total Operating Expenses **(2)**	263,912	233,638	212,023	176,068	179,033
Operating Income **(2)**	54,806	67,732	56,606	62,060	50,057
Interest Expense	21,330	21,582	21,121	14,657	18,095
Interest Income	1,837	2,371	2,818	1,103	44
Net Income **(2)**	$ 22,005	$ 28,030	$ 23,081	$ 26,766	$ 18,541
Basic Earnings per Common Share **(1)**	$ 1.27	$ 1.62	$ 1.34	$ 1.58	$ 1.19
Dividends Declared per Common Share	$ 1.000	$ 0.955	$ 0.910	$ 0.900	$ 0.888
Average Shares Outstanding	17,262	17,121	16,934	16,778	15,633
Average Number of Diluted Shares Outstanding	17,394	17,177	17,101	16,809	15,663
Fully Diluted Earnings per Common Share	$ 1.26	$ 1.61	$ 1.33	$ 1.57	$ 1.18
Balance Sheet Information					
Total Assets	$ 1,061,287	$ 963,898	$ 936,955	$ 873,135	$ 810,277
Common Shareholders Equity	310,503	302,129	283,734	264,094	251,465
Long-Term Debt	266,536	267,226	267,833	268,405	228,902
Total Capitalization	$ 577,039	$ 569,355	$ 551,567	$ 532,499	$ 480,367

(1) In accordance with Emerging Issues Task Force No. 03-06, *Participating Securities and the Two-Class Method under FASB Statement No. 128* which was effective in the second quarter of 2004, AWR uses the two-class method of computing EPS for the affects of participating securities. The two-class method is an earnings allocation formula that determines EPS for each class of common stock and participating security. AWR has participating securities related to stock options and stock units that earn dividend equivalents on an equal basis with Common Shares. Net income available for common shareholders excluding earnings available and allocated to participating securities, was $21,890,000, $27,723,000, $22,623,000 and $26,468,000 for the years ended December 31, 2008, 2007, 2006 and 2005, respectively.

(2) In 2008, results include a $7.7 million goodwill impairment charge related to CCWC, in accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets* .

GOLDEN STATE WATER COMPANY (GSWC):

(in thousands)	**2008(3)**	**2007(3)**	**2006(3)**	**2005**	**2004**
Income Statement Information					
Total Operating Revenues	$ 268,888	$ 258,752	$ 244,425	$ 225,872	$ 220,769
Total Operating Expenses	205,970	194,046	189,123	163,230	167,164
Operating Income	62,918	64,706	55,302	62,642	53,605
Interest Expense	19,651	20,063	19,186	13,288	17,168
Interest Income	1,774	2,111	2,670	1,047	30
Net Income	$ 27,819	$ 26,900	$ 23,258	$ 27,828	$ 20,911
Balance Sheet Information					
Total Assets	$ 970,150	$ 889,973	$ 867,661	$ 807,249	$ 756,276
Common Shareholder s Equity	324,533	278,441	266,965	255,518	243,848
Long-Term Debt	260,561	260,941	261,248	261,540	221,697
Total Capitalization	$ 585,094	$ 539,382	$ 528,213	$ 517,058	$ 465,545

(3) Effective December 31, 2006, Registrant adopted SFAS No. 158, *Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R)* . Because pensions and other postretirement costs have historically been recovered through rates, upon implementing SFAS No. 158, a regulatory asset was recorded for the costs that would otherwise be charged to common shareholders equity in accordance with SFAS No. 158. At December 31, 2008, 2007 and 2006, $40.9 million, $11.4 million and $22.8 million, respectively, has been recorded as a regulatory asset related to pension and other postretirement costs, with a corresponding amount to pension and postretirement liabilities. Increases in 2008 were caused by declines in the market value of plan assets and lower discount rates used resulting in an increase in the underfunded position. Decreases in 2007 were caused by increases in the discount rates used to measure the pension and postretirement obligations.

Table of Contents

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operation

The following discussion and analysis provides information on AWR s consolidated operations and assets and where necessary, includes specific references to AWR s individual segments and/or other subsidiaries: GSWC, CCWC, ASUS and its subsidiaries.

Overview

Registrant s revenues, operating income and cash flows are earned primarily through delivering potable water to homes and businesses through approximately 2,900 miles of water distribution pipelines and the delivery of electricity in the Big Bear area of San Bernardino county. Rates charged to customers of GSWC and CCWC are determined by the CPUC and ACC, respectively. These rates are intended to allow recovery of operating costs and a reasonable rate of return on capital. Factors affecting financial performance of our regulated utilities include the process and timing of setting rates charged to customers; the ability to recover, and the process for recovering in rates, the costs of distributing water and electricity and our overhead costs; weather; the impact of increased water quality standards and environmental regulations on the cost of operations and capital expenditures; pressures on water supply caused by population growth, more stringent water quality standards, deterioration in water quality and water supply from a variety of causes; capital expenditures needed to upgrade water systems and increased costs; and risks associated with litigation relating to water quality and water supply, including suits initiated by Registrant to protect its water supply.

Operating revenues and income from contracted services at ASUS and its subsidiaries are earned primarily from the operation and maintenance of water and/or wastewater systems for the U.S. government at various military bases. All of the operations and maintenance contracts with the U.S. government are 50-year firm, fixed-price contracts with prospective price redeterminations. ASUS also may generate revenues from the construction of infrastructure improvements at these bases pursuant to the terms of these 50-year contracts or pursuant to supplemental contracts. Revenues generated by contract operations are primarily dependent on these new business activities, including military base operations and the construction of new and/or replacement infrastructure at these military bases. As a result, ASUS is subject to risks that are different than those of Registrant s regulated water and electric utilities. ASUS plans to continue seeking contracts for the operation and maintenance of water and/or wastewater services at military bases. Factors affecting the financial performance of our Military Utility Privatization Subsidiaries include delays in receiving payments from the U.S. government and the redetermination and equitable adjustment of prices under contracts with the U.S. government.

Registrant plans to continue to seek additional rate increases in future years to recover operating and supply costs and receive reasonable returns on invested capital. Capital expenditures in future years are expected to remain at much higher levels than depreciation expense. Cash solely from operations is not expected to be sufficient to fund Registrant s needs for capital expenditures, dividends, investments in Registrant s contract business and other cash requirements. Registrant expects to fund a portion of these needs through a combination of debt and common stock offerings over the next twelve months depending on market conditions. On August 25, 2008, AWR amended its $85 million syndicated credit facility, to increase its aggregate bank commitments by $30 million to $115 million. In addition, a senior note in the amount of $40.0 million has been issued on March 10, 2009, to CoBank, ACB (CoBank). Under the terms of this senior note, CoBank purchased a 6.7% Senior Note due March 10, 2019 in the aggregate principal amount of $40.0 million from GSWC. The proceeds will be used to pay down GSWC s intercompany short-term borrowings and to fund capital expenditures.

For 2008, net income was $22.0 million compared to $28.0 million in 2007, a decrease of 21.5%. Diluted earnings per share for 2008 were $1.26 compared to $1.61 in 2007. The decrease in earnings is due primarily to: (i) decreased water consumption and higher operating expenses at GSWC, (ii) a goodwill impairment charge of $7.7 million at CCWC, (iii) and the reduced financial performance of the Military Utility

Privatization Subsidiaries. Prior to the implementation of GSWC s water revenue adjustment mechanism in November 2008, GSWC s earnings were affected by decreased consumption. GSWC s water consumption in 2008 decreased by approximately 5% as compared to 2007, or $0.18 per share. Although precipitation was overall lower in most of 2008 (with the exception of the first quarter), compared to the same period in 2007, the 2008 water revenues appear to have been impacted by the effects of state-wide customer conservation efforts. Due to the implementation of GSWC s water revenue adjustment mechanism in late November 2008, earnings were favorably impacted by approximately $0.03 per share in the fourth quarter of 2008 that would have previously been lost due to conservation. Therefore, the net impact due to lower sales in 2008 was $0.15 per share. Higher operating expenses in 2008, as compared to the same period of last year, also negatively impacted GSWC s earnings in 2008. These decreases in GSWC s earnings were partially offset by increases in customer rates approved by the CPUC and effective January 1, 2008 and a lower effective income tax rate.

Table of Contents

During 2008, a charge of $7.7 million, or $0.27 per share, was recorded to reflect the impairment of goodwill at CCWC in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* . During the recent impairment testing, Registrant determined that revenue growth for its Arizona utility, CCWC, was likely to be slower than originally projected due to downturns in overall economic conditions and new housing construction, as well as the current regulatory environment in Arizona resulting in regulatory lags and lower than anticipated rate increases.

Registrant s 2008 results have also been affected by the reduced financial performance of ASUS contracted service operations at military bases, due to increases in operating expenses primarily incurred at two bases in North Carolina and South Carolina under new operating and maintenance contracts. ASUS incurred higher than anticipated operating costs, losses on certain construction projects under these new contracts and emergency construction activities not anticipated in the contracts to address the age and pre-existing condition of the infrastructure. ASUS is attempting to recover these increased costs through the equitable adjustment provisions of the contracts for these two bases. Moreover, ASUS results in 2007 included a significant wastewater expansion project at Fort Bliss that added about $0.17 per share. There was no similar significant project during the year ended December 31, 2008. ASUS overall performance in 2008 decreased by $0.10 per share when compared to 2007.

Unrealized gains and losses on purchased power contracts have been impacting GSWC s earnings since 2002 when GSWC entered into certain purchase power contracts. These contracts qualified as derivative instruments under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.* The pretax unrealized gain on purchased power contracts was $1.6 million increasing net income by $0.05 per share in 2008 compared to $2.1 million or $0.07 per share for the same period of 2007, a $0.02 per share decrease in earnings between the two periods.

Summary Results by Segment

AWR has three reportable segments: water, electric and contracted services. Within the segments, AWR has three principal business units: water and electric service utility operations conducted through GSWC, a water-service utility operation conducted through CCWC, and a contracted services unit conducted through ASUS and its subsidiaries. The tables below set forth summaries of the results by segment (in thousands) for the years ended December 31, 2008 and 2007:

	Operating Revenues				**Pretax Operating Income**			
	Year Ended 12/31/2008	**Year Ended 12/31/2007**	**$ CHANGE**	**% CHANGE**	**Year Ended 12/31/2008**	**Year Ended 12/31/2007**	**$ CHANGE**	**% CHANGE**
Water	$ 247,936	$ 237,882	$ 10,054	4.2%	$ 54,609	$ 62,622	$ (8,013)	-12.8%
Electric	28,424	28,574	(150)	-0.5%	1,334	3,274	(1,940)	-59.3%
Contracted services	42,358	34,914	7,444	21.3%	(988)	2,045	(3,033)	-148.3%
AWR parent					(149)	(209)	60	28.7%
Totals from operation	$ 318,718	$ 301,370	$ 17,348	5.8%	$ 54,806	$ 67,732	$ (12,926)	-19.1%

Water - For the year ended December 31, 2008, pretax operating income for water decreased by $8.0 million compared to the year ended December 31, 2007, or 12.8%. The decrease was, due in large part, to the goodwill impairment charge of $7.7 million, or $0.27 per share, recorded at CCWC in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* , as more fully described later.

The dollar water margin increased $7.5 million as compared to the same period of 2007 due to higher water rates approved by the CPUC effective January 1, 2008, offset by lower water consumption. An approximately 5% decrease in water consumption during the year of 2008 resulted in a $7.5 million decrease in water revenues, or $0.18 per share. This decrease in consumption occurred even though precipitation was overall lower in most of 2008 (with the exception of the first quarter) as compared to 2007. Differences in temperature and rainfall in Registrant s service areas as well as the effects of conservation, have impacted consumption of water by customers causing fluctuations in Registrant s revenues and earnings between comparable periods.

In August 2008, the CPUC issued a final decision regarding conservation rate design that allows for the establishment and implementation of a Water Revenue Adjustment Mechanism (WRAM) to decouple sales from revenues and a Modified Cost Balancing Account (MCBA) to remove the impact to earnings due to supply mix changes. GSWC prospectively implemented the new WRAM and MCBA in late November 2008 for Regions II and III. This should help mitigate fluctuations in Registrant s future water margin due to changes in water consumption and supply mix. In addition, the CPUC also approved an advice letter filed by GSWC to allow GSWC to create and implement a Water Conservation Memorandum Account (WCMA) to track the extraordinary expenses and revenue shortfall associated with conservation measures in conjunction with the declared drought in California. See further discussion on conservation included in the

Table of Contents

Regulatory Matters section. With the implementation of the WRAM and MCBA in late November 2008, earnings were favorably impacted by approximately $0.03 per share in the fourth quarter of 2008 that would have previously been lost due to conservation. Therefore, the net impact due to lower sales in 2008 was $0.15 per share. Higher operating expenses, as more fully described later, decreased pretax operating income by $7.8 million.

Electric - For the year ended December 31, 2008, pretax operating income from electric operations decreased by $1.9 million due in part to a decrease of $546,000 in the pretax unrealized gain on purchased power contracts for the year ended December 31, 2008 as compared to the same period in 2007. The unrealized gain on purchased power contracts increased operating income by approximately $1.6 million for the year of 2008, or $0.05 per share, as compared to $2.1 million, or $0.07 per share, for the same period in 2007. The remainder of the decrease was due primarily to an increase of $802,000 in allocation of costs from corporate headquarters to BVES and a lower electric margin resulting from lower electric usage and reconnection fees.

Contracted Services - For the year ended December 31, 2008, the pretax operating income for contracted services decreased by $3.0 million to a pretax loss of $988,000. This was primarily due to losses incurred at military bases under two new contracts. ASUS began operating and maintaining the water and wastewater systems under two new contracts in North Carolina and South Carolina during the first quarter of 2008. Pretax operating losses at these two bases were $3.6 million for the year ended December 31, 2008, including $935,000 for emergency construction and maintenance at PSUS to address pre-existing conditions not anticipated in the contract and for which ASUS is pursuing recovery from the U.S. government, and $379,000 in anticipated losses associated with certain initial capital upgrade projects. In September 2008, PSUS submitted a Request for Equitable Adjustment (REA) for the water and wastewater systems at Fort Jackson, South Carolina requesting a contract modification for these initial capital upgrades and emergency construction costs. The aggregate value of the REA relating to construction work is approximately $1.6 million. The REA has not yet been approved by the U.S. government, and therefore, the anticipated losses on these projects and the emergency costs have been recorded during 2008 in construction expense. In addition, ASUS plans to submit an REA for the water and wastewater systems at Fort Bragg/Pope Air Force Base in North Carolina upon completion of the U.S. government s review of the Joint Inventory Report filed by ASUS in August 2008. The Joint Inventory Report indicates the quantity of the Fort Bragg/Pope Air Force Base infrastructure to be 20-30% greater than what was assumed under the original 50-year contract. Higher than anticipated transition costs, increases in nonincome tax assessments and other operating expenses also contributed to the losses.

Pretax operating income at the other military bases under existing contracts increased by $44,000 for the year ended December 31, 2008 as compared to the same period last year. During 2007, there was a $20.6 million wastewater expansion construction project at Fort Bliss with the U.S. government that generated approximately $4.9 million in pretax operating income during 2007. The project was completed in August 2007. However, ASUS subsidiaries did undertake similar construction activity in 2008 that were on a smaller scale and helped replace construction revenues and operating income generated from the wastewater expansion project in 2007. Earnings and cash flows from amendments and modifications to the original 50-year contracts with the U.S. government are sporadic and may or may not continue in future periods.

The timely receipt of price redeterminations is critical in order for ASUS to recover increasing costs for operating and maintaining the water and wastewater systems at the military bases. In addition, higher allocations of corporate headquarters expenses to ASUS and its wholly-owned subsidiaries by the CPUC were not contemplated at the time the contracts with the U.S. government were negotiated and will be addressed in future price redeterminations. Under the terms of these contracts, the contract price is subject to price redetermination two years after commencement of operations and every three years thereafter. Redeterminations have been submitted and are under review by the U.S. government for operations of ODUS and TUS in Virginia and Maryland, respectively. The price redeterminations are expected to be completed in 2009. Pending redetermination of prices, ASUS has received interim inflation adjustments during 2008 to the management fees for operating and maintaining the water and wastewater systems at Fort Eustis, Fort Story and Fort Monroe in Virginia, and the wastewater system at Fort Lee also in Virginia effective on the second anniversary of the date when ASUS began operating these bases (February 23, 2006 for Fort Lee and April 3, 2006 for the other three bases).

FBWS has experienced delays in the redetermination of prices at Fort Bliss following completion of the first two years of operation in October 2006. At Fort Bliss, management fees for operation and maintenance of the water and wastewater systems are based on cost levels prevailing in 2003 when the contract with the U.S. government was bid. Further, the contract pricing was also based on assumptions about the size and age of the infrastructure to be operated and maintained over the 50-year contract. The REA had been filed as a claim with the U.S. government to adequately reflect the amount of assets included in the infrastructure at Fort Bliss, which is substantially more than originally estimated by the U.S. government as part of its solicitation for this contract. In December 2008, the U.S. government approved an interim adjustment at Fort Bliss which increased the monthly water and wastewater fees by 50% and 59%, respectively. The increase was retroactive to October 1, 2008 and is expected to generate approximately $1.2 million of additional revenues annually

Table of Contents

related to operating and maintaining the Fort Bliss systems. ASUS is continuing negotiations with Fort Bliss to finalize the adjustment necessary due to the increased infrastructure and will also be preparing a price redetermination request for Fort Bliss which it expects to file by mid-2009.

These price redeterminations and equitable adjustments, which include adjustments to reflect changes in operating conditions and infrastructure levels from that assumed at the time of the execution of the contracts, as well as inflation in costs, are expected to provide added revenues prospectively to help offset increased costs and provide Registrant the opportunity to generate positive operating income at its Military Utility Privatization Subsidiaries. As of December 31, 2008, ASUS has $1.1 million of goodwill, which may be at risk for potential impairment if requested price redeterminations and equitable adjustments that have not yet been approved, are not received.

The following discussion and analysis for the years ended December 31, 2008, 2007 and 2006 provides information on AWR s consolidated operations and assets and where necessary, includes specific references to AWR s individual segments and/or other subsidiaries: GSWC, CCWC, ASUS and its subsidiaries.

Table of Contents

Consolidated Results of Operations Years Ended December 31, 2008 and 2007 (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
OPERATING REVENUES				
Water	$ 247,936	$ 237,882	$ 10,054	4.2%
Electric	28,424	28,574	(150)	-0.5%
Contracted services	42,358	34,914	7,444	21.3%
Total operating revenues	318,718	301,370	17,348	5.8%
OPERATING EXPENSES				
Water purchased	46,617	45,439	1,178	2.6%
Power purchased for pumping	10,428	10,591	(163)	-1.5%
Groundwater production assessment	10,623	9,944	679	6.8%
Power purchased for resale	13,616	14,199	(583)	-4.1%
Unrealized gain on purchased power contracts	(1,554)	(2,100)	546	-26.0%
Supply cost balancing accounts	(387)	(1,962)	1,575	-80.3%
Other operating expenses	30,076	27,375	2,701	9.9%
Administrative and general expenses	62,716	52,637	10,079	19.1%
Depreciation and amortization	31,562	28,941	2,621	9.1%
Maintenance	16,331	15,779	552	3.5%
Property and other taxes	12,312	11,254	1,058	9.4%
ASUS construction expenses	23,872	22,125	1,747	7.9%
Goodwill impairment charge	7,700		7,700	100.0%
Net gain on sale of property		(584)	584	-100.0%
Total operating expenses	263,912	233,638	30,274	13.0%
OPERATING INCOME	54,806	67,732	(12,926)	-19.1%
OTHER INCOME AND EXPENSES				
Interest expense	(21,330)	(21,582)	252	-1.2%
Interest income	1,837	2,371	(534)	-22.5%
Other	71	299	(228)	-76.3%
	(19,422)	(18,912)	(510)	2.7%
INCOME FROM OPERATIONS BEFORE INCOME TAX EXPENSE	35,384	48,820	(13,436)	-27.5%
Income tax expense	13,379	20,790	(7,411)	-35.6%
NET INCOME	$ 22,005	$ 28,030	$ (6,025)	-21.5%

Net income for the year ended December 31, 2008 was $22.0 million, equivalent to $1.27 and $1.26 per common share on a basic and fully diluted basis, respectively, compared to $28.0 million or $1.62 and $1.61 per common share on a basic and fully diluted basis, respectively, for the year ended December 31, 2007. Impacting the comparability in the results of the two periods on a fully diluted per share basis are the following significant items:

- A goodwill impairment charge of $7.7 million, or $0.27 per share, during the year ended December 31, 2008 related to CCWC.

- An unrealized gain on purchased power contracts which increased pretax income during the year ended December 31, 2008 by $1.6 million, or $0.05 per share, as compared to $2.1 million, or $0.07 per share, for the same period in 2007, a net decrease of $0.02 per share.

- Increased water rates partially offset by higher water supply costs contributed $0.41 per share to earnings while an approximate 5% decrease in water usage during the year ended December 31, 2008 resulted in a $7.5 million decrease in water revenues, or $0.18 per share. The 2008 water revenues appear to have been impacted by the effects of state-wide customer conservation efforts. As previously mentioned, with the implementation of the WRAM and MCBA in late November 2008, earnings were favorably impacted by approximately $0.03 per

Table of Contents

share in the fourth quarter of 2008 that would have previously been lost due to conservation. Therefore, the net impact due to lower sales in 2008 was $0.15 per share. As a result of these individual factors, the overall dollar water margin increased by $7.5 million, or $0.26 per share, during the year ended December 31, 2008.

- Pretax operating income for contracted services declined by $3.0 million, or $0.10 per share, during the year ended December 31, 2008 due primarily to losses incurred at new bases. ASUS commenced operation of water and wastewater systems at military bases in North Carolina and South Carolina during the first quarter of 2008 and has incurred higher than anticipated transition, maintenance and emergency construction costs as well as projected losses on certain construction contracts. Current estimates of construction costs compared to contract revenues indicate losses on certain initial capital upgrade projects. Modifications or change orders have not yet been approved by the U.S. government, and therefore, the anticipated losses on these projects and pre-contract costs have been recorded in construction expenses during 2008.

- Registrant recorded a net gain on sale of property of $584,000, or $0.02 per share, during the year ended December 31, 2007. There was no similar gain in the same period of 2008.

- GSWC recorded $480,000 in interest income, or $0.02 per share, during the second quarter of 2008 in connection with the IRS s examination of the 2002 income tax return.

- A significant decrease in the effective income tax rate during the year ended December 31, 2008 as compared to the same period in 2007, due primarily to changes between book and taxable income that are treated as flow-through adjustments in accordance with regulatory requirements favorably impacted earnings by $0.10 per share during 2008.

- Higher other expenses at GSWC in 2008 primarily consisting of administrative, general, depreciation and other operating expenses as described below, contributed to an overall decrease of $0.32 per diluted share to the results of operations.

Operating Revenues

Water

For the year ended December 31, 2008, revenues from water operations increased by 4.2% to $247.9 million, compared to $237.9 million for the year ended December 31, 2007. Contributing to this increase were the following: (i) rate increases in all three GSWC water regions approved by the CPUC effective January 1, 2008, which added approximately $13.2 million to water revenues during the year ended December 31, 2008; (ii) an increase in water revenues of $2.1 million due to the surcharge approved by the CPUC effective in May 2008 to recover Region III s under-collection in supply costs; this increase in revenues is offset by a corresponding amount in the supply cost balancing accounts discussed below, resulting in no impact to pretax operating income; (iii) the adoption of the WRAM effective November 25, 2008 at which time GSWC began recording the difference between what is billed to its metered customers in Regions II and III and that which is authorized by the CPUC;

and as a result, GSWC recorded $1.3 million of additional revenues caused by the under-collection in the WRAM accounts during the month of December 2008, and (iv) the recording of $541,000 in July 2008 of additional revenues in connection with corrections to the rate calculation for Region III.

These increases in water revenues were partially offset by a decrease of approximately 5% in water consumption due to conservation during 2008, which caused water revenues to be lower by approximately $7.5 million. The implementation of the WRAM should help mitigate fluctuations in Registrant s future revenues due to changes in water consumption. The decline in the number of customers did not result in a significant decrease in water revenues.

Electric

For the year ended December 31, 2008, revenues from electric operations decreased by 0.5% to $28.4 million compared to $28.6 million for the year ended December 31, 2007 due to a decrease of 2.2% in electric usage and lower connections and reconnection fees. The effects of lower electric usage were partially offset by an adjustment of $437,000 in December 2007 resulting from BVES low income program balancing account which reduced electric revenues during 2007. There was no similar adjustment made during 2008.

Table of Contents

Contracted Services

Revenues from contracted services are composed of construction revenues and management fees for operating and maintaining the water and/or wastewater systems at military bases. For the year ended December 31, 2008, revenues from contracted services increased by $7.4 million, or 21.3%, to $42.4 million compared to $34.9 million for the year ended December 31, 2007. Approximately $5.0 million in new revenue was generated from management fees for operating and maintaining the water and wastewater systems under the two new contracts in North Carolina and South Carolina, both of which began during the first quarter of 2008. There was also approximately $4.9 million in construction and transition revenues at these two bases.

At the other bases under existing contracts in 2008 and 2007, there was an increase of $666,000 in management fees due primarily to interim increases at FBWS and ODUS. This was offset by a net decrease of $3.1 million in construction revenues at these existing bases during 2008 when compared to 2007. In 2007, a wastewater expansion project at Fort Bliss generated $20.6 million of construction revenues out of a total of $29.0 million for all ASUS subsidiaries during the year ended December 31, 2007. The project was completed in August 2007 and did not recur in 2008. Although there was no similar singularly significant project during 2008, ASUS subsidiaries did undertake similar construction activities in 2008 that were on a smaller scale and collectively helped replace construction revenues generated from the wastewater expansion project in 2007. Earnings and cash flows from amendments and modifications to the original 50-year contracts with the U.S. government are sporadic and may or may not continue in future periods.

Table of Contents

Operating Expenses:

Supply Costs

Supply costs for the water segment consist of purchased water, purchased power for pumping, groundwater production assessment and water supply cost balancing accounts. Supply costs for the electric segment consist of power purchased for resale (including the cost of natural gas) and the electric supply cost balancing accounts. Water and electric margins are computed by taking total revenues, less total supply costs. Registrant uses these margins and related percentages as an important measure in evaluating its operating results. Registrant believes this measure is a useful internal benchmark in evaluating the utility business performance within its water and electric segments. Registrant reviews these measurements regularly and compares them to historical periods and to its operating budget as approved. However, this measure, which is not presented in accordance with generally accepted accounting principles (GAAP) may not be comparable to similarly titled measures used by other entities and should not be considered as an alternative to operating income, which is determined in accordance with GAAP, as an indicator of operating performance.

Total supply costs comprise the largest segment of total operating expenses. Supply costs accounted for approximately 30.7% and 33.5% of total operating expenses for the year ended December 31, 2008 and 2007, respectively. The table below provides the amount of increases (decreases), percent changes in supply costs, and margins during the year ended December 31, 2008 and 2007 (amounts in thousands):

		Year Ended 12/31/2008		**Year Ended 12/31/2007**		**$ CHANGE**	**% CHANGE**
WATER OPERATING REVENUES **(1)**	$	247,936	$	237,882	$	10,054	4.2%
WATER SUPPLY COSTS:							
Water purchased **(1)**	$	46,617	$	45,439	$	1,178	2.6%
Power purchased for pumping **(1)**		10,428		10,591		(163)	-1.5%
Groundwater production assessment **(1)**		10,623		9,944		679	6.8%
Water supply cost balancing accounts **(1)**		(2,784)		(3,648)		864	-23.7%
TOTAL WATER SUPPLY COSTS	$	64,884	$	62,326	$	2,558	4.1%
WATER MARGIN **(2)**	$	183,052	$	175,556	$	7,496	4.3%
PERCENT MARGIN - WATER		73.8%		73.8%			
ELECTRIC OPERATING REVENUES **(1)**	$	28,424	$	28,574	$	(150)	-0.5%
ELECTRIC SUPPLY COSTS:							
Power purchased for resale **(1)**	$	13,616	$	14,199	$	(583)	-4.1%
Electric supply cost balancing accounts **(1)**		2,397		1,686		711	42.2%
TOTAL ELECTRIC SUPPLY COSTS	$	16,013	$	15,885	$	128	0.8%
ELECTRIC MARGIN **(2)**	$	12,411	$	12,689	$	(278)	-2.2%
PERCENT MARGIN - ELECTRIC		43.7%		44.4%			

(1) As reported on AWR s Consolidated Statements of Income, except for supply cost balancing accounts. The sum of water and electric supply cost balancing accounts in the table above are shown on AWR s Consolidated Statements of Income and totaled ($387,000) and ($1,962,000) for the year ended December 31, 2008 and 2007, respectively.

(2) Water and electric margins do not include any depreciation and amortization, maintenance expense, unrealized gains and losses on purchased power contracts or other operating expenses.

Two of the principal factors affecting water supply costs and gross margin are the amount of water produced and the source of the water. Generally, the variable cost of producing water from wells is less than the cost of water purchased from wholesale suppliers. In addition, GSWC is authorized to establish water and electric supply cost balancing accounts for increases and/or decreases in costs due to changes in rates charged by its suppliers which provide purchased water and purchased power, and by agencies assessing groundwater related pump taxes for water service areas in California. Higher or

Table of Contents

lower actual costs as compared to costs authorized by the CPUC will either be recovered from or refunded to customers in the future.

Prior to November 2008, changes in the water resource mix between water supplied from purchased sources and that supplied from Registrant s wells would increase/decrease actual supply-related costs relative to the mix approved for recovery through rates, thereby impacting earnings either negatively or positively. On August 21, 2008, the CPUC issued a final decision which approved the establishment of a modified cost balancing account that allows recovery of supply costs for changes in water supply mix. GSWC implemented the MCBA in November 2008 prospectively in connection with the new conservation rate design and the implementation of a WRAM to decouple sales from revenues. Under the MCBA, GSWC began tracking adopted expense levels for purchased water, purchased power and pump taxes, as established by the CPUC. Variances (which include the effects of changes in both rate and volume) between adopted and actual purchased water, purchased power, and pump tax expenses are recorded as a component of the supply cost balancing account provision, as the amount of such variances will be recovered from or refunded to GSWC s customers at a later date. This is reflected with an offsetting entry to a current asset or liability balancing account (tracked individually for Regions II and III).

For the year ended December 31, 2008, 40.1% of GSWC s water supply mix was purchased as compared to 40.5% purchased for the year ended December 31, 2007. Because the cost of water purchased is generally higher than pumped water from GSWC s wells, this change in mix resulted in a slight improvement in water s percent margin prior to November 2008 compared to the same period in 2007. As noted above, in November 2008 GSWC implemented the MCBA for Regions II and III which eliminates the effects of changes in the water supply mix prospectively.

Purchased water costs for the year ended December 31, 2008 increased by 2.6% to $46.6 million as compared to $45.4 million in 2007. The increase in purchased water due to higher water rates charged from wholesale suppliers was offset by lower customer usage and the slight favorable change in the supply mix discussed above. In general, the supply cost balancing account as discussed above allows GSWC to track incremental rate changes from suppliers for future recovery in water rates. The favorable change in the supply mix allowed GSWC to serve a portion of the customer demand from groundwater production rather than wholesale purchases, primarily because of the return to service or replacement of wells which had been removed from service in 2007 as a result of water quality issues and mechanical problems.

For the year ended December 31, 2008, the decrease of 1.5% in power purchased for pumping was principally due to lower customer demand, partially offset by a favorable change in the supply mix, as discussed above. Groundwater production assessments were higher by 6.8% due to a favorable change in supply mix and increases in assessment rates (pump tax rates) levied against groundwater production, effective July 2007 and 2008. Average pump tax rates increased in Regions II and III by approximately 3% and 6%, respectively, between the two periods. These increases in groundwater production assessments were partially offset by lower customer demand. Again, the supply cost balancing account and MCBA tracks the increases in pump tax rates for future recovery in water rates.

The supply cost balancing account tracks differences between the current cost for supply items (water, power, and pump taxes) charged by GSWC s suppliers and the cost for those items incorporated into GSWC s rates. Over-collections occur when the current cost of these items is less than the amount in rates which has the effect of increasing the supply cost balancing account in the Statements of Income. Under-collections occur when the current cost exceeds the amount in rates for these items and, conversely, will have the effect of decreasing the supply cost balancing account in the Statements of Income. Typically, over-collections or under-collections, when they occur, are tracked in the supply cost balancing accounts for future refund or recovery through a surcredit (in the event of an over-collection) or surcharge (in the event of an under-collection) on customers bills. Once in rates, the amortization of surcharges that are in place to recover under-collections from customers have the effect of increasing the supply cost balancing account and increasing revenues in the Statements of Income, resulting in no earnings impact. Conversely, the amortization of surcredits that are in rates to refund over-collections to customers have the effect of decreasing the supply cost balancing account and decreasing revenues, also resulting in no earnings impact.

An increase of $864,000 in the water supply cost balancing account provision during the year ended December 31, 2008 as compared to the same period in 2007 was primarily caused by: (i) a $2.8 million increase in the amortization of the water supply cost balancing accounts for surcharges currently in effect; (ii) the recording of $497,000 in the MCBA accounts effective November 25, 2008, and (iii) a $310,000 decrease in interest earned on the supply cost balancing accounts due to lower interest rates, offset by: (i) a net increase totaling $2.5 million of under-collections in 2008 compared to the same period in 2007, and (ii) the recording of a $181,000 net under-collection adjustment relating to Region III s pre-2001 supply costs which were approved by the CPUC in May of 2008; upon approval by the CPUC, a regulatory asset was established for these previously incurred supply costs.

For the year ended December 31, 2008, the cost of power purchased for resale to customers in GSWC s BVES division decreased by 4.1% to $13.6 million compared to $14.2 million for the year ended December 31, 2007 reflecting

Table of Contents

primarily lower customer demand and kilowatt-hour usage. Overall, electric s dollar margin decreased by $278,000 due to lower demand and a $579,000 decrease in interest earned on the electric supply cost balancing account due to lower interest rates, partially offset by an adjustment of $437,000 in 2007 resulting from BVES low income program which reduced electric revenues, previously discussed.

Unrealized (Gain) Loss on Purchased Power Contracts

Unrealized (gain) and loss on purchased power contracts represent gains and losses recorded for GSWC s purchased power agreements with Morgan Stanley Capital Group, Inc. There was a $1.6 million pretax unrealized gain on purchased power contracts for the year ended December 31, 2008 compared to $2.1 million for the year ended December 31, 2007. The contract for unrealized gains and losses at BVES terminated at December 31, 2008. We have filed an application with the CPUC to review our new purchased power contracts, effective after December 31, 2008, and intend to seek the CPUC s authorization of a memorandum account to track the changes in the fair market value of the contracts resulting in unrealized gains and losses. If this application is approved, in future periods unrealized gains and losses on the new purchased power contracts will not impact earnings.

Other Operating Expenses

The primary components of other operating expenses include payroll, materials and supplies, chemicals and water treatment, and outside service costs of operating the regulated water systems, including the costs associated with water transmission and distribution, pumping, water quality, meter reading, billing, and operations of district offices. Registrant s electric and contracted services operations incur many of the same types of costs as well. For the year ended December 31, 2008 and 2007, other operating expenses by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water Services	$ 23,232	$ 21,721	$ 1,511	7.0%
Electric Services	2,230	1,927	303	15.7%
Contracted Services	4,614	3,727	887	23.8%
Total other operating expenses	$ 30,076	$ 27,375	$ 2,701	9.9%

For the year ended December 31, 2008, other operating expenses for water services increased by $1.5 million, or 7.0%, due primarily to an increase: (i) in labor costs of $755,000 due to higher wages and related benefits, and an overall increase in the number of employees; (ii) of $497,000 in bad debt expense due to current economic situation which is affecting customers across all water service areas; (iii) of $359,000 in outside legal and consulting services, and (iv) of $101,000 in GSWC s water education program costs in connection with conservation, partially offset by a decrease of $162,000 due to lower water treatment and chemical costs, including the removal of nitrate and perchlorate at various groundwater treatment plants that occurred in 2007, and a decrease of $39,000 in other expenses.

There was an increase of $303,000 in other operating expenses for electric services primarily due to higher wages and related benefits of $177,000, an increase of $113,000 in bad debt expense and an increase of $13,000 in other expenses.

Contracted services experienced increases in other operating expenses of $887,000 primarily due to the commencement of the operation of water and wastewater systems at military bases in North Carolina and South Carolina that began during the first quarter of 2008. As a result of these new bases, other operating expenses increased by $3.0 million during the year ended December 31, 2008, including $1.0 million in transition costs. These increases were partially offset by decreases at the other military bases during 2008 resulting from lower outside services of $1.4 million primarily paid to the subcontractor that provided wastewater services to certain of ASUS subsidiaries. On January 31, 2008, ASUS and its subsidiaries agreed to buy out all current and future rights which this subcontractor had to provide wastewater services at any bases operated by ASUS and any of its present and/or future subsidiaries. For the year ended December 31, 2008, most of these services were performed internally at lower cost, some of which is recorded in labor costs within maintenance expense. There was also a decrease of $791,000 in bad debt expense due to the reversal of previously recorded reserves resulting from collections of past due receivables from the U.S. government, partially offset by an increase of $78,000 in other expenses.

Table of Contents

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, outside legal and consulting fees, regulatory utility commission expenses, expenses associated with being a public company and general corporate expenses. For the year ended December 31, 2008 and 2007, administrative and general expenses by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water Services	$ 45,184	$ 40,735	$ 4,449	10.9%
Electric Services	6,857	5,744	1,113	19.4%
Contracted Services	10,675	6,158	4,517	73.4%
Total administrative and general expenses	$ 62,716	$ 52,637	$ 10,079	19.1%

For the year ended December 31, 2008, administrative and general expenses increased by $4.4 million in water services compared to the year ended December 31, 2007 due primarily to: (i) an increase of $3.1 million in labor costs and other miscellaneous employee benefits due to higher wages largely related to Registrant s annual performance-based salary review program and an increase in overall number of employees; (ii) additional compensation expenses of $590,000 relating to payments made to a former executive officer under a severance and release agreement; (iii) an increase of $699,000 in outside services including legal, tax and consulting costs, and (iv) an increase of $60,000 in other expenses.

For the year ended December 31, 2008, administrative and general expenses increased by $1.1 million in electric services compared to the year ended December 31, 2007 due primarily to: (i) an increase of $802,000 in allocation of costs from the corporate headquarters to BVES; (ii) a $151,000 increase in labor costs and employee related benefits, and (iii) a $160,000 increase in outside consulting, legal and other services.

There was an increase of $4.5 million in contracted services administrative and general expenses due primarily to an increase of $3.9 million associated with the commencement of the operation of water and wastewater systems at military bases in North Carolina and South Carolina that began during the first quarter of 2008, including allocations from ASUS headquarters and the General Office headquarters. There were also increases at the other bases including: (i) an increase of approximately $217,000 in outside services for legal and consulting work, including costs incurred in connection with a business acquisition, previously discussed; (ii) an approximate $239,000 increase in labor and employee benefit costs, and (iii) a charge of $213,000 relating to the acquisition of the assets of a wastewater subcontractor and the related settlement of the preexisting relationship between ASUS and the wastewater subcontractor used by the Military Utility Privatization Subsidiaries in 2007. These increases were partially offset by a decrease of $62,000 in other expenses.

Depreciation and Amortization

For the year ended December 31, 2008 and 2007, depreciation and amortization by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water Services	$ 28,840	$ 26,561	$ 2,279	8.6%
Electric Services	2,209	2,175	34	1.6%
Contracted Services	513	205	308	150.2%
Total depreciation and amortization	$ 31,562	$ 28,941	$ 2,621	9.1%

Table of Contents

For the year ended December 31, 2008, depreciation and amortization expense for water and electric services increased by $2.3 million to $31.0 million compared to $28.7 million for the year ended December 31, 2007 reflecting, among other things, the approximately $55.0 million of additions to utility plant during 2007, depreciation on which began in January 2008. There were also changes to the composite depreciation rates approved by the CPUC. Registrant anticipates that depreciation expense will continue to increase due to ongoing construction at its regulated subsidiaries. Registrant believes that depreciation expense related to property additions approved by the appropriate regulatory agency will be recovered through water and electric rates.

There was also an increase in depreciation and amortization expense for contracted services due to the commencement of the operation of water and wastewater systems at military bases in North Carolina and South Carolina that began during the first quarter of 2008. As a result of these new bases, depreciation and amortization expense increased by $137,000 during the year ended December 31, 2008. There were also increases of approximately $171,000 at the other military bases and at ASUS corporate office due to the addition of fixed assets.

Maintenance

For the year ended December 31, 2008 and 2007, maintenance expense by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water Services	$ 12,993	$ 14,471	$ (1,478)	-10.2%
Electric Services	805	787	18	2.3%
Contracted Services	2,533	521	2,012	386.2%
Total maintenance	$ 16,331	$ 15,779	$ 552	3.5%

For the year ended December 31, 2008, maintenance expense for water services decreased by $1.5 million to $13.0 million compared to $14.5 million for the year ended December 31, 2007 due principally to a decrease in emergency maintenance on GSWC s wells and water supply sources in its Region II and III service areas. Region II and III s maintenance expense decreased by $1.3 million and $268,000, respectively. This decrease was partially offset by an increase of $302,000 in maintenance expense at Region I. There was also a decrease of $170,000 at CCWC.

There was an increase of $18,000 in maintenance for electric services related to the 8.4 MW natural gas-fueled generation plant.

There was an increase of $2.0 million in contracted services maintenance expense due primarily to the commencement of the operation of water and wastewater systems at military bases in North Carolina and South Carolina that began during the first quarter of 2008, which added $1.8 million in maintenance expense for the year ended December 31, 2008. The level of maintenance costs at these bases also reflects the age and condition of the infrastructure at these bases. There was also increased maintenance expense of $247,000 at the other bases due primarily to higher internal labor costs as a result of the Military Utility Privatization Subsidiaries performing services directly that were formerly performed by a wastewater subcontractor. As previously mentioned, in January 2008, ASUS and its subsidiaries agreed to buy out all current and future rights which this subcontractor had to provide wastewater services at any bases operated by ASUS.

Table of Contents

Property and Other Taxes

For the year ended December 31, 2008 and 2007, property and other taxes by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water Services	$ 10,641	$ 10,247	$ 394	3.8%
Electric Services	530	882	(352)	-39.9%
Contracted Services	1,141	125	1,016	812.8%
Total property and other taxes	$ 12,312	$ 11,254	$ 1,058	9.4%

For the year ended December 31, 2008, overall property and other taxes for water and electric services increased by $42,000. Additional property taxes resulting from higher assessed values and increases in payroll taxes based on increased labor costs, were partially offset by lower franchise fees at BVES.

Property and other taxes were higher in contracted services due to the commencement of the operation of water and wastewater systems at military bases in North Carolina and South Carolina that began during the first quarter of 2008. As a result of these new bases, property and other taxes increased by $370,000 during the year ended December 31, 2008. There was also an increase of $646,000 primarily in gross receipt taxes at the other military bases mostly related to the ODUS military bases in Virginia due in part to an increase in gross revenues.

Construction Expenses

For the year ended December 31, 2008, ASUS construction expenses increased to $23.9 million compared to $22.1 million for the same period in 2007. The commencement of the operation of water and wastewater systems at military bases in North Carolina and South Carolina that began during the first quarter of 2008 added construction expenses of $4.1 million during the year ended December 31, 2008, including $935,000 for emergency construction at PSUS to address pre-existing conditions not anticipated in the contract and for which ASUS is pursuing recovery from the U.S. government and $379,000 in anticipated losses associated with certain initial capital upgrade projects. Additional construction expenses of $13.3 million at ASUS other subsidiaries during 2008 were offset by the 2007 wastewater expansion project at Fort Bliss, previously discussed. For the year ended December 31, 2007, this project generated $15.7 million in construction expenses. The project was completed in August 2007 and did not recur in 2008.

Goodwill Impairment Charge

During 2008, a charge of $7.7 million was recorded to reflect the impairment of goodwill in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*. As required by SFAS No. 142, Registrant tests goodwill annually for impairment at the reporting unit level, or when events or circumstances indicate the carrying values may not be recoverable. Registrant evaluates goodwill for impairment using discounted cash flow methodologies, transaction values for comparable companies, and other valuation techniques for reporting units with goodwill balances. The realization of goodwill is dependent on expected future cash flows from the underlying operations. Forecasted revenues and capital expenditures, which include forecasted customer connection growth and the timing and amount of regulated rate increases, are key components of the discounted cash flow projections.

During the recent impairment analysis, Registrant determined that revenue growth for its Arizona utility, CCWC, was likely to be slower than originally projected due to downturns in overall economic conditions and new housing construction, as well as the current regulatory environment in Arizona resulting in regulatory lags and lower than anticipated rate increases. Based on the recent goodwill impairment analysis, $7.7 million of goodwill associated with CCWC was found to be impaired and was charged to expense during the fourth quarter of 2008.

Table of Contents

Net Gain on Sale of Property

For the year ended December 31, 2007, water services recorded a net pretax gain of $584,000 on the sale of property primarily related to a gain of $325,000 relating to GSWC s sale of a parcel of land to the Los Angeles Unified School District for the purpose of constructing a high school. There was also a pretax gain of $238,000 on the sale of property it owned in the City of Claremont. There were no similar gains in the same period of 2008. Earnings and cash flows from these transactions are sporadic and may or may not continue in future periods.

Interest Expense

For the year ended December 31, 2008 and 2007, interest expense by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water and Electric Services	$ 20,437	$ 20,515	$ (78)	-0.4%
Contracted Services	893	1,067	(174)	-16.3%
Total interest expense	$ 21,330	$ 21,582	$ (252)	-1.2%

For the year ended December 31, 2008, overall interest expense decreased by 1.2% to $21.3 million compared to $21.6 million for the year ended December 31, 2007 despite an increase in short term borrowings due to lower short-term interest rates. The average interest rate on short-term borrowings for the year ended December 31, 2008 was 3.32%, as compared to an average of 5.95% during the same period of 2007. Average bank loan balances outstanding under an AWR credit facility for the year ended December 31, 2008 were approximately $57 million, as compared to an average of $32 million during the same period of 2007.

Interest Income

For the year ended December 31, 2008 and 2007, interest income by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water and Electric Services	$ 1,832	$ 2,340	$ (508)	-21.7%
Contracted Services	5	31	(26)	-83.9%
Total interest income	$ 1,837	$ 2,371	$ (534)	-22.5%

Interest income for water and electric services decreased by 21.7% due to less interest earned on short-term cash surplus of $402,000 and a decrease of $617,000 in interest accrued on the uncollected balance of the Aerojet litigation memorandum account authorized by the CPUC due to lower interest rates. These decreases were partially offset by the recording of $480,000 in interest income during the second quarter of 2008 in connection with the IRS s examination of the 2002 income tax return.

Other

For the year ended December 31, 2008 and 2007, water services recorded other income of $71,000 and $299,000, respectively, as a result of Registrant s equity interest in an investment.

Table of Contents

Income Tax Expense

For the year ended December 31, 2008 and 2007, income tax expense by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE
Water and Electric Services	$ 14,105	$ 20,450	$ (6,345)	-31.0%
Contracted Services	(726)	340	(1,066)	-313.5%
Total income tax expense	$ 13,379	$ 20,790	$ (7,411)	-35.6%

For the year ended December 31, 2008, income tax expense for water and electric services decreased by 31.0% to $14.1 million compared to $20.5 million for the year ended December 31, 2007 due primarily to a decrease in pretax income and a lower effective tax rate (ETR). The ETR for water and electric services for the year ended December 31, 2008 was 37.9% as compared to a 42.8% ETR applicable to the year ended December 31, 2007. The ETR deviates from the federal statutory rate primarily due to state taxes and the changes between book and taxable income that are treated as flow-through adjustments in accordance with regulatory requirements (principally plant, rate case and compensation, including expected contributions to Registrant s pension plans in 2009). Flow-through adjustments increase or decrease tax expense in one period, with an offsetting increase or decrease occurring in another period.

Income tax expense for contracted services decreased to a tax benefit of $726,000 compared to a tax expense of $340,000 for the year ended December 31, 2007 due primarily to a decrease in pretax income. The ETR for contracted services for the year ended December 31, 2008 was 38.6% as compared to a 33.7% ETR applicable to the year ended December 31, 2007. The 2008 ETR is higher than the 2007 ETR primarily as a result of the impact of differing state tax rates among the stand-alone state taxing jurisdictions within which ASUS and its subsidiaries operate.

Table of Contents

Consolidated Results of Operations - Years Ended December 31, 2007 and 2006 (dollars in thousands)

	Year Ended 12/31/2007	Year Ended 12/31/2006	$ CHANGE	% CHANGE
OPERATING REVENUES				
Water	$ 237,882	$ 222,912	$ 14,970	6.7%
Electric	28,574	29,268	(694)	-2.4%
Contracted services	34,914	16,449	18,465	112.3%
Total operating revenues	301,370	268,629	32,741	12.2%
OPERATING EXPENSES				
Water purchased	45,439	44,641	798	1.8%
Power purchased for pumping	10,591	10,007	584	5.8%
Groundwater production assessment	9,944	9,033	911	10.1%
Power purchased for resale	14,199	14,383	(184)	-1.3%
Unrealized (gain) loss on purchased power contracts	(2,100)	7,071	(9,171)	-129.7%
Supply cost balancing accounts	(1,962)	(1,835)	(127)	6.9%
Other operating expenses	27,375	24,134	3,241	13.4%
Administrative and general expenses	52,637	47,110	5,527	11.7%
Depreciation and amortization	28,941	26,272	2,669	10.2%
Maintenance	15,779	12,254	3,525	28.8%
Property and other taxes	11,254	10,187	1,067	10.5%
Construction expenses	22,125	9,024	13,101	145.2%
Net gain on sale of property	(584)	(258)	(326)	126.4%
Total operating expenses	233,638	212,023	21,615	10.2%
OPERATING INCOME	67,732	56,606	11,126	19.7%
OTHER INCOME AND EXPENSES				
Interest expense	(21,582)	(21,121)	(461)	2.2%
Interest income	2,371	2,818	(447)	-15.9%
Other	299	459	(160)	-34.9%
	(18,912)	(17,844)	(1,068)	6.0%
INCOME FROM OPERATIONS BEFORE INCOME TAX EXPENSE	48,820	38,762	10,058	25.9%
Income tax expense	20,790	15,681	5,109	32.6%
NET INCOME	$ 28,030	$ 23,081	$ 4,949	21.4%

Net income for the year ended December 31, 2007 increased by 21.4% to $28.0 million, equivalent to $1.62 and $1.61 per common share on a basic and fully diluted basis, respectively, compared to $23.1 million or $1.34 and $1.33 per basic and diluted common shares, respectively, for the year ended December 31, 2006. Impacting the comparability in the results of the two periods are the following significant items:

Table of Contents

- There was an unrealized gain on purchased power contracts in 2007 due to increasing energy prices versus an unrealized loss on purchased power contracts in 2006. The cumulative unrealized gain on purchased power contracts increased pretax income by approximately $2.1 million, or $0.07 per share, for the year ended December 31, 2007, as compared to a cumulative unrealized loss on purchased power contracts that decreased pretax income by $7.1 million, or $0.24 per share in 2006.

- A decision issued by the CPUC on April 13, 2006 regarding the accounting treatment of GSWC s water rights lease revenues, increased pretax operating income by about $2.3 million in March 2006, or approximately $0.08 per share, when compared to the same period in 2007. Pursuant to a March 2004 CPUC order, the apportionment of any Folsom lease revenues that GSWC may collect commencing in January 2004 was to be determined by a later decision. Pending that later decision and beginning in the first quarter of 2004, all amounts billed to the City of Folsom had been included in a regulatory liability account and no amounts were recognized as revenue until uncertainties about this matter were resolved with the CPUC. On April 13, 2006, the CPUC authorized GSWC to reinvest all lease revenues since January 2004, inclusive of the balances in the regulatory liability accounts established by GSWC for this matter, in water system infrastructure. These investments will be included in the rate base upon which GSWC earns a rate of return. In accordance with California law, GSWC has eight years in which to reinvest the proceeds, after which any amount remaining would inure to the customer s benefit. As a result, in the first quarter of 2006, GSWC transferred about $2.3 million of water rights lease revenues received from the City of Folsom in 2004 and 2005 from the regulatory liability account, into water revenues.

- There was an increase, excluding the $2.3 million of water right lease revenues discussed above, in the margin for the water segment of $15.5 million, or $0.52 per share, as compared to the same period of 2006 due to increased water rates approved by the CPUC that were effective January 1, 2007, an increase in water consumption over that in the prior period, and a favorable supply mix change.

- There was an increase in pretax operating income from contracted services at ASUS of $1.9 million, or $0.07 per share, as compared to the same period of 2006 for operating, maintaining and improving the water and wastewater systems at military bases for the U.S. government. The increases include revenue recognized for certain special projects under the percentage-of-completion method of accounting.

- There was an increase in GSWC s other operating and maintenance expenses of $5.3 million, or $0.18 per share, as compared to the same period of 2006, resulting from higher chemical and water treatment costs along with an increase in required and emergency maintenance on GSWC s wells and water supply sources.

- Higher other expenses primarily consisting of administrative and general expenses, a change in the effective income tax rate, as well as other items described below, contributed to an overall decrease of $0.36 per basic share to the results of operations.

Operating Revenues

Water

For the year ended December 31, 2007, revenues from water operations increased by 6.7% to $237.9 million, compared to $222.9 million for the year ended December 31, 2006. Contributing to this increase were rate increases approved by the CPUC effective January 1, 2007, which added approximately $13.0 million in 2007 to water revenues. Included in the rate increases for 2007 were $6.4 million for Region II and $3.0 million to recover general office expenses allocated to Region III. These increases were approved by the CPUC on November 16, 2007 and were retroactive to January 1, 2007. In addition, an increase of about 2.6% in the volume of billed water consumption resulting from much warmer and drier weather conditions increased revenues by approximately $3.8 million. Differences in temperature and rainfall in Registrant s service areas impact sales of water to customers, causing fluctuations in Registrant s revenues and earnings between comparable periods. Partially offsetting these increases was the fact that operating revenues for 2006 were positively impacted by a CPUC decision issued on April 13, 2006 enabling GSWC to record $2.3 million of water rights lease revenues from the City of Folsom for the period from January 2004 to December 2005. Prior to this decision, the apportionment of any lease revenues that GSWC collected in 2004 and 2005 had been included in a regulatory liability account and no amounts were recognized as revenues until regulatory uncertainties about this matter were resolved. There was no such adjustment in 2007. In addition, the increases in revenues are partially offset by the expiration in October 2006 of the surcharge that was in rates to recover Region III s under-collection in supply costs. This decrease in revenues is offset by a corresponding amount in the supply cost balancing accounts discussed below, resulting in no impact to pretax operating income.

Table of Contents

Electric

For the year ended December 31, 2007, revenues from electric operations decreased by 2.4% to $28.6 million compared to $29.3 million for the year ended December 31, 2006 due primarily to lower electric usage and the recording of a regulatory liability of approximately $178,000, with a corresponding decrease in revenues, for probable refunds to customers related to the construction of GSWC s 8.4 MW natural gas-fueled generation plant.

Contracted Services

Revenues from contracted services are comprised of construction revenues and management fees for operating and maintaining the water and wastewater systems at military bases. For the year ended December 31, 2007, revenues from contracted services increased by $18.5 million, or 112.3%, to $34.9 million compared to $16.4 million for the year ended December 31, 2006 due primarily to an increase of approximately $18.9 million related to construction revenues earned from the U.S. government and recognized on the percentage-of-completion method of accounting. The revenues earned were for the construction of certain improvements, renewals and replacements to the existing water and wastewater infrastructure at Fort Bliss and at the military bases located in Virginia and Maryland pursuant to contracts entered into in 2005. Certain of the construction projects are fixed-price contracts and are supplements to ASUS 50-year contracts with the U.S. government. In particular, ASUS entered into a $20.6 million project for the construction of certain improvements to the existing wastewater infrastructure located at Fort Bliss. The project was a firm-fixed price contract and was an amendment and supplement to the 50-year contract with the U.S. government to manage the entire water and wastewater systems at Fort Bliss. Revenues from this agreement have been recognized under the percentage-of-completion method of accounting. As a result of this new project, which began in early 2007, revenues for contracted services increased by $20.6 million during 2007. The project was completed in August 2007. The year over year revenue increase resulting from this project was partially offset by the non-recurrence of revenues for other one-time construction projects that were completed in 2006. Earnings and cash flows from amendments and modifications to the original 50-year contracts with the U.S. government are sporadic and may or may not continue in future periods.

There were also additional management fee revenues totaling $539,000 during 2007 generated from operating and maintaining the water and wastewater systems under the military privatization contracts in Virginia and Maryland. Offsetting these increases was a decrease in management fees totaling $938,000 related to contracts with various municipalities to provide billing, call handling and meter reading services. Effective January 1, 2007, ASUS assigned these service contracts with the various municipalities to GSWC. These management fees are now earned by GSWC so there was no impact on Registrant s consolidated earnings as a result of this assignment.

Registrant relies upon rate approvals by state regulatory agencies in California and Arizona and price redeterminations and equitable adjustments by the U.S. government in order to recover operating expenses and provide for a return on invested and borrowed capital used to fund utility plant. Without such adequate rate relief granted in a timely manner, operating revenues and earnings can be negatively impacted.

Table of Contents

Operating Expenses:

Supply Costs

Supply costs for the water segment consist of purchased water, purchased power for pumping, groundwater production assessments and water supply cost balancing accounts. Supply costs for the electric segment consist of purchased power for resale and the electric supply cost balancing account. Water and electric margins are computed by taking total revenues, less total supply costs. Registrant uses these margins and related percentages as an important measure in evaluating its operating results. Registrant believes this measure is a useful internal benchmark in evaluating the utility business performance within its water and electric segments. Registrant reviews these measurements regularly and compares them to historical periods and to our operating budget as approved. However, this measure, which is not presented in accordance with GAAP, may not be comparable to similarly titled measures used by other entities and should not be considered as an alternative to operating income, which is determined in accordance with GAAP, as an indicator of operating performance.

Total supply costs comprise the largest segment of total operating expenses. Supply costs accounted for approximately 33.5% and 36.0% of total operating expenses for the years ended December 31, 2007 and 2006, respectively. The table below provides the amount of increases (decreases), percent changes in supply costs, and margins during the years ended December 31, 2007 and 2006 (amounts in thousands):

		Year Ended 12/31/2007		**Year Ended 12/31/2006**		**$ CHANGE**	**% CHANGE**
WATER OPERATING REVENUES **(1)**	$	237,882	$	222,912	$	14,970	6.7%
WATER SUPPLY COSTS:							
Water purchased **(1)**	$	45,439	$	44,641	$	798	1.8%
Power purchased for pumping **(1)**		10,591		10,007		584	5.8%
Groundwater production assessment **(1)**		9,944		9,033		911	10.1%
Water supply cost balancing accounts **(1)**		(3,648)		(3,141)		(507)	16.1%
TOTAL WATER SUPPLY COSTS	$	62,326	$	60,540	$	1,786	3.0%
WATER MARGIN **(2)**	$	175,556	$	162,372	$	13,184	8.1%
PERCENT MARGIN - WATER		73.8%		72.8%			
ELECTRIC OPERATING REVENUES **(1)**	$	28,574	$	29,268	$	(694)	-2.4%
ELECTRIC SUPPLY COSTS:							
Power purchased for resale **(1)**	$	14,199	$	14,383		(184)	-1.3%
Electric supply cost balancing accounts **(1)**		1,686		1,306		380	29.1%
TOTAL ELECTRIC SUPPLY COSTS	$	15,885	$	15,689	$	196	1.2%
ELECTRIC MARGIN **(2)**	$	12,689	$	13,579	$	(890)	-6.6%
PERCENT MARGIN - ELECTRIC		44.4%		46.4%			

(1) As reported on AWR s Consolidated Statements of Income, except for supply cost balancing accounts. The sum of water and electric supply cost balancing accounts in the table above are shown on AWR s Consolidated Statements of Income and totaled ($1,962,000) and ($1,835,000) for the years ended December 31, 2007 and 2006, respectively.

(2) Water and electric margins do not include any depreciation and amortization, maintenance expense, unrealized gains and losses on purchased power contracts, or other operating expenses.

For the year ended December 31, 2007, 42% of the Company s water supply mix was purchased as compared to 44% purchased for the year ended December 31, 2006. This change in mix resulted in improved margins in 2007 compared to the same period in 2006. Water gross margin for the year ended December 31, 2006 included the $2.3 million water rights

Table of Contents

lease revenues from the City of Folsom. Without the $2.3 million water rights lease revenues in 2006, water gross margin for the year ended December 31, 2006 would have been 71.8%.

Purchased water costs for the year ended December 31, 2007 increased by 1.8% to $45.4 million compared to $44.6 million for the year ended December 31, 2006. The increase is due primarily to higher water rates charged by wholesale suppliers and higher customer consumption. In general, the supply cost balancing account as discussed above allows GSWC to track incremental rate changes from suppliers, for future recovery in water rates. These increases in purchased water costs were offset by a favorable change in the supply mix discussed above. The favorable change in supply mix allowed GSWC to serve a portion of the increased customer demand from groundwater production rather than wholesale purchases, primarily because of the 2007 return to service or replacement of wells which had been removed from service in 2006 as a result of water quality issues and mechanical problems.

For the year ended December 31, 2007, the increases in power purchased for pumping and groundwater production assessments were due to higher customer demand and an increase in pumping volume resulting from the favorable supply mix change as discussed. There were also increases in assessment rates (pump tax rates) levied against groundwater production, effective July 2006 and 2007. Average 2007 pump tax rates increased in Region II and III by approximately 8% and 6%, respectively. Again, the supply cost balancing account tracks the increases in pump tax rates for future recovery in water rates.

A decrease of $507,000 during 2007 in the water supply cost balancing account provision as compared to 2006 was primarily caused by a $2.1 million decrease due to the expiration in October 2006 of the surcharge that was in rates to recover previously incurred supply costs in GSWC s Region III service areas. This decrease was partially offset by an overall increase of $1.6 million in the provision as compared to the same period of 2006. On November 16, 2007, the CPUC approved general rate case increases, retroactive to January 1, 2007, for GSWC s Region II service area. The decision reflects the revenue requirement for supply costs that included recent rate increases from GSWC s suppliers. As a result, there was less under-collection in supply costs to record as compared to 2006, resulting in an increase to the supply cost balancing account as discussed.

For the year ended December 31, 2007, the cost of power purchased for resale to customers in GSWC s BVES division decreased slightly by 1.3% to $14.2 million compared to $14.4 million for the year ended December 31, 2006 reflecting primarily lower customer demand and kilowatt-hour usage.

Unrealized (Gain) Loss on Purchased Power Contracts

Unrealized (gain) and loss on purchased power contracts represent gains and losses recorded for GSWC s purchased power agreements with Pinnacle West Marketing & Trading Company, LLC (PWMT) (formerly Pinnacle West Capital Corporation), which qualify as derivative instruments under SFAS No. 133. In June 2007, PWMT sold many of its wholesale power contracts to Morgan Stanley Capital Group, Inc. (MSCG). The sale included the contract between PWMT and GSWC. GSWC was notified by PWMT about the sale of its contracts, and in September 2007 an assignment agreement was executed by GSWC, PWMT and MSCG that became effective November 1, 2007. The assignment agreement retained the identical terms and conditions of the original contract.

The $2.1 million pretax unrealized gain on purchased power contracts for the year ended December 31, 2007 is due to an increase in the forward market prices at December 31, 2007 since December 31, 2006. There was a $7.1 million pretax unrealized loss on purchased power contracts for the year ended December 31, 2006. Unrealized gains and losses at BVES will continue to impact earnings positively or negatively during the life of the contract, which terminates at the end of 2008. As of December 31, 2007, there is an accumulated unrealized loss of $1.6 million which will be recognized in income by December 31, 2008.

Table of Contents

Other Operating Expenses

The components of other operating expenses include primarily payroll, materials and supplies, chemicals and water treatment, 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, and operations of district offices. For the years ended December 31, 2007 and 2006, other operating expenses by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2007	Year Ended 12/31/2006	$ CHANGE	% CHANGE
Water Services	$ 21,721	$ 19,846	$ 1,875	9.4%
Electric Services	1,927	1,789	138	7.7%
Contracted Services	3,727	2,499	1,228	49.1%
Total other operating expenses	$ 27,375	$ 24,134	$ 3,241	13.4%

For the year ended December 31, 2007, other operating expenses for water services increased by $1.9 million due primarily to higher chemicals and water treatment costs, including supplies and materials, of $1.2 million in particular at GSWC s Region II and III services areas. Region II incurred additional costs primarily for the removal of arsenic and volatile organic compounds at six of its wells, while Region III incurred additional costs primarily for two of its treatment plants. There was also an increase in labor costs of $399,000 due to higher wages and related benefits, and an increase of $738,000 in conservation costs at GSWC s Region II service area. In 2007, GSWC began expensing conservation costs in Region II pursuant to an agreement reached with the CPUC during its general rate case. Some of the 2007 Region II conservation expenses were recovered in rates. Previously, conservation costs in Region II were capitalized and recovered in rate base. These expense increases in 2007 were offset, in part, by a decrease of $343,000 in bad debt expense.

There was also an increase in other operating expenses of $1.2 million for contracted services primarily due to the commencement of the operation of water and wastewater systems at military bases in Maryland and Virginia. ASUS operated these bases during the full year ended December 31, 2007, whereas, with service commencement dates in the first four months of 2006, they were only operated by ASUS during part of 2006. Other operating expenses increased by approximately $573,000 at these bases. There was also an increase of $654,000 in bad debt expense primarily related to aged accounts receivable balances from the U.S. government. As of December 31, 2007, approximately $2.1 million of amounts due from the U.S. government were past due.

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, outside legal and consulting fees, regulatory utility commission expenses, expenses associated with being a public company, and general corporate expenses. For the years ended December 31, 2007 and 2006, administrative and general expenses by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2007	Year Ended 12/31/2006	$ CHANGE	% CHANGE

Water Services	$	40,735	$	37,995	$	2,740	7.2%
Electric Services		5,744		5,013		731	14.6%
Contracted Services		6,158		4,102		2,056	50.1%
Total administrative and general expenses	$	52,637	$	47,110	$	5,527	11.7%

For the year ended December 31, 2007, administrative and general expenses increased by $3.5 million in water and electric services compared to the year ended December 31, 2006 due primarily to: (i) an increase of $470,000 in outside

Table of Contents

services relating primarily to additional tax, accounting and legal services; (ii) an approximate $1.9 million increase in labor costs due to higher wages largely related to Registrant s annual performance-based salary review program; (iii) an agreement with the City of Folsom to dismiss all opposition to GSWC providing service to the proposed Westborough development; the agreement requires GSWC to pay the City of Folsom $550,000 with Aerojet reimbursing GSWC for 50%, or $275,000, of the settlement payment; as of and for the year ended December 31, 2007, GSWC has recorded an obligation to the City of Folsom for $550,000, an additional receivable of $275,000 from Aerojet for the amount to be reimbursed and a net charge to administrative and general expenses in the amount of $275,000 for its share of the settlement payment; (iv) an increase in insurance premiums of approximately $610,000; (v) a $351,000 increase in rent expense for office space and the telephone system; (vi) an increase in regulatory commission expenses of approximately $149,000, and (vii) a $494,000 net increase in other miscellaneous expenses primarily related to bank fees, postage, supplies and other general corporate expenses. These increases were offset by a decrease of $741,000 in pension costs as a result of favorable changes to actuarial assumptions.

There was also an increase of $2.1 million in contracted services administrative and general expenses due primarily to: (i) the recovery in 2006 of transition period operating expenses of about $672,000 at the various military bases pursuant to the contracts with the U.S. government; there was no such recovery in 2007; (ii) an increase of approximately $367,000 in outside services including legal and consulting costs; (iii) an approximate $402,000 increase in labor and employee benefit costs; and (iv) an increase of $526,000 in allocation from the corporate headquarters to the Military Utility Privatization Subsidiaries. A final decision on the general rate case for GSWC s Region II and the application to cover general office expenses allocated to Regions II and III were approved on November 16, 2007 and imposed an increased allocation of corporate headquarters expenses to contracted services. This adjustment was retroactive to January 1, 2007 and was made in the fourth quarter of 2007, thus negatively impacting contracted services pretax income and positively impacting water and electric services pretax income by the same amount.

Depreciation and Amortization

For the years ended December 31, 2007 and 2006, depreciation and amortization by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2007	Year Ended 12/31/2006	$ CHANGE	% CHANGE
Water Services	$ 26,561	$ 24,040	$ 2,521	10.5%
Electric Services	2,175	2,040	135	6.6%
Contracted Services	205	192	13	6.8%
Total depreciation and amortization	$ 28,941	$ 26,272	$ 2,669	10.2%

For the year ended December 31, 2007, depreciation and amortization expense for water and electric services increased by $2.7 million to $28.7 million compared to $26.1 million for the year ended December 31, 2006 reflecting, among other things, the effects of closing approximately $73 million of additions to utility plant during 2006, depreciation on which began in January 2007. Registrant anticipates that depreciation expense will continue to increase due to Registrant s on-going construction program at its regulated subsidiaries. Registrant believes that depreciation expense related to property additions approved by the appropriate regulatory agency will be recovered through water and electric rates.

There was also an increase in depreciation and amortization expense for contracted services due to the addition of fixed assets.

45

Table of Contents

Maintenance

For the years ended December 31, 2007 and 2006, maintenance expense by segment consisted of the following (amounts in thousands):

		Year Ended 12/31/2007		Year Ended 12/31/2006		$ CHANGE	% CHANGE
Water Services	$	14,471	$	11,225	$	3,246	28.9%
Electric Services		787		632		155	24.5%
Contracted Services		521		397		124	31.2%
Total maintenance	$	15,779	$	12,254	$	3,525	28.8%

For the year ended December 31, 2007, maintenance expense for water services increased by 28.9% to $14.5 million compared to $11.2 million for the year ended December 31, 2006 due principally to an increase in planned and emergency maintenance on GSWC s water supply and distribution facilities. A significantly higher than anticipated number of water main repairs were completed during 2007, many of which were attributed to much colder than average temperatures reacting with the cast iron pipe materials in older sections of GSWC s distribution system. In January 2007, GSWC s largest distribution system in Los Angeles County experienced over 200 leaks due to the colder than normal temperatures. In addition to the increase in repairs to the distribution systems owned by GSWC, an increased effort in 2007 was focused on planned maintenance of fire hydrants, gate valves and flushing dead-end water lines compared to 2006.

GSWC also experienced an increase in planned and unplanned maintenance of its water supply sources, namely company-owned wells. Many planned well treatment and rehabilitation projects were deferred in 2006 due to unanticipated water quality and mechanical problems in many wells discussed above. In 2007, a number of new wells and treatment facilities were placed into service allowing GSWC to continue with the well maintenance projects originally scheduled for 2006 without experiencing a decline in groundwater production. In general, well and pump maintenance expenses continue to increase due to rising labor and material costs and more stringent water discharge requirements. These maintenance increases are included in each general rate case and are generally recovered in rates. However, amounts included in each general rate case are estimated for future years and overages from those estimates may not be covered in rates.

There was an increase of $155,000 in maintenance for electric services related to the 8.4 MW natural gas-fueled generation plant. There was also an increase of $124,000 in contracted services maintenance expense due primarily to increases at Fort Bliss.

Property and Other Taxes

For the years ended December 31, 2007 and 2006, property and other taxes by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2008	Year Ended 12/31/2007	$ CHANGE	% CHANGE

Water Services	$ 10,247	$ 9,422	$ 825	8.8%
Electric Services	882	635	247	38.9%
Contracted Services	125	130	(5)	-3.8%
Total property and other taxes	$ 11,254	$ 10,187	$ 1,067	10.5%

For the year ended December 31, 2007, overall property and other taxes increased by 10.5% to $11.3 million compared to $10.2 million for the year ended December 31, 2006 reflecting additional property taxes resulting from higher assessed values, and increases in payroll taxes based on increased labor costs.

Table of Contents

Construction Expenses

For the year ended December 31, 2007, ASUS construction expenses increased to $22.1 million compared to $9.0 million for the same period in 2006 reflecting the costs incurred for the construction of various improvements, renewals and replacements to the existing water and wastewater infrastructures at Fort Bliss and at the military bases located in Virginia and Maryland pursuant to contracts entered into in 2005. The increase in construction activity resulted from amendments to the original 50-year contracts with the U.S. government which required the construction of additional improvements at the various military bases. As previously mentioned, ASUS entered into a $20.6 million project for the construction of certain improvements to the existing wastewater infrastructure located at Fort Bliss. As a result of this new project, construction expenses increased by $15.7 million during 2007. The project was completed in August 2007. The increase in construction expenses because of this project was partially offset by other non-recurring construction projects that were completed in 2006.

Net Gain on Sale of Property

For the year ended December 31, 2007, water services recorded a net pretax gain of $584,000 on the sale of property. This gain includes a settlement of $325,000 reached with the Los Angeles Unified School District in connection with the condemnation of a parcel of land for the purpose of constructing a high school. This parcel of land had not been used for a number of years in GSWC s public utility operations. In addition, there was a gain of $238,000 related to the sale of property in the City of Claremont. Earnings and cash flows from these transactions are sporadic and may or may not continue in future periods.

Interest Expense

For the years ended December 31, 2007 and 2006, interest expense by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2007	Year Ended 12/31/2006	$ CHANGE	% CHANGE
Water and Electric Services	$ 20,515	$ 20,073	$ 442	2.2%
Contracted Services	1,067	1,048	19	1.8%
Total interest expense	$ 21,582	$ 21,121	$ 461	2.2%

For the year ended December 31, 2007, interest expense increased by 2.2% to $21.6 million compared to $21.1 million for the year ended December 31, 2006 primarily reflecting higher interest rates. There was also an increase in short-term borrowings. Average bank loan balances outstanding under an AWR credit facility for the year ended December 31, 2007 were approximately $32 million, as compared to an average of $28 million during the same period of 2006.

Table of Contents

Interest Income

For the years ended December 31, 2007 and 2006, interest income by segment consisted of the following (amounts in thousands):

	Year Ended 12/31/2007	Year Ended	$	%