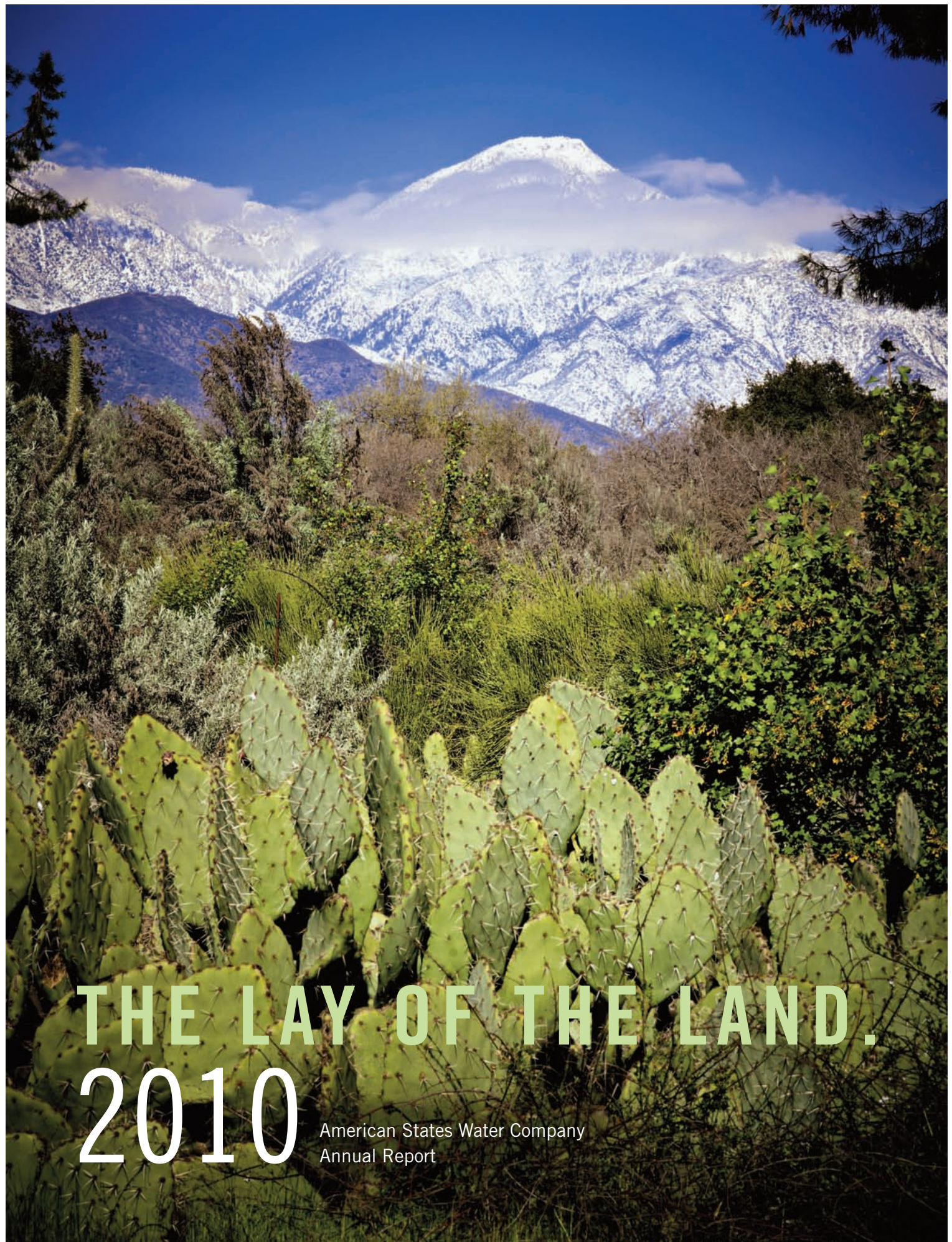
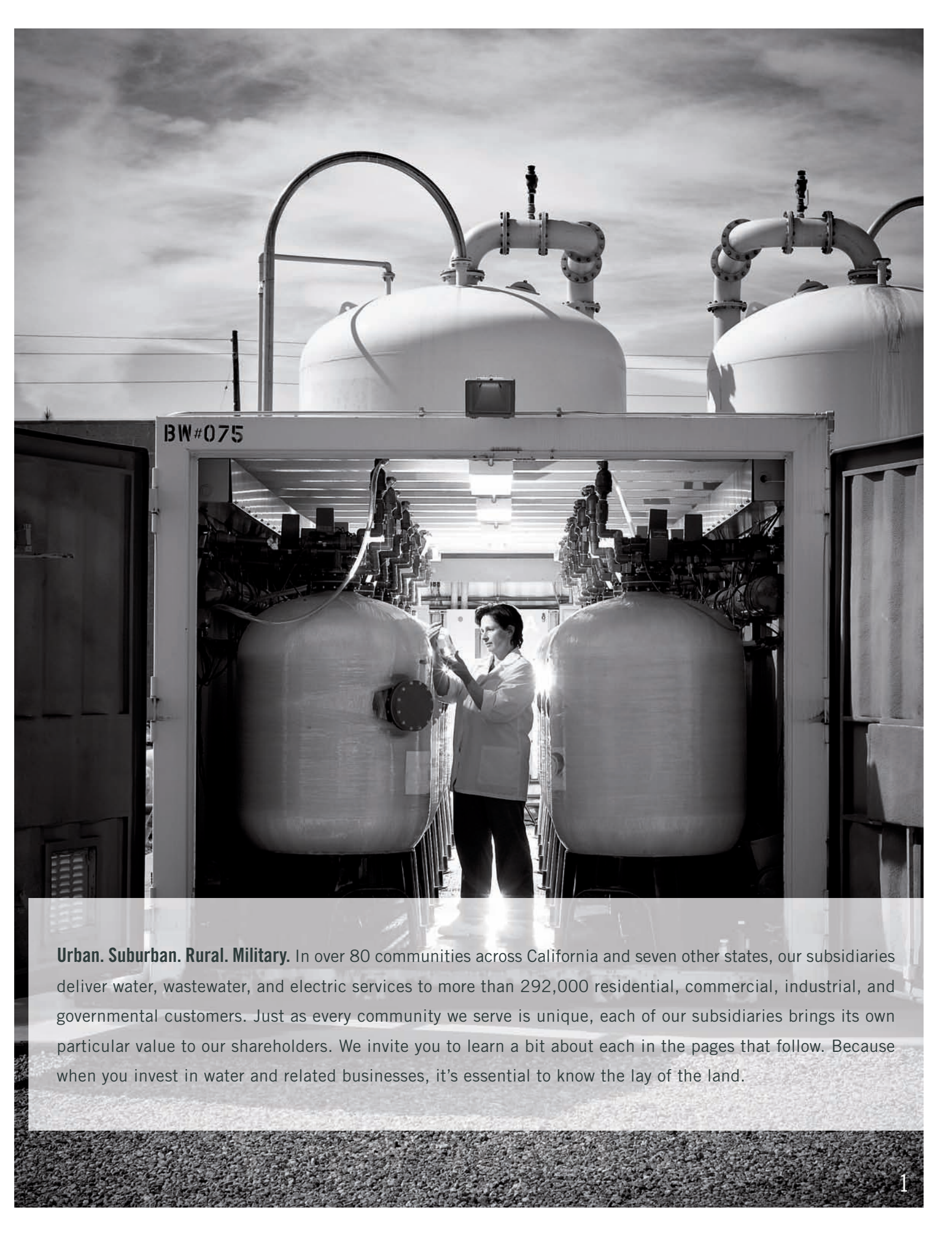




# THE LAY OF THE LAND. 2010

American States Water Company  
Annual Report

**LIKE THE COUNTRY  
WE SERVE, BREADTH  
AND DIVERSITY  
MAKE US STRONG.**



BW#075

**Urban. Suburban. Rural. Military.** In over 80 communities across California and seven other states, our subsidiaries deliver water, wastewater, and electric services to more than 292,000 residential, commercial, industrial, and governmental customers. Just as every community we serve is unique, each of our subsidiaries brings its own particular value to our shareholders. We invite you to learn a bit about each in the pages that follow. Because when you invest in water and related businesses, it's essential to know the lay of the land.



# APPROVAL OF RATE INCREASES ACROSS OUR SERVICE AREA

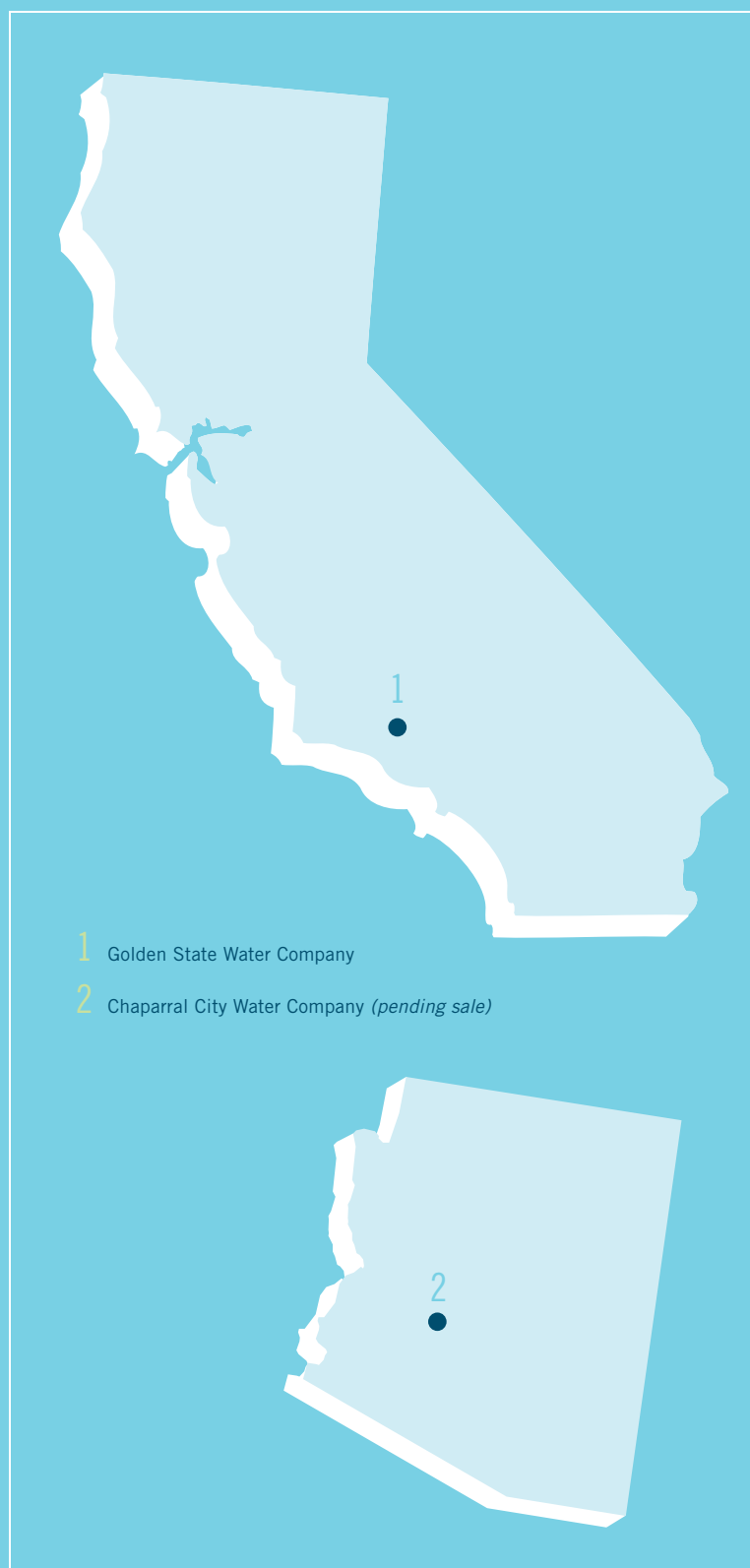
Golden State Water Company



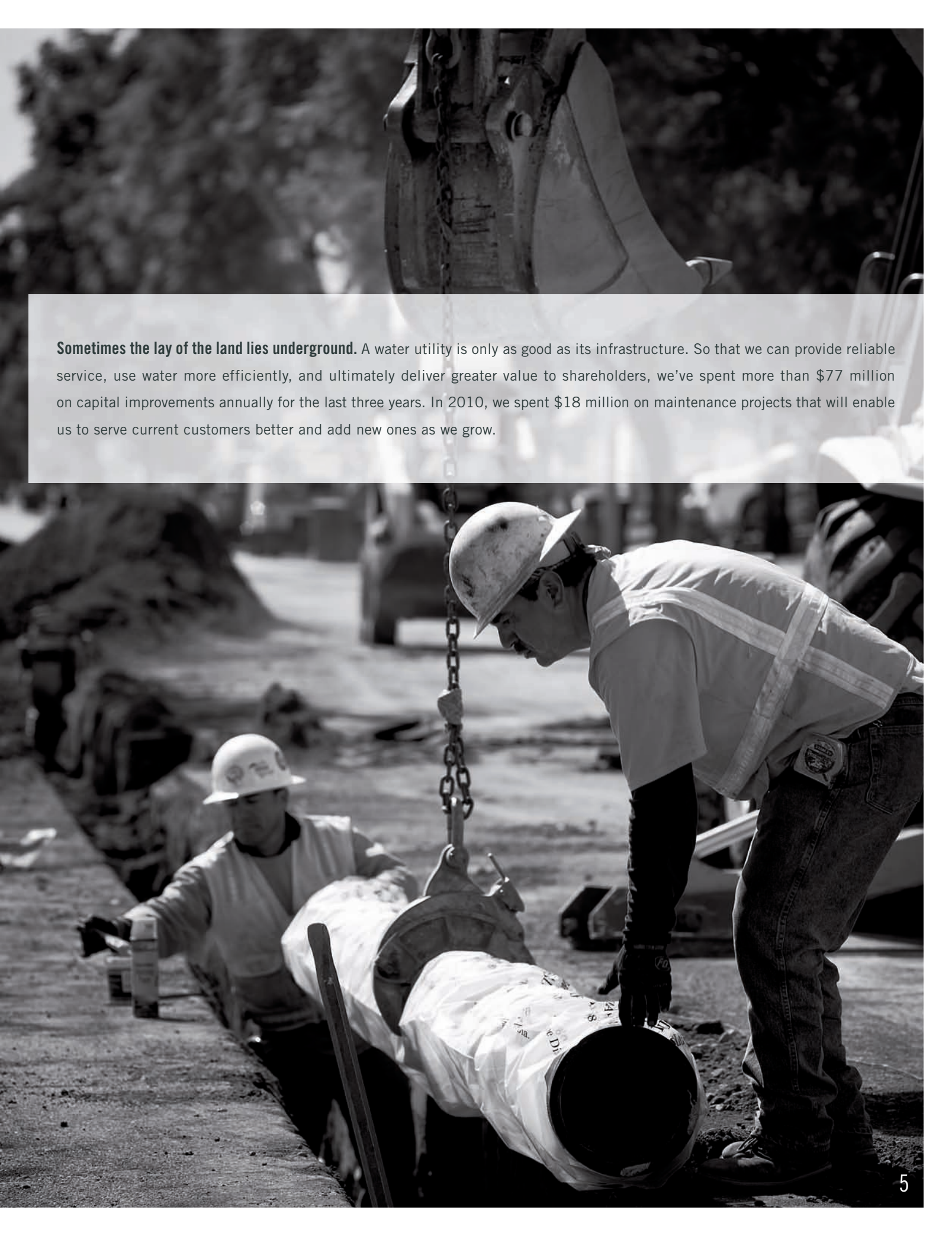
**Our largest subsidiary's greatest achievement in 2010 was gaining the California Public Utilities Commission's approval of rate increases for all of its water service areas.** As a result, we'll not only be able to increase revenue in coming years—we'll also be able to continue the annual investment in infrastructure that is enabling us to sustain existing service and reach new customers as well. We will also continue to look for new sources of water amidst California's complicated water politics. This year, we signed an option agreement with a regional supplier, which will supply water from a carefully managed sustainable source.

# GOLDEN STATE WATER COMPANY

## CHAPARRAL CITY WATER COMPANY *(PENDING SALE)*



| CALIFORNIA                                                | customers      |
|-----------------------------------------------------------|----------------|
| <b>GOLDEN STATE WATER COMPANY</b>                         |                |
| <b>Northern District</b>                                  |                |
| Arden/Rancho Cordova                                      | 16,185         |
| Bay Point                                                 | 4,901          |
| Clearlake                                                 | 2,149          |
| <b>Coastal District</b>                                   |                |
| Los Osos                                                  | 3,275          |
| Ojai                                                      | 2,895          |
| Santa Maria                                               | 13,375         |
| Simi Valley                                               | 13,302         |
| <b>Central District</b>                                   |                |
| Central Basin East                                        | 20,019         |
| Central Basin West                                        | 19,946         |
| Culver City                                               | 9,556          |
| <b>Southwest District</b>                                 |                |
| Southwest                                                 | 51,352         |
| <b>Foothill District</b>                                  |                |
| Claremont                                                 | 11,044         |
| San Dimas                                                 | 15,922         |
| San Gabriel                                               | 12,314         |
| <b>Mountain/Desert District</b>                           |                |
| Apple Valley                                              | 2,864          |
| Barstow                                                   | 8,932          |
| Calipatria                                                | 1,193          |
| Morongo Valley                                            | 945            |
| Wrightwood                                                | 2,684          |
| <b>Orange County District</b>                             |                |
| Los Alamitos                                              | 27,334         |
| Placentia                                                 | 15,375         |
| <b>Bear Valley Electric Service</b>                       | 23,257         |
| <b>ARIZONA</b>                                            |                |
| <b>CHAPARRAL CITY WATER COMPANY <i>(pending sale)</i></b> |                |
| Fountain Hills and a portion of Scottsdale                | 13,468         |
| <b>TOTAL</b>                                              | <b>292,287</b> |



**Sometimes the lay of the land lies underground.** A water utility is only as good as its infrastructure. So that we can provide reliable service, use water more efficiently, and ultimately deliver greater value to shareholders, we've spent more than \$77 million on capital improvements annually for the last three years. In 2010, we spent \$18 million on maintenance projects that will enable us to serve current customers better and add new ones as we grow.



# SERVING OUR MILITARY—AND OUR SHAREHOLDERS

American States Utility Services, Inc.

Our subsidiary, American States Utility Services, Inc. (ASUS), is one of the leaders in privatization of water and wastewater services for U.S. military installations. In 2010, ASUS was one of our company's greatest drivers of growth, with revenues that increased 22 percent over 2009.

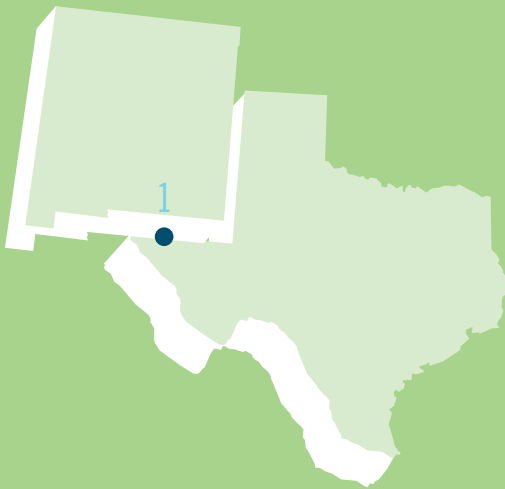




**Serving our nation's soldiers and their families is a big job.** It requires big equipment—like the pump at ASUS' Lift Station Number One at Ft. Bragg, North Carolina—as well as a big commitment and serious know-how from our employees. ASUS is a growing company that has posted strong results for two consecutive years. With 50-year contracts at ten domestic bases—several of which are growing to accommodate more troops and their families—ASUS is poised to deliver solid returns to our shareholders.

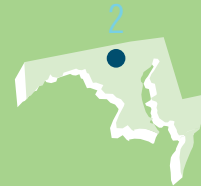
## AMERICAN STATES UTILITY SERVICES

American States Utility Services, Inc., contracts with the U.S. Government to provide various services, including operation & maintenance and construction & replacement of water and wastewater systems as identified below:



### TEXAS / NEW MEXICO

Fort Bliss Water Services Company provides services to the United States Army at the Fort Bliss military installation in El Paso, Texas. The service area also includes Dona Ana, MacGregor, and Myers Range Camps located in New Mexico.



### MARYLAND

Terrapin Utility Services, Inc. provides services to the United States Air Force at Andrews Air Force Base in Maryland.



### VIRGINIA

Old Dominion Utility Services, Inc (ODUS) provides services to the United States Army at Fort Story, Fort Eustis, and Fort Monroe in Virginia. In addition, ODUS performs the same functions for the wastewater system at Fort Lee, Virginia for the United States Army.



### NORTH CAROLINA

Old North Utility Services, Inc. provides services to the United States Army at Fort Bragg, Pope Air Force Base, and Camp MacKall in North Carolina.

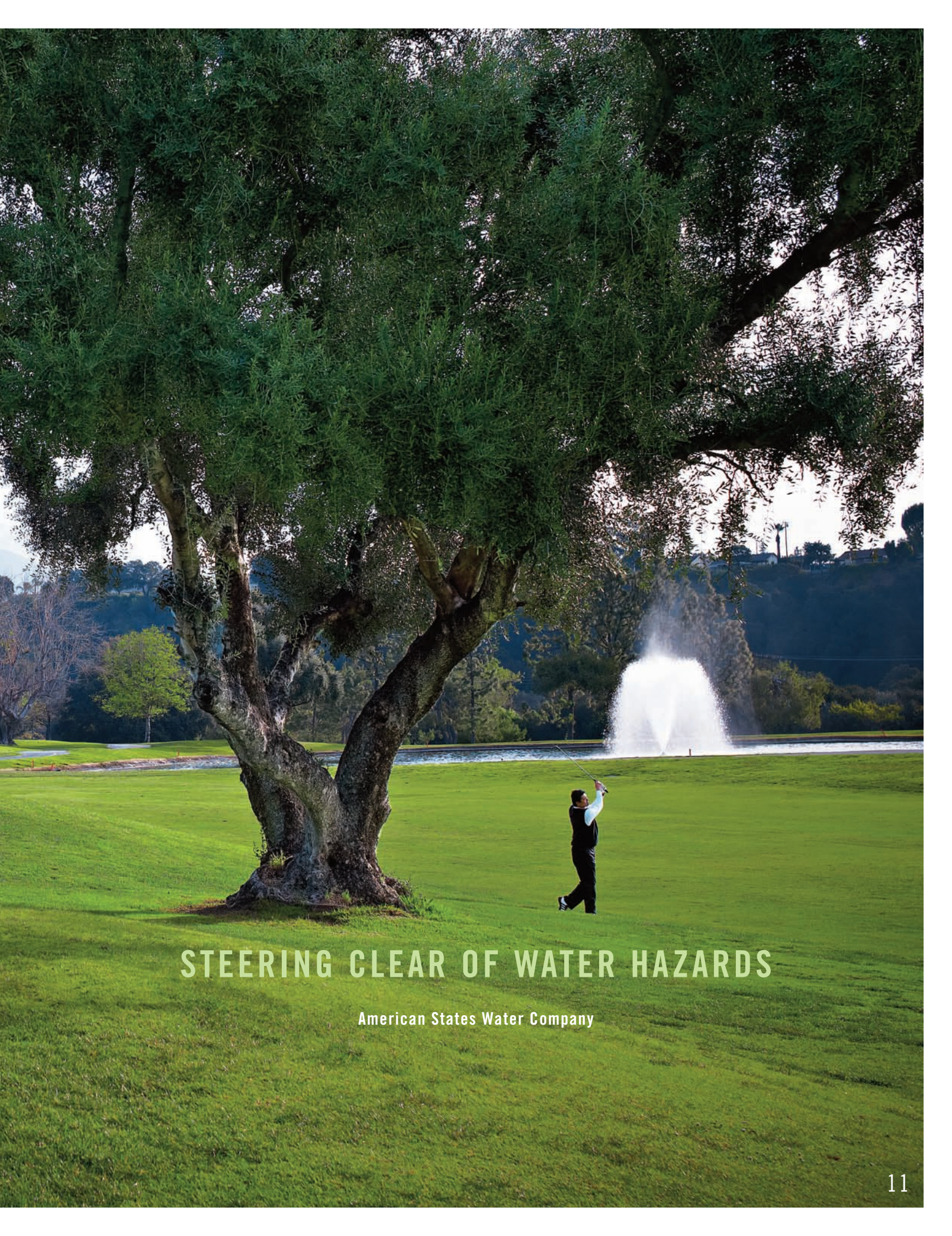


### SOUTH CAROLINA

Palmetto State Utility Services, Inc. provides services to the United States Army at Fort Jackson in South Carolina.



**It's a fundamental truth that's all too easy to forget: without water, nothing grows.** Not people, not crops, and certainly not economies. California's economy is one of the top ten in the world, and the state's economic story is largely a story of water. As a water provider, we understand the crucial role we play for commercial customers like San Dimas Canyon Golf Course in San Dimas, California, pictured here. We have an obligation to not only deliver the water that drives growth and prosperity today, but to also make sure plenty of water is available in years to come. That's why we provide conservation-related equipment and incentives to help customers conserve water, and why we work with schools to help educate the next generation of water consumers. It's why we continually expand our water portfolio, and why we've implemented a water revenue adjustment mechanism that ensures we are not financially disadvantaged when our customers use water more efficiently.



# STEERING CLEAR OF WATER HAZARDS

American States Water Company



## DEAR SHAREHOLDERS,

Looking at a map showing the reach of our company—the “lay of the land”—one sees how the breadth and diversity of our service areas make us strong. That strength served us well in 2010, which, by most measures, was another solid year for American States Water Company (AWR).

Despite a slowly recovering economy and continuing water supply challenges, we improved earnings and increased our annual dividend to shareholders for the 56th consecutive year. We received final decisions on rate cases for all three of Golden State Water Company's water service areas and saw American States Utility Services post another strong year. We continued building on our foundation of ongoing infrastructure improvements and outstanding customer service. And thanks to an upgrade in our Standard & Poor's debt rating, our credit strength is now rated among the highest of all the water companies in the U.S.

Here, in greater detail and chronological order, are key developments from our Company in 2010:

- 1 In January, American States Utility Services, Inc. (ASUS), our contracted services subsidiary, received approval from the U.S. government on \$12.5 million of requested equitable adjustments for managing more infrastructure than the government originally estimated in its bid solicitation for operation of the water and wastewater facilities at Fort Bragg in North Carolina and Fort Bliss in Texas. As a result, ASUS recorded \$6.1 million in pretax income during the first quarter of 2010 for these items. The remaining \$6.4 million is for additional construction funds to be recognized in revenues when the construction work is performed.
- 2 During the first six months, Golden State Water Company (GSWC) received California Public Utilities Commission (CPUC) approvals to implement customer surcharges to recover the December 31, 2009 balances of \$20.4 million in undercollections in its Water Revenue Adjustment Mechanisms, net of the Modified Cost Balancing Accounts. These undercollections are the result of reductions in usage due to conservation and water rationing for all GSWC water regions.
- 3 In June, we entered into a stock purchase agreement for the sale of Chaparral City Water Company to EPCOR Water (USA) Inc. (See next page.)
- 4 In July, Standard & Poor's Rating Services upgraded the corporate credit rating on both AWR and GSWC from “A” with a “positive” outlook to “A+” with a “stable” outlook. We are now one of the highest-rated water utilities in the nation.

- 5 During the third quarter, ASUS received an interim price increase for operations at Andrews Air Force Base in Maryland and an equitable adjustment for Fort Jackson in South Carolina, which resulted in \$1.4 million of pretax income.
- 6 In November, a final decision was issued by the CPUC in GSWC's Region II/Region III/General Office rate case with rates retroactive to January 1, 2010. The decision provided for an increase in annual revenues of approximately \$33 million for 2010, which includes an increase of \$14 million in supply costs.
- 7 In the second half of the year, GSWC took pre-tax charges to earnings aggregating to \$16.6 million, or \$0.55 per American States common share. The charges were the result of the disallowance of certain construction projects in a GSWC rate case decision and a pending CPUC investigation of certain work orders and charges paid to a specific contractor used by Golden State Water for numerous construction projects between 1989 and 2003.
- 8 In December, the CPUC issued a final decision in GSWC's Region I general rate case with rates effective 2011 and 2012. The rate case decision provides for a \$1.9 million annual increase in revenues and authorizes GSWC to file advice letters for revenue recovery on \$18.5 million of capital projects when each of these projects are completed. The decision also allows GSWC to recover the cost of debt and equity used to finance these capital projects.

#### **IMPROVED EARNINGS**

We reported consolidated fully diluted earnings per share of \$1.77 for 2010 compared to consolidated diluted earnings per share of \$1.62 for 2009. Because of our agreement to sell Chaparral City Water Company (CCWC), we began reporting the contribution to consolidated earnings by AWR (the parent), GSWC, and ASUS as "Income from Continuing Operations" and CCWC's contribution to consolidated earnings as "Income from Discontinued Operations" consistent with generally accepted accounting principles beginning in the second quarter 2010.

Fully diluted earnings per share (EPS) from continuing operations as reported increased to \$1.66 from \$1.61 in 2009. Included in the key developments of 2010 as discussed above, were two significant items that were not reflective of our day-to-day operations for the year. We recorded \$6.1 million of pretax income from approved equitable adjustments at Fort Bragg and Fort Bliss (item 1 above), and a one-time pretax charge of \$16.6 million associated with asset impairments and loss contingencies (item 7 above). Removing the effect of these two items, adjusted diluted earnings for 2010 from continuing operations would have been \$2.02 per share, an increase of \$0.41 per share from 2009.

The significantly higher adjusted diluted EPS from continuing operations in 2010 versus 2009 were primarily due to the increase in water rates resulting from the final decision in GSWC's Region II/Region III/General Office rate case (item 6 above) and improved profitability at Bear Valley Electric Service due to rate increases. The increases in rates for the Region II and III water regions were retroactive to January 1, 2010. A detailed comparison of the financial performance of 2010 and 2009 can be found beginning on page 27 of the attached 2010 Form 10-K.

#### **OUR FIVE-YEAR SHAREHOLDER RETURN**

AWR's compounded annual return to shareholders for the period 2006-2010 was 5.1 percent compared to a return of 2.3 percent for the S&P 500 and 4.3 percent by our peer group for the same period. (Please see additional information on page 18 of our 2010 Form 10-K.) Though it exceeds both the S&P 500 and our peer group, this level of return is not acceptable. We are committed to improving it.

#### **THE SALE OF CHAPARRAL CITY WATER COMPANY**

Also unacceptable were the low historical returns on our investment in Chaparral City Water Company (CCWC), our Arizona subsidiary. In light of those returns, we did not have an interest in growing CCWC. We further concluded that given CCWC's small size, it made business sense to consider a sale.

During the first six months of 2010, we implemented a sale process that resulted in our signing an agreement to sell CCWC to EPCOR Water (USA) Inc. for \$35 million, including \$29 million in cash and \$6 million in assumed debt. We hope to receive Arizona Corporation Commission approval of the sale in 2011

and complete it shortly thereafter. We expect to recognize a pretax gain on sale of approximately \$5 million at closing, net of transaction costs and the benefit of ceasing depreciation expense in accordance with generally accepted accounting principles. We plan to use the cash from the sale to fund capital expenditures at GSWC, allowing us to defer one of our periodic AWR equity issuances.

### **STAYING THE COURSE WITH GSWC**

GSWC continues to be our flagship subsidiary. During 2010, it accounted for approximately 82 percent of AWR's revenues and 81 percent of AWR's income from continuing operations. The key tenets of GSWC's strategy continue to include (1) timely filing for rate recovery, (2) a well-managed capital expenditure/infrastructure replacement program, (3) a customer service culture, (4) maintaining a strong water supply portfolio and (5) establishing a rate structure that provides the right customer incentives for conservation of precious water resources.

**Timely Filing For Rate Recovery** Timely recovery of operating expenses and capital expenditures in rates charged to customers is critical to successfully operating regulated utilities. In July 2011, we will file our first consolidated water rate proceeding before the CPUC with rates to be effective in 2013, 2014, and 2015. We have been transitioning from filing on a regional basis under the CPUC's rate case plan. A brief description of the rate increases granted to our regulated utilities in 2010 has been provided previously. Further descriptions of regulatory activities are presented, beginning on page 62 of the attached 2010 Form 10-K.

In June 2008, GSWC's Bear Valley Electric Service (BVES) division filed its general rate case with the CPUC's electric division. The filing was the first full general rate case for BVES since 1996. New rates were implemented based on a CPUC decision issued in October 2009 and have since improved the profitability at BVES. The decision also allowed for an update to BVES' rates in 2010 for the corporate headquarters' costs. A four-year rate case cycle has been established and BVES' next general rate case will be filed by the end of 2011, with new rates effective January 1, 2013.

**A Well-Managed Capital Expenditure/Infrastructure Replacement Program** GSWC's rates are set based on forward-looking forecasts of operating expenses and capital expenditures. As a result, it is critical that we invest capital in a timely manner and consistent with the plans approved by the CPUC. During 2010, GSWC invested \$77.0 million in expanding its systems and replacing infrastructure to preserve the high quality service our customers have come to expect. As a result of this level of construction, GSWC's net utility plant increased from \$819.0 million at the end of 2009 to \$851.4 million at the end of 2010.

**A Customer Service Culture** GSWC has been in business for more than 80 years because we have always put our customers first. We are one of the few water companies that operate a call center 24 hours a day, 7 days per week, 365 days per year. In an effort to improve our customer service and the response time to our customers, we are in the process of replacing our customer information and billing system. We expect to have the new system up and running in 2011.

**Maintaining A Strong Water Supply Portfolio** GSWC owns nearly 118,000 acre-feet of water rights, 106,000 acre-feet of which are groundwater rights. We remain intent on preserving the ever-increasing value of these water rights, particularly given the concern over diminishing water supply in the western states.

GSWC maintains 56 connections to a network of pipelines owned and operated by the Metropolitan Water District of Southern California and other suppliers, which provide imported water supplies for 17 of GSWC's 38 systems in California. In addition, GSWC enjoys flexibility in its water supply portfolio as 32 of its 38 water systems are linked to the broader statewide conveyance systems. We continue to plan for our future water supply needs. During 2010, GSWC negotiated with two new regional water suppliers on future supply projects.

**A Rate Structure That Provides Incentives to Conserve** We believe conservation is the most cost effective way to address the water supply shortages in the Southwestern U.S. In 2008 and 2009, after receiving CPUC approval and providing notice to our customers, GSWC implemented an increasing block design in the rates charged in all three GSWC water regions to encourage conservation. As part of the implementation, we were authorized by the CPUC to establish a water revenue adjustment mechanism to decouple revenues from

sales in order to avoid penalizing GSWC for the decline in sales related to conservation resulting from the impact of the increasing block water rates. Due to the implementation of the increasing block rate design, water rationing in some areas and the media attention encouraging Californians to conserve, GSWC's water sales in 2010 were more than 15 percent lower than water sales in 2008.

#### **ANOTHER STRONG YEAR AT ASUS**

ASUS operates the water and wastewater systems at nine military bases throughout the country and the wastewater system only at a tenth base, under fifty-year contracts with the U.S. government. ASUS completed its second consecutive strong year from a financial perspective, generating pre-tax operating income of \$11.5 million on revenues of \$72.4 million. The strong performance was bolstered by the approved equitable adjustments at Fort Bragg, Fort Bliss, and Fort Jackson and the contract modification for an interim price increase at Andrews Air Force Base in Maryland previously discussed. An increase in construction work at Fort Jackson and Fort Bragg also contributed to the strong financial performance for 2010.

To be successful long-term in the contracted services business, ASUS needs to be able to charge prices that reflect our costs of serving the bases, plus a mark-up for profit. Under the terms of the military privatization program, suppliers such as ASUS are allowed to file for a price increase two years after implementing a contract and every three years thereafter. These price increases are referred to as price redeterminations. In addition, to the degree a supplier is managing more assets at specific military bases than were included in the military's original solicitation or if the assets are in substandard condition, that supplier is allowed to file a request for equitable adjustment (REA). Under the REA process, ASUS can request an increase in both its operations-related revenues and its renewal and replacement (capital-related) revenues to compensate for the additional costs it may incur maintaining a larger system.

**Price Redeterminations and Requests for Equitable Adjustment (REAs)** During 2008, ASUS filed for price redeterminations with the U.S. government at the bases it manages in Virginia and at Andrews Air Force Base in Maryland and received interim price increases pending consideration of permanent increases. In February 2011, ASUS received a contract modification resolving the operation and maintenance portion of one of two contracts in Virginia. At the writing of this letter, ASUS has not received permanent resolutions to the other price redetermination filings. ASUS plans to file price redeterminations at Fort Bragg in North Carolina and Fort Jackson in South Carolina during the second quarter of 2011 and at Fort Bliss in Texas during 2012. ASUS filed an REA at Fort Jackson, South Carolina in connection with the condition of assets and at Fort Bragg for increased costs. A more detailed description of the pending price redeterminations and REAs can be found on page 61 of the 2010 Form 10-K.

ASUS continues to pursue opportunities and respond to solicitations from the U.S. government on military bases where the water and wastewater utilities are in the process of being privatized.

#### **A SOLID PERFORMANCE. A PROMISING OUTLOOK.**

By all significant metrics, the "lay of the land" for American States Water looked promising at the close of 2010. We continue to deliver value to customers and shareholders alike by executing a proven business strategy and capitalizing on opportunities as they present themselves. As always, credit for our company's performance belongs to our 719 employees around the country, whose skill, dedication, and heart are among our greatest assets. On their behalf, and on behalf of our board of directors, thank you for your investment in American States Water Company.



**Lloyd E. Ross**  
Chairman of the Board



**Robert J. Sprowls**  
President and Chief Executive Officer

## AMERICAN STATES WATER COMPANY FINANCIAL HIGHLIGHTS

| <i>(dollars in thousands, except per share amounts)</i>                 | 2010         | 2009         | Variance  | % Change |
|-------------------------------------------------------------------------|--------------|--------------|-----------|----------|
| <b>Income Statement Information</b>                                     |              |              |           |          |
| Total Operating Revenues                                                | \$ 398,942   | \$ 353,251   | \$ 45,691 | 12.9%    |
| Total Operating Expenses                                                | 325,123      | 284,409      | 40,714    | 14.3%    |
| Operating Income                                                        | 73,819       | 68,842       | 4,977     | 7.2%     |
| Interest Charges (net)                                                  | 19,230       | 20,988       | (1,758)   | -8.4%    |
| Net Income from Continuing Operations                                   | 31,091       | 29,374       | 1,717     | 5.8%     |
| Net Income from Discontinued Operations                                 | 2,106        | 157          | 1,949     | 1241.4%  |
| Fully Diluted Earnings per Common Share<br>from Continuing Operations   | \$ 1.66      | \$ 1.61      | \$ 0.05   | 3.1%     |
| Fully Diluted Earnings per Common Share<br>from Discontinued Operations | \$ 0.11      | \$ 0.01      | \$ 0.10   | 1000.0%  |
| Average Number of Diluted Shares Outstanding                            | 18,736       | 18,188       | 548       | 3.0%     |
| Dividends Declared per Common Share                                     | \$ 1.040     | \$ 1.010     | \$ 0.030  | 3.0%     |
| <b>Balance Sheet Information</b>                                        |              |              |           |          |
| Total Assets                                                            | \$ 1,192,035 | \$ 1,113,293 | \$ 78,742 | 7.1%     |
| Common Shareholders' Equity                                             | 377,541      | 359,430      | 18,111    | 5.0%     |
| Long-Term Debt                                                          | 299,839      | 300,221      | (382)     | -0.1%    |
| Total Capitalization                                                    | 677,380      | 659,651      | 17,729    | 2.7%     |
| Book Value per Common Share                                             | \$ 20.26     | \$ 19.40     | \$ 0.86   | 4.4%     |

## ABOUT OUR COMPANY

**Every day, well over a million people in the United States depend on the American States Water Company family of companies for the water, wastewater, and electric services that enable their quality of life. We are the holding company for Golden State Water Company, Chaparral City Water Company\*, and American States Utility Services, Inc.**

Golden State Water Company is a public utility company regulated by the California Public Utilities Commission (CPUC). Golden State Water engages principally in the reliable delivery of water. We operate 38 separate water systems within 75 communities in 10 counties in the State of California and provide water service to over 1 million people, or 1 out of every 36 Californians. In addition, we provide electric service to over 23,000 customers in the Big Bear recreational area of California.

Chaparral City Water Company\*, an Arizona public utility regulated by the Arizona Corporation Commission (ACC), provides water service to over 13,000 customers located in the town of Fountain Hills and a small portion of Scottsdale.

American States Utility Services, Inc. is our contracted services business. Through its wholly-owned subsidiaries—Fort Bliss Water Services Company, Terrapin Utility Services, Inc., Old Dominion Utility Services, Inc., Old North Utility Services, Inc., and Palmetto State Utility Services, Inc.—American States Utility Services provides full-service contracts to operate and maintain water and wastewater systems on U.S. Army and U.S. Air Force installations in Texas, New Mexico, Maryland, Virginia, North Carolina, and South Carolina.

Founded in 1929, we continue to offer investors the opportunity to invest with a historically stable company that has achieved substantial growth. We have paid dividends to shareholders every year since 1931, and have increased our dividend payout every year since 1953.

Read more about us and our subsidiaries at [www.aswater.com](http://www.aswater.com).

*\*Pending Sale*

# 10-YEAR STATISTICAL REVIEW

(dollars in thousands, except for per share and per customer amounts)

2010

2009

2008

## FINANCIAL INFORMATION FOR CONTINUING OPERATIONS \*

### Revenues by Segment from Continuing Operations

|                              |            |            |            |
|------------------------------|------------|------------|------------|
| Water Revenues               | \$ 290,781 | \$ 265,197 | \$ 240,464 |
| Electric Revenues            | 35,801     | 28,922     | 28,424     |
| Contracted Services Revenues | 72,360     | 59,132     | 42,358     |
| Total Operating Revenues     | 398,942    | 353,251    | 311,246    |

|                                     |           |           |           |
|-------------------------------------|-----------|-----------|-----------|
| Net Income                          | \$ 31,091 | \$ 29,374 | \$ 25,996 |
| Diluted Earnings per Common Share   | 1.66      | 1.61      | 1.49      |
| Dividends Declared per Common Share | 1.040     | 1.010     | 1.000     |
| Book Value per Common Share         | 20.26     | 19.40     | 17.95     |

|                         |              |              |              |
|-------------------------|--------------|--------------|--------------|
| Total Assets            | \$ 1,192,035 | \$ 1,113,293 | \$ 1,061,287 |
| Net Utility Plant       | 854,956      | 822,027      | 780,148      |
| Capital Additions       | 79,050       | 77,459       | 77,018       |
| Long-term Debt          | 299,839      | 300,221      | 260,561      |
| Investment per Customer | 4,422        | 4,227        | 3,987        |

## FINANCIAL INFORMATION FOR DISCONTINUED OPERATIONS \*

|                                          |          |          |          |
|------------------------------------------|----------|----------|----------|
| Water Revenues                           | \$ 8,745 | \$ 7,722 | \$ 7,472 |
| Net Income (loss)                        | 2,106    | 157      | (3,991)  |
| Diluted Earnings (loss) per Common Share | 0.11     | 0.01     | (0.23)   |

## FINANCIAL INFORMATION FOR CONSOLIDATED OPERATIONS

|                                   |            |            |            |
|-----------------------------------|------------|------------|------------|
| Total Operating Revenues          | \$ 407,687 | \$ 360,973 | \$ 318,718 |
| Net Income                        | 33,197     | 29,531     | 22,005     |
| Diluted Earnings per Common Share | 1.77       | 1.62       | 1.26       |

## OPERATING INFORMATION FOR CONTINUING OPERATIONS \*

### Water Sold by Classification (mg)

|                            |        |        |        |
|----------------------------|--------|--------|--------|
| Residential and Commercial | 44,057 | 48,169 | 51,679 |
| Industrial                 | 429    | 442    | 483    |
| Fire Service               | 180    | 93     | 75     |
| Other - Water              | 4,346  | 4,831  | 5,550  |
| Total Water                | 49,012 | 53,535 | 57,787 |

|                            |         |         |         |
|----------------------------|---------|---------|---------|
| Total Electric Sales (mwh) | 132,167 | 136,365 | 137,358 |
|----------------------------|---------|---------|---------|

### Water Production by Source (mg)

|                     |        |        |        |
|---------------------|--------|--------|--------|
| Purchased           | 19,005 | 21,504 | 25,244 |
| Pumped - Electric   | 30,583 | 33,562 | 34,241 |
| Pumped - Gas        | -      | -      | 190    |
| Gravity and Surface | 3,264  | 3,162  | 3,232  |
| Total Supply        | 52,852 | 58,228 | 62,907 |

### Customers by Classification

|                            |         |         |         |
|----------------------------|---------|---------|---------|
| Residential and Commercial | 247,607 | 247,275 | 246,891 |
| Industrial                 | 352     | 356     | 363     |
| Fire Service               | 4,073   | 3,995   | 3,946   |
| Other - Water              | 3,530   | 3,372   | 3,282   |
| Total Water                | 255,562 | 254,998 | 254,482 |
| Electric                   | 23,257  | 23,234  | 23,172  |
| Total Company              | 278,819 | 278,232 | 277,654 |

|                          |       |       |       |
|--------------------------|-------|-------|-------|
| Miles of Main in Service | 2,782 | 2,753 | 2,727 |
| Number of Employees      | 707   | 692   | 658   |

mg = millions of gallons mwh=mega-watt hours

\* On June 7, 2010, AWR entered into a stock purchase agreement to sell all of the common shares of its wholly-owned subsidiary, Chaparral City Water Company ("CCWC"). The results of CCWC for all periods included have been presented as a discontinued operation. Operating information for all periods included have been presented for continuing operations only.

| 2007       | 2006       | 2005       | 2004       | 2003       | 2002       | 2001       |
|------------|------------|------------|------------|------------|------------|------------|
| \$ 230,178 | \$ 215,157 | \$ 198,672 | \$ 195,176 | \$ 181,052 | \$ 181,539 | \$ 176,285 |
| 28,574     | 29,268     | 27,224     | 25,594     | 24,492     | 21,298     | 15,251     |
| 34,914     | 16,449     | 5,213      | 1,776      | 1,014      | 846        | 789        |
| 293,666    | 260,874    | 231,109    | 222,546    | 206,558    | 203,683    | 192,325    |
| \$ 27,121  | \$ 21,857  | \$ 25,061  | \$ 17,416  | \$ 10,758  | \$ 19,013  | \$ 20,130  |
| 1.56       | 1.26       | 1.47       | 1.11       | 0.71       | 1.25       | 1.32       |
| 0.955      | 0.910      | 0.900      | 0.888      | 0.884      | 0.872      | 0.867      |
| 17.53      | 16.64      | 15.72      | 15.01      | 13.97      | 14.05      | 13.54      |
| \$ 964,675 | \$ 936,955 | \$ 873,135 | \$ 810,277 | \$ 758,818 | \$ 700,553 | \$ 681,829 |
| 733,105    | 712,384    | 675,516    | 629,167    | 570,817    | 534,460    | 511,184    |
| 49,867     | 66,599     | 71,184     | 84,216     | 57,211     | 40,655     | 47,750     |
| 260,941    | 261,248    | 261,540    | 221,697    | 221,996    | 222,725    | 236,804    |
| 3,716      | 3,551      | 3,344      | 3,131      | 2,872      | 2,703      | 2,579      |
| \$ 7,704   | \$ 7,755   | \$ 7,019   | \$ 6,544   | \$ 6,221   | \$ 6,157   | \$ 6,270   |
| 909        | 1,224      | 1,705      | 1,125      | 1,134      | 1,326      | 1,326      |
| 0.05       | 0.07       | 0.10       | 0.07       | 0.07       | 0.09       | 0.09       |
| \$ 301,370 | \$ 268,629 | \$ 238,128 | \$ 229,090 | \$ 212,779 | \$ 209,840 | \$ 198,595 |
| 28,030     | 23,081     | 26,766     | 18,541     | 11,892     | 20,339     | 21,456     |
| 1.61       | 1.33       | 1.57       | 1.18       | 0.78       | 1.34       | 1.41       |
| 54,531     | 53,175     | 52,254     | 54,371     | 53,292     | 54,980     | 53,496     |
| 622        | 711        | 776        | 831        | 836        | 835        | 814        |
| 54         | 35         | 18         | 377        | 733        | 695        | 570        |
| 5,763      | 5,345      | 4,518      | 5,023      | 4,959      | 5,219      | 4,645      |
| 60,970     | 59,266     | 57,566     | 60,602     | 59,820     | 61,729     | 59,525     |
| 140,441    | 141,235    | 134,066    | 137,857    | 132,850    | 131,826    | 126,911    |
| 26,506     | 27,521     | 29,027     | 29,624     | 27,502     | 27,218     | 24,962     |
| 35,868     | 34,888     | 32,705     | 33,346     | 33,888     | 36,608     | 36,464     |
| 6          | 8          | 29         | 85         | 39         | 5          | 118        |
| 3,216      | 1,890      | 1,801      | 2,176      | 2,298      | 1,926      | 1,463      |
| 65,596     | 64,307     | 63,562     | 65,231     | 63,727     | 65,757     | 63,007     |
| 247,270    | 246,910    | 245,950    | 245,155    | 243,698    | 242,381    | 241,068    |
| 374        | 368        | 370        | 357        | 354        | 349        | 329        |
| 3,725      | 3,605      | 3,518      | 3,424      | 3,379      | 3,305      | 3,260      |
| 3,177      | 3,087      | 3,007      | 2,719      | 2,651      | 2,476      | 2,142      |
| 254,546    | 253,970    | 252,845    | 251,655    | 250,082    | 248,511    | 246,799    |
| 23,273     | 23,248     | 22,966     | 22,692     | 22,276     | 21,987     | 21,747     |
| 277,819    | 277,218    | 275,811    | 274,347    | 272,358    | 270,498    | 268,546    |
| 2,724      | 2,720      | 2,707      | 2,681      | 2,672      | 2,652      | 2,719      |
| 557        | 543        | 532        | 501        | 505        | 488        | 481        |

# CORPORATE INFORMATION

As of March 18, 2011

## BOARD OF DIRECTORS

**American States Water Company, Golden State Water Company, and Chaparral City Water Company<sup>(1)</sup>**

**Lloyd E. Ross<sup>(2)</sup>** (70, 16) (a, b, c, d, e)  
(Chairman of the Board of Directors)  
Indian Wells, California

**James L. Anderson** (67, 14) (c, d, e)  
(Chairperson of the Compensation Committee)  
Senior Vice President  
Americo Life Inc.  
Kansas City, Missouri

**Diana M. Bontá** (60, 4) (a, c, d)  
Vice President, Public Affairs  
Kaiser Foundation Health Plan & Hospitals,  
Southern California Region  
Los Angeles, California

**N. P. Dodge, Jr.** (74, 21) (a, b, d)  
(Chairperson of the ASUS Committee)  
President, N.P. Dodge Company  
Omaha, Nebraska

**Anne M. Holloway** (58, 13) (c, d, e)  
(Chairperson of the Nominating  
and Governance Committee)  
Atherton, California

**Robert F. Kathol** (69, 16) (a, b)  
(Chairperson of the Audit  
and Finance Committee)  
Executive Vice President  
Smith Hayes Financial Services Corp.  
Omaha, Nebraska

**Gary F. King** (64, 4) (b, e)  
(Chairperson of the Strategy & Corporate  
Development Committee and Vice Chairperson  
of the Audit and Finance Committee)  
Hermosa Beach, California

**James F. McNulty** (68, 1) (a, e)  
Board Member  
La Jolla, California

**Robert J. Sprowls** (53, 2)<sup>(3)</sup> (a, e)  
President and Chief Executive Officer

## OFFICERS

**American States Water Company**

**Robert J. Sprowls** (53, 6)  
President and Chief Executive Officer

**Eva G. Tang** (55, 14)  
Senior Vice President – Finance,  
Chief Financial Officer,  
Corporate Secretary and Treasurer

**Gladys M. Farrow** (46, 8)  
Assistant Secretary

## OFFICERS

**Golden State Water Company**

**Robert J. Sprowls** (53, 6)  
President and Chief Executive Officer

**Denise L. Kruger** (46, 18)  
Senior Vice President – Regulated Utilities

**Eva G. Tang** (55, 14)  
Senior Vice President – Finance,  
Chief Financial Officer and Secretary

**Shengder D. Chang** (54, 14)  
Vice President – Environmental Quality

**Gladys M. Farrow** (46, 8)  
Vice President – Finance, Treasurer  
and Assistant Secretary

**William C. Gedney** (56, 13)  
Vice President – Asset Management

**Diane D. Rentfrow** (62, 19)  
Vice President – Human Capital Management

**Patrick R. Scanlon** (53, 32)  
Vice President – Water Operations

**Bryan K. Switzer** (54, 10)  
Vice President – Regulatory Affairs

**Roland S. Tanner** (54, 17)  
Vice President – Customer Support Services

## OFFICERS

**Chaparral City Water Company<sup>(1)</sup>**

**Robert J. Sprowls** (53, 6)  
President and Chief Executive Officer

**Denise L. Kruger** (46, 18)  
Senior Vice President – Regulated Utilities

**Eva G. Tang** (55, 14)  
Senior Vice President – Finance,  
Chief Financial Officer and Secretary

**Patrick R. Scanlon** (53, 32)  
Vice President – Operations

**Gladys M. Farrow** (46, 8)  
Treasurer and Assistant Secretary

## BOARD OF DIRECTORS

**American States Utility Services, Inc.  
and Subsidiaries:**

**N. P. Dodge, Jr.** (74, 12)  
(Chairman of the Board of Directors)  
Omaha, Nebraska

**Lloyd E. Ross** (70, 12)  
Indian Wells, California

**Robert J. Sprowls** (53, 2)<sup>(3)</sup>  
President and Chief Executive Officer

## OFFICERS

**American States Utility Services, Inc.  
and Subsidiaries:** *Fort Bliss Water Services Company,  
Old Dominion Utility Services, Inc., Old North Utility  
Services, Inc., Palmetto State Utility Services, Inc.,  
Terrapin Utility Services, Inc.*

**Robert J. Sprowls** (53, 6)  
President and Chief Executive Officer

**McClellan Harris III** (59, 20)  
Senior Vice President and Assistant Secretary

**Eva G. Tang** (55, 14)  
Senior Vice President – Finance,  
Chief Financial Officer and Secretary

**James B. Gallagher** (56, 23)  
Vice President – Management Services

**Granville R. Hodges, Jr.** (51, 32)  
Vice President – Operations

**Gladys M. Farrow** (46, 8)  
Treasurer and Assistant Secretary

(a) Member – ASUS Committee

(b) Member – Audit & Finance Committee

(c) Member – Compensation Committee

(d) Member – Nominating & Governance Committee

(e) Member – Strategy & Corporate Development Committee

<sup>(1)</sup> Pending Sale

<sup>(2)</sup> Non-voting ex-officio member of all committees

<sup>(3)</sup> Became a board member of American States Water Company on May 19, 2009 and its subsidiaries on January 1, 2009

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**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)

- ☒ **Annual Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2010 or**
- ☐ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from        to**

| <b>Commission<br/>File Number</b> | <b>Registrant, State of Incorporation<br/>Address, Zip Code and Telephone Number</b>                                                                                                                          | <b>IRS Employer<br/>Identification No.</b> |
|-----------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------|
| 001-14431                         | <b>American States Water Company</b><br>(Incorporated in California)<br>630 E. Foothill Boulevard, San Dimas, CA 91773-1212<br>(909) 394-3600                                                                 | 95-4676679                                 |
| 001-12008                         | <b>Golden State Water Company</b><br>(Incorporated in California)<br>630 E. Foothill Boulevard, San Dimas, CA 91773-1212<br>(909) 394-3600<br><br>Securities registered pursuant to Section 12(b) of the Act: | 95-1243678                                 |

| <b>Title of Each Class</b>                  | <b>Name of Each Exchange on Which Registered</b> |
|---------------------------------------------|--------------------------------------------------|
| 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 ☐ No ☒  
Golden State Water Company        Yes ☐ No ☒

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 ☐ No ☒  
Golden State Water Company        Yes ☐ No ☒

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 ☒ No ☐  
Golden State Water Company        Yes ☒ No ☐

Indicate by check mark whether Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or such shorter period that the Registrant was required to submit and post such files).

American States Water Company        Yes ☐ No ☐  
Golden State Water Company        Yes ☐ No ☐

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

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

**American States Water Company**Large accelerated filer ☐      Accelerated filer ☒      Non-accelerated filer ☐      Smaller reporting company ☐**Golden State Water Company**Large accelerated filer ☐      Accelerated filer ☐      Non-accelerated filer ☒      Smaller reporting company ☐

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

American States Water Company        Yes ☐ No ☒  
Golden State Water Company        Yes ☐ No ☒

The aggregate market value of the total voting common stock held by non-affiliates of American States Water Company was approximately \$616,060,000 and \$638,717,000 on June 30, 2010 and March 9, 2011, respectively. The closing price per Common Share on March 9, 2011, as quoted in the *The Wall Street Journal website*, was \$34.24. As of March 9, 2011, the number of Common Shares of American States Water Company outstanding was 18,654,106. As of that same date, American States Water Company owned all 142 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, 2010 and March 9, 2011.

Golden State Water Company meets the conditions set forth in General Instruction I(1)(a) and (b) 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.

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**AMERICAN STATES WATER COMPANY  
and  
GOLDEN STATE WATER COMPANY**

**FORM 10-K**

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## **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](http://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, 2010.

### **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 contracted services 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 in 75 communities in 10 counties in the State of California. GSWC is regulated by the California Public Utilities Commission (“CPUC”). It was incorporated as a California corporation on December 31, 1929. GSWC is organized into nine water and one electric rate-making areas. The nine water rate-making areas are divided into three regions for rate filing purposes. Region I consists of 7 rate-making and customer service areas in northern and central California. Region II consists of one rate-making area servicing 4 customer service areas located in Los Angeles County. Region III consists of one rate-making areas servicing 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 255,562 water customers and 23,257 electric customers at December 31, 2010, or a total of 278,819 customers, compared with 254,998 water customers and 23,234 electric customers at December 31, 2009, or a total of 278,232 customers. 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, 2010, 2009 and 2008.

CCWC is an Arizona public utility company serving 13,468 customers as of December 31, 2010, compared with 13,406 customers at December 31, 2009. 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. On June 7, 2010, AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. (“EPCOR”) to sell all of the common stock of CCWC for a total purchase price of \$35.0 million, including the assumption of approximately \$6.0 million of long-term debt. The purchase price is subject to certain adjustment for changes in retained earnings. The consummation of the transaction contemplated by the agreement is subject to customary conditions, including among other things, regulatory approval by the ACC, which is anticipated to be received in 2011.

ASUS, through its wholly-owned subsidiaries, has contracted with the U.S. government to provide water and/or wastewater services, including the operation, maintenance, renewal and replacement of the water and/or wastewater systems, pursuant to 50-year fixed price contracts. Each of the contracts with the U.S. government may be subject to termination, 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, each Military Utility Privatization Subsidiary so impacted should be 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 the contract. 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 the contract. Prices are subject to equitable adjustment based upon changes in circumstances, changes in laws and/or regulations, and changes in wages and fringe benefits to the extent provided in each of the contracts. AWR guarantees performance of ASUS' military privatization 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 and extending into southeastern New Mexico 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 February 16, 2008; and
- ONUS - water and wastewater systems at Fort Bragg, Pope Air Force Base and Camp MacKall, North Carolina effective March 1, 2008.

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. Other than a contract with a municipality to provide billing and meter reading services, which will terminate on April 1, 2011, the U.S. government is the only 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 primarily on the basis of price and quality of service.

### **Employee Relations**

AWR had a total of 719 employees as of December 31, 2010 as compared to 703 employees as of December 31, 2009. GSWC had 592 employees as of December 31, 2010 as compared to 582 employees as of December 31, 2009. Nineteen 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 expired in 2010. GSWC is currently in negotiations with this union on a new agreement. Sixty-five employees 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 127 employees as of December 31, 2010. Eleven of the employees of a subsidiary of ASUS are covered by a collective bargaining agreement with the International Union of Operating Engineers which expires in 2011.

### **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,” “may” and other words that convey uncertainty of future events or outcomes, 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 customers, 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; changes in pension and post-retirement 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.

## **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 redeterminations 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. Similarly, if the CPUC approves rates that are higher than the interim rates, the CPUC may authorize us to recover the difference between the interim rates and the final rates.

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 a subsidiary. 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. A change in our evaluation of the probability of recovery of regulatory assets, a regulatory disallowance of all or a portion of our costs could have a material adverse effect on our financial results.

Management also reviews goodwill for impairment at least annually. ASUS has \$1.1 million of goodwill which may be at risk for potential impairment if requested price redeterminations and/or equitable adjustments are not granted. CCWC has \$3.3 million of goodwill which we do not believe is at risk for potential impairment.

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, the 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. The U.S. government may disagree with the increases that we request and may 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.

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.

***We may sustain losses that exceed or are excluded from our insurance coverage or for which we are not insured***

We are, from time to time, parties to legal or regulatory proceedings. These proceedings may pertain to regulatory investigations, employment matters or other disputes. Management periodically reviews its assessment of the probable outcome of these proceedings, the costs and expenses reasonably expected to be incurred, and the availability and extent of insurance coverage. On the basis of this review, management establishes reserves for such matters. We may, however, from time to time be required to pay fines, penalties or damages that exceed our insurance coverage and/or reserves if our estimate of the probable outcome of such proceedings proves to be inaccurate.

We maintain insurance coverage as part of our overall legal and risk management strategy to minimize our potential liabilities. However, our insurance policies contain exclusions and other limitations that may not cover our potential liabilities. Generally, our insurance policies cover worker's compensation, employer's liability, general liability and automobile liability. Each policy includes deductibles or self-insured retentions and policy limits for covered claims. As a result, we may sustain losses that exceed or that are excluded from our insurance coverage or for which we are not insured.

**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 emergency situations, we have supplied our customers with bottled water until the emergency situation has been resolved.

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. 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 asserted claims against water distributors on a variety of theories and have thus far brought the water distributors (including GSWC) 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;
- Legal limitations on production, diversion, storage, conveyance and use; and
- Climate change.

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. In addition, new court-ordered pumping restrictions on water obtained from the Sacramento-San Joaquin Delta may decrease the amount of water Metropolitan Water District of Southern California (“MWD”), is able to import from northern California. We are providing incentives to and/or assessing penalties on our customers in order to encourage water conservation. We are also acting to secure additional supplies from desalination and water transfers. However, we cannot predict to what extent these efforts to reduce stress on our water supplies will be successful or sustainable.

CCWC obtains its water supply from operating wells and from the Colorado River through the Central Arizona Project (“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.

Water shortages at our rate-regulated water utilities 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. GSWC has implemented a modified supply cost balancing account to track and recover costs from supply mix changes and rate changes by wholesale suppliers, as authorized by the CPUC. 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 in those areas 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.

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

Some of our systems in California are more than 50 years old. We have experienced leaks and water quality and mechanical problems in some of these older systems. In addition, well and pump maintenance expenses are affected by labor and material costs and more stringent water discharge requirements. These costs can increase unexpectedly 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.

***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. We implemented a water revenue adjustment mechanism (“WRAM”) at GSWC which has the effect of reducing the adverse impacts of our customers’ conservation efforts on revenues; however, cash flows from operations can be significantly affected as much of the revenues recognized in the WRAM accounts will be collected from customers primarily through a surcharge over a 12 - 24 month period.

***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. GSWC implemented a conservation rate design and a water revenue adjustment mechanism, for Regions II and III in late November 2008, and for Region I’s ratemaking areas in September 2009, 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. In November 2009, GSWC implemented a base revenue requirement adjustment mechanism for our electric business which 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 generator in our electric service area.

The CPUC permits us to recover energy purchase costs from customers, up to an annual weighted average cost of \$77 per megawatt hour (“MWh”) each year. Upon expiration of the \$77 MWh rate in August 2011, the CPUC will grant approval for revised rates to recover these energy costs. 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.

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 affect the unrealized gains and losses on our block forward purchased power contracts that qualify as derivative instruments as we adjust the asset or liability on these contracts to reflect the fair market value of the contracts at the end of each month. The CPUC has authorized us to establish a memorandum account to track the changes in the fair market value of our power purchased contracts that became effective on January 1, 2009. As a result, unrealized gains and losses on these purchased power contracts will not impact earnings.

***We may not be able to procure sufficient renewable energy resources to comply with CPUC rules***

We are required to procure a portion of our electricity from renewable energy resources. Due to our small size as compared to other energy utilities and the constrained renewable energy market, we have not been able to obtain sufficient resources to achieve the established interim target purchase levels. We believe that BVES is permitted to defer compliance with these requirements under the CPUC's flexible compliance rules. However, BVES may be subject to fines and penalties by the CPUC if the CPUC determines that BVES is not in compliance with the renewable resource procurement rules.

***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 the divestiture of these assets.

**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 most of 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 our public 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. We have also experienced delays in the past 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.

We are required to record all costs incurred under these types of contracts as these costs are incurred. As a result, we may record losses associated with unanticipated conditions, higher than anticipated infrastructure levels and emergency work at the time such expenses occur. We recognize revenue for such work as, and to the extent that, our requests for equitable adjustments are approved. Delays in obtaining approval of equitable adjustments can negatively impact our results of operations and cash flows.

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 specifically.

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.

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

The wastewater collection system operations of our subsidiaries providing 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. This risk is most acute during periods of substantial rainfall or flooding, which are common causes of sewer overflows and system failures. 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 contract modifications with the U.S. government (and in some cases third parties) for the construction of new water and/or wastewater infrastructure at the military bases. Most of these contracts are firm fixed-price contracts. Under firm 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 or the physical completion of the construction projects. 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 firm 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.

***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 military bases. 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 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 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; however, our contracts with these subcontractors include certain protective provisions, which may include the assessment of liquidated damages. We mitigate these risks by requiring many of our subcontractors to obtain performance bonds and to compensate us for any penalties we may be required to pay as a result of their failure to perform.

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

Seasonal weather conditions, such as hurricanes or significant winter storms, occasionally cause temporary office closures and/or result in temporary halts to construction activity at military bases. To the extent that our construction activities are impeded by these events, we will experience a delay in recognizing revenues from these construction projects.

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

We continue to incur additional costs in connection with the attempted expansion of our contract operations associated with the preparation of bids for 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

or completed, the U.S. government will repay us over time. 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 economic conditions***

Economic uncertainty continues to impact the growth of the debt and equity markets. Although portions of our operations are funded through cash flows from operations, we obtain funds through external sources such as bank borrowings as well as issuance of debt and equity securities. Access to these 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 which expires in May 2013. In the event of financial turmoil affecting the banking system and financial markets, additional consolidation of the financial services industry, significant financial service institution failures or our inability to renew or replace our existing revolving credit facility on attractive terms, it may become necessary for us to seek funds from other sources on unattractive terms.

***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 81% of our revenues in 2010 were 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 customers 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.

***We are increasingly dependent on the continuous and reliable operation of our information technology systems***

We rely on our information technology systems in connection with the operation of our business, especially with respect to customer service and billing, accounting and, in some cases, the monitoring and operation of our treatment, storage and pumping facilities. A loss of these systems or major problems with the operation of these systems could affect our operations and have a significant material adverse effect on our results of operations.

***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 recent economic crisis. California is, among other things, raising taxes in order to help 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.

***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 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.

## **Item 2 - Properties**

### **Electric Properties**

GSWC's electric properties are located in the Big Bear area of San Bernardino County, California. As of December 31, 2010, GSWC owned and operated 29 miles of overhead 34.5 kilovolt ("kv") transmission lines, 1 mile of underground 34.5 kv transmission lines, 177.03 miles of 4.16 kv or 2.4 kv distribution lines, 53.15 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, 2010, GSWC's physical properties consisted of water transmission and distribution systems which included 2,782 miles of pipeline together with services, meters and fire hydrants and approximately 425 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, 2010, GSWC owned 254 wells, of which 188 are active operable wells equipped with pumps with an aggregate production capacity of approximately 199.0 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, information regarding water utility plant of GSWC for each of its water regions:

| <b>Region</b> | <b>Pumps</b> |                | <b>Distribution Facilities</b> |                 |                 | <b>Reservoirs</b> |                  |
|---------------|--------------|----------------|--------------------------------|-----------------|-----------------|-------------------|------------------|
|               | <b>Well</b>  | <b>Booster</b> | <b>Mains*</b>                  | <b>Services</b> | <b>Hydrants</b> | <b>Tanks</b>      | <b>Capacity*</b> |
| Region I      | 76           | 121            | 662                            | 56,080          | 4,036           | 46                | 34,678           |
| Region II     | 53           | 65             | 920                            | 100,879         | 8,718           | 25                | 21,480           |
| Region III    | 125          | 194            | 1,200                          | 98,637          | 10,476          | 74                | 53,069(1)        |
| Total         | 254          | 380            | 2,782                          | 255,596         | 23,230          | 145               | 109,227          |

\* 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, 2010, 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 a surface water treatment plant, which treats water from the CAP.

### **Adjudicated and Other Water Rights**

#### **GSWC**

GSWC owns groundwater and surface water rights in California, as shown in the table below. Water rights are divided between groundwater and surface water. 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 typically measured by maximum historical usage over the last five years. 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.

| <b>Region</b> | <b>Groundwater</b>              |                                   | <b>Surface Water</b>      | <b>Totals (AFY)</b> |
|---------------|---------------------------------|-----------------------------------|---------------------------|---------------------|
|               | <b>Adjudicated Rights (AFY)</b> | <b>Unadjudicated Rights (AFY)</b> | <b>Water Rights (AFY)</b> |                     |
| Region I      | 10,248                          | 20,113                            | 10,134                    | 40,495              |
| Region II     | 23,942                          | 1,771                             | —                         | 25,713              |
| Region III    | 27,377                          | 23,010                            | 1,201                     | 51,588              |
| Total         | 61,567                          | 44,894                            | 11,335                    | 117,796             |

### CCWC

CCWC has an assured water supply designation, by decision and order of the Arizona Department of Water Resources stating that 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.

### **Office Buildings**

Registrant's general headquarters are housed in two office buildings located in San Dimas, California, one of which GSWC owns. GSWC also owns and/or leases certain facilities that house 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. ONUS leases a service center located in North Carolina. TUS, PSUS and FBWS rent temporary service center facilities in Maryland, South Carolina and Texas, respectively. ODUS owns a service center in Virginia.

### **Mortgage and Other Liens**

As of December 31, 2010, GSWC had no mortgage debt outstanding or liens securing indebtedness.

As of December 31, 2010, 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, 2010, 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.

### **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, 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.

The Town of Apple Valley (the "Town") abandoned its activities related to a potential condemnation of GSWC's water systems serving the Town in 2007. However, in January 2011, the Town Council directed staff to update the previously prepared financial feasibility study for the acquisition of GSWC's water systems. GSWC's Apple Valley water systems serve approximately 2,800 customers.

Except for Town of Apple Valley, GSWC is currently not 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 GSWC'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 and the San Gabriel Basin Water Quality Authority (“WQA”), against some of those allegedly responsible for the contamination of two of these wells. 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 U.S. 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 the two impacted GSWC 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 have been reached between WQA and some PRPs. Settlements with a number of other PRPs are being finalized; however, Registrant is presently unable to predict the ultimate outcome of these settlement discussions.

#### **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 seeking to adjudicate the rights to water in the Santa Maria Groundwater Basin. 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).

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. GSWC’s participation in the stipulation is subject to CPUC approval.

On March 20, 2008, the non-stipulating parties filed notices of appeal. Registrant is unable to predict the outcome of the appeal.

#### **Other Litigation:**

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. [Removed and Reserved]**

## PART II

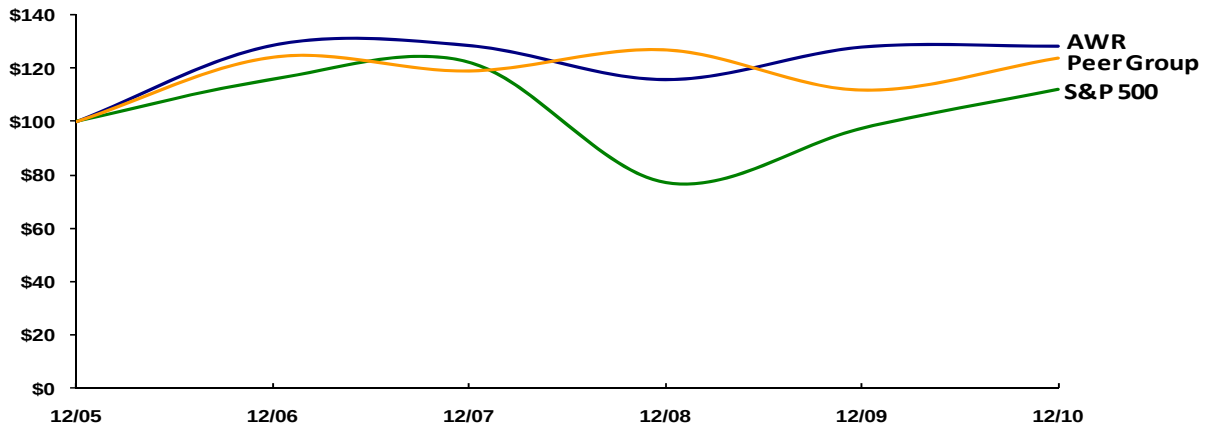
### **Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

#### **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 five companies that includes: Artesian Resources Corp., California Water Service Group, Connecticut Water Service Inc., Middlesex Water Company and SJW Corp. The peer group of companies differs from the peer group used by AWR in last year's Annual Report on Form 10-K which also included SouthWest Water Company. SouthWest Water Company no longer has any publicly traded common stock. 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, 2005 to December 31, 2010.

#### **COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN\***

Among American States Water Company, the S&P 500 Index  
and a Peer Group



\*\$100 invested on 12/31/05 in stock or index, including reinvestment of dividends.  
Fiscal year ending December 31.

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|                               | 12/05     | 12/06    | 12/07     | 12/08     | 12/09     | 12/10     |
|-------------------------------|-----------|----------|-----------|-----------|-----------|-----------|
| American States Water Company | \$ 100.00 | \$128.58 | \$ 128.49 | \$ 115.72 | \$ 127.91 | \$ 128.24 |
| S&P 500                       | 100.00    | 115.80   | 122.16    | 76.96     | 97.33     | 111.99    |
| Peer Group                    | 100.00    | 124.02   | 118.87    | 126.75    | 111.75    | 123.69    |

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

### **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      |
| <b><u>2010</u></b> |              |          |
| First Quarter      | \$ 36.42     | \$ 31.20 |
| Second Quarter     | 39.61        | 31.41    |
| Third Quarter      | 37.00        | 31.24    |
| Fourth Quarter     | 38.59        | 33.01    |
| <b><u>2009</u></b> |              |          |
| First Quarter      | \$ 38.79     | \$ 29.76 |
| Second Quarter     | 36.40        | 30.82    |
| Third Quarter      | 37.42        | 32.10    |
| Fourth Quarter     | 36.92        | 31.58    |

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 9, 2011 was \$34.24

### **Approximate Number of Holders of Common Shares**

As of March 9, 2011, there were 2,776 holders of record of the 18,654,106 outstanding Common Shares of American States Water Company. AWR owns all of the 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:

|                | 2010    | 2009    |
|----------------|---------|---------|
| First Quarter  | \$ 0.26 | \$ 0.25 |
| Second Quarter | \$ 0.26 | \$ 0.25 |
| Third Quarter  | \$ 0.26 | \$ 0.25 |
| Fourth Quarter | \$ 0.26 | \$ 0.26 |
| Total          | \$ 1.04 | \$ 1.01 |

AWR’s ability to pay dividends is subject to the requirement in its \$100.0 million revolving credit facility 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 \$21.0 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, \$298.8 million was available from GSWC to pay dividends to AWR as of December 31, 2010. GSWC is also prohibited under the terms of senior notes from paying dividends if, after giving effect to the dividend, its total indebtedness to capitalization ratio (as defined) would be more than 0.6667 to 1. GSWC would have to issue additional debt of \$372.7 million to invoke this covenant as of December 31, 2010.

The ability of AWR, ASUS and GSWC to pay dividends is also restricted by California law. Under the restrictions of the California tests, approximately \$150.2 million of AWR’s retained earnings was available to pay dividends to common shareholders at December 31, 2010. Approximately \$141.1 million was available from the retained earnings of GSWC at December 31, 2010 to pay dividends to AWR. Approximately \$2.1 million was available from retained earnings of ASUS at December 31, 2010 to pay dividends to AWR under the California tests.

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 \$4.1 million was available to pay dividends to AWR at December 31, 2010. 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 \$19.3 million in common dividends to shareholders for the year ended December 31, 2010, as compared to \$18.1 million for the year ended December 31, 2009. GSWC paid dividends of \$19.6 million and \$19.4 million to AWR in 2010 and 2009, respectively. CCWC and ASUS did not pay any dividends to AWR in 2010 or 2009.

### **Securities Authorized for Issuance under Equity Compensation Plans**

AWR has made stock awards to its executive officers and managers under the 2000 Stock Incentive Plan and the 2008 Stock Incentive Plan. It has also made stock awards to its non-employee directors under the Non-Employee Directors Stock Plan. Information regarding the securities which have been issued and which are available for issuance under these plans are set forth in the table below as of December 31, 2010. This table does not include any common shares that may be issued under our 401(k) plan

| <b>Plan Category</b>                                   | <b>(a)<sup>(1)</sup><br/>Number of<br/>securities<br/>to be issued upon<br/>exercise of<br/>outstanding options,<br/>warrants and rights</b> | <b>(b)<br/>Weighted-average<br/>exercise price of<br/>outstanding options,<br/>warrants and rights</b> | <b>(c)<sup>(1)</sup><br/>Number of securities<br/>remaining available for<br/>future issuance under<br/>equity<br/>compensation plans<br/>(excluding securities<br/>reflected in column (a))</b> |
|--------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by shareholders     | 726,405                                                                                                                                      | \$32.00                                                                                                | 997,366                                                                                                                                                                                          |
| Equity compensation plans not approved by shareholders | —                                                                                                                                            | —                                                                                                      | —                                                                                                                                                                                                |
| Total                                                  | 726,405                                                                                                                                      | \$32.00                                                                                                | 997,366                                                                                                                                                                                          |

<sup>(1)</sup> Amounts shown are for options granted only. At December 31, 2010, there were 48,630 restricted stock units outstanding that had been granted to employees under the 2000 and 2008 Stock Incentive Plans and 57,097 restricted stock units outstanding that had been granted to directors under the 2003 Non-Employee Directors Stock Plan. Each restricted stock unit was issued with dividend equivalent rights until the restricted stock unit vests or is terminated earlier pursuant to the terms 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.

## **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 2010.

The following table provides information about AWR repurchases of its Common Shares during the fourth quarter of 2010:

| <b>Period</b>         | <b>Total Number of<br/>Shares Purchased</b> | <b>Average Price Paid<br/>per Share</b> | <b>Total Number of<br/>Shares Purchased as<br/>Part of Publicly<br/>Announced Plans or<br/>Programs (1)</b> | <b>Maximum Number<br/>of Shares That May<br/>Yet Be Purchased<br/>under the Plans or<br/>Programs (3)</b> |
|-----------------------|---------------------------------------------|-----------------------------------------|-------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|
| October 1 - 31, 2010  | 490                                         | \$ 36.98                                | —                                                                                                           | NA                                                                                                        |
| November 1 - 30, 2010 | 157                                         | \$ 37.50                                | —                                                                                                           | NA                                                                                                        |
| December 1 - 31, 2010 | 33,114                                      | \$ 34.56                                | —                                                                                                           | NA                                                                                                        |
| <b>TOTAL</b>          | <b>33,761 <sup>(2)</sup></b>                | <b>\$ 34.61</b>                         | <b>—</b>                                                                                                    | <b>NA</b>                                                                                                 |

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

(2) Of this amount, 33,100 Common Shares were acquired on the open market for employees pursuant to our 401(k) Plan. The remainder of the Common Shares were acquired on the open market for participants in the AWR'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. There is no termination date for either of these plans.

**Item 6. Selected Financial Data****AMERICAN STATES WATER COMPANY (AWR):****(in thousands, except per share amounts)****Income Statement Information:**

|                                                            | 2010 (4)   | 2009       | 2008 (2)   | 2007      | 2006      |
|------------------------------------------------------------|------------|------------|------------|-----------|-----------|
| Total Operating Revenues                                   | \$ 398,942 | \$ 353,251 | \$ 311,246 | \$293,666 | \$260,874 |
| Total Operating Expenses                                   | 325,123    | 284,409    | 250,308    | 227,873   | 206,706   |
| Operating Income                                           | 73,819     | 68,842     | 60,938     | 65,793    | 54,167    |
| Interest Expense                                           | 21,636     | 21,899     | 20,877     | 21,102    | 20,578    |
| Interest Income                                            | 2,406      | 911        | 1,832      | 2,321     | 2,753     |
| Income from Continuing Operations                          | \$ 31,091  | \$ 29,374  | \$ 25,996  | \$ 27,121 | \$ 21,857 |
| Income (loss) from Discontinued Operations, net of tax (3) | \$ 2,106   | \$ 157     | \$ (3,991) | \$ 909    | \$ 1,224  |

**Basic Earnings per Common Share (1):**

|                                                |         |         |           |         |         |
|------------------------------------------------|---------|---------|-----------|---------|---------|
| Income from Continuing Operations              | \$ 1.67 | \$ 1.62 | \$ 1.50   | \$ 1.57 | \$ 1.27 |
| Income (loss) from Discontinued Operations (3) | \$ 0.11 | \$ 0.01 | \$ (0.23) | \$ 0.05 | \$ 0.07 |

**Fully Diluted Earnings per Common Share:**

|                                                |          |          |           |          |          |
|------------------------------------------------|----------|----------|-----------|----------|----------|
| Income from Continuing Operations              | \$ 1.66  | \$ 1.61  | \$ 1.49   | \$ 1.56  | \$ 1.26  |
| Income (loss) from Discontinued Operations (3) | \$ 0.11  | \$ 0.01  | \$ (0.23) | \$ 0.05  | \$ 0.07  |
| Average Shares Outstanding                     | 18,585   | 18,052   | 17,262    | 17,121   | 16,934   |
| Average Number of Diluted Shares Outstanding   | 18,736   | 18,188   | 17,394    | 17,177   | 17,101   |
| Dividends Declared per Common Share            | \$ 1.040 | \$ 1.010 | \$ 1.000  | \$ 0.955 | \$ 0.910 |

**Balance Sheet Information:**

|                             |              |             |             |           |           |
|-----------------------------|--------------|-------------|-------------|-----------|-----------|
| Total Assets                | \$ 1,192,035 | \$1,113,293 | \$1,061,287 | \$964,675 | \$936,955 |
| Common Shareholders' Equity | 377,541      | 359,430     | 310,503     | 302,129   | 283,734   |
| Long-Term Debt              | 299,839      | 300,221     | 260,561     | 260,941   | 261,248   |
| Total Capitalization        | \$ 677,380   | \$ 659,651  | \$ 571,064  | \$563,070 | \$544,982 |

- (1) In accordance with authoritative guidance for the effect of participating securities on earnings per share ("EPS") calculations, AWR uses the "two-class" method of computing EPS for the effects of participating securities. 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 \$33,023,000, \$29,399,000, \$21,890,000, \$27,723,000 and \$22,623,000 for the years ended December 31, 2010, 2009, 2008, 2007 and 2006, respectively.
- (2) In 2008, results include a \$7.7 million goodwill impairment charge related to CCWC, in accordance with accounting guidance for goodwill and other intangible assets.
- (3) On June 7, 2010, AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. to sell all of the common shares of CCWC for a total purchase price of \$35.0 million, including the assumption of approximately \$6.0 million of long-term debt. The consummation of the transaction contemplated by the agreement is subject to customary conditions, including among other things, regulatory approval by the ACC, which is anticipated to be received in 2011. Therefore, no gain on disposal of CCWC has been recorded during the year ended December 31, 2010. The results of CCWC for all periods included have been presented as a discontinued operation.
- (4) In 2010, results include a \$16.6 million charge related to the impairment of assets and loss contingencies in connection with regulatory matters.

**GOLDEN STATE WATER COMPANY (GSWC):****(in thousands)****Income Statement Information:**

|                          | 2010 (4)   | 2009      | 2008      | 2007      | 2006      |
|--------------------------|------------|-----------|-----------|-----------|-----------|
| Total Operating Revenues | \$ 326,582 | \$294,119 | \$268,888 | \$258,752 | \$244,425 |
| Total Operating Expenses | 262,781    | 230,633   | 205,970   | 194,046   | 189,123   |
| Operating Income         | 63,801     | 63,486    | 62,918    | 64,706    | 55,302    |
| Interest Expense         | 21,215     | 21,398    | 19,651    | 20,063    | 19,186    |
| Interest Income          | 1,914      | 898       | 1,774     | 2,111     | 2,670     |
| Net Income               | \$ 25,110  | \$ 25,373 | \$ 27,819 | \$ 26,900 | \$ 23,258 |

**Balance Sheet Information:**

|                             |             |             |           |           |           |
|-----------------------------|-------------|-------------|-----------|-----------|-----------|
| Total Assets                | \$1,078,478 | \$1,021,845 | \$970,150 | \$889,973 | \$867,661 |
| Common Shareholder's Equity | 358,295     | 331,530     | 324,533   | 278,441   | 266,965   |
| Long-Term Debt              | 299,839     | 300,221     | 260,561   | 260,941   | 261,248   |
| Total Capitalization        | \$658,134   | \$631,751   | \$585,094 | \$539,382 | \$528,213 |

## **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. Included in the following analysis is a discussion of water and electric margins. 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 performance of GSWC and CCWC. 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 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. A reconciliation of water and electric margins to the most directly comparable GAAP measures are included in the table under the section titled "*Operating Expenses: Supply Costs*".

### **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; fines, penalties and disallowances by state regulatory agencies arising from failures to comply with regulatory requirements; 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 GSWC to protect its water supply.

Operating revenues and income from contracted services at ASUS and its subsidiaries are earned from the operation and maintenance and renewal and replacement of the water and/or wastewater systems for the U.S. government at various military bases, as well as from construction of new water and/or wastewater facilities at those bases under contract modifications. All of the current contracts with the U.S. government are 50-year firm, fixed-price contracts with prospective price redeterminations. Additional revenues generated by contract operations are primarily dependent on these new construction activities. As a result, ASUS is subject to risks that are different than those of Registrant's public utility water and electric utilities. ASUS plans to continue seeking contracts for the operation and maintenance and renewal and replacement 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 the contracts with the U.S. government; fines, penalties or disallowance of costs by the federal government; and termination of contracts and suspension or debarment for a period of time from contracting with the federal government due to violations of federal law and regulations in connection with military utility privatization activities.

GSWC plans to continue to seek additional rate increases in future years from the CPUC and the U.S. government to recover operating and supply costs and receive reasonable returns on invested capital. Capital expenditures in future years at GSWC are expected to remain at much higher levels than depreciation expense. When necessary, Registrant obtains funds from external sources in the capital markets and through bank borrowings. GSWC plans to issue public debt in 2011, depending on market conditions. Proceeds from the debt issuance are expected to be used to pay down short-term borrowings from AWR which will be used by AWR to reduce borrowings under its \$100.0 million revolving credit facility, and retire other long-term debt with higher interest rates.

On June 7, 2010, AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. ("EPCOR") to sell all the common shares of CCWC for a total purchase price of \$35.0 million, including the assumption of approximately \$6.0 million of long-term debt. Approximately \$29.0 million in cash will be paid to AWR at closing. The purchase price is subject to certain adjustments for changes in retained earnings. The consummation of the transaction contemplated by the agreement is subject to customary conditions, including among other things, regulatory approval by the ACC, which is anticipated to be received in 2011. Therefore, no gain on disposal of CCWC has been recorded in 2010. Had the transaction closed as of December 31, 2010, AWR would have recognized a pretax gain on disposal of approximately \$5.8 million, net of transaction costs of \$708,000. The results of operations of CCWC for 2010, 2009 and 2008 have been presented as a discontinued operation.

On November 19, 2010, the CPUC issued a final decision on GSWC's Region II, Region III and general office rate case. The CPUC approved revenue increases for 2010 of approximately \$33.0 million as compared to 2009 adopted revenues, including an increase of \$14.0 million for supply costs. The rate increases were retroactive to January 1, 2010. The \$33.0 million revenue increase included approximately \$12.2 million already collected in 2010 as of the date of the decision through a supply cost offset surcharge (in effect since 2009). Effective January 1, 2011, a twenty-four month surcharge is in effect to collect the remaining uncollected retroactive portion of the revenue increase, which totals approximately \$19.5 million, and has been recorded as a regulatory asset as of December 31, 2010.

The CPUC also authorized GSWC to establish a two-way balancing account to track differences between the forecasted annual pension expenses adopted in rates for calendar years 2010, 2011 and 2012 and the actual annual expense to be recorded by GSWC's water regions in accordance with the accounting guidance for pension costs. As a result, GSWC recorded \$1.8 million to the pension balancing account in the fourth quarter of 2010, which reduces operating expenses.

Had the new rates from the final decision been in place on January 1, 2010, the impact by quarter to diluted earnings per share from continuing operations would be as follows:

| Impact by Quarter                     | Fully Diluted<br>EPS from<br>Continuing Operations |      | Impact of<br>Retroactive<br>Rates |        | Adjusted<br>Fully Diluted<br>EPS (2) |      |
|---------------------------------------|----------------------------------------------------|------|-----------------------------------|--------|--------------------------------------|------|
|                                       | As Reported                                        |      |                                   |        |                                      |      |
| First Quarter (1) .....               | \$                                                 | 0.44 | \$                                | 0.04   | \$                                   | 0.48 |
| Second Quarter.....                   |                                                    | 0.47 |                                   | 0.11   |                                      | 0.58 |
| Third Quarter (3).....                |                                                    | 0.30 |                                   | 0.15   |                                      | 0.45 |
| Fourth Quarter (3).....               |                                                    | 0.44 |                                   | (0.30) |                                      | 0.14 |
| Year ended December 31, 2010 (4)..... | \$                                                 | 1.66 | \$                                | -      | \$                                   | 1.66 |

- (1) During the first quarter of 2010, ASUS recorded an increase to pretax income of \$6.1 million, or \$0.19 per share, reflecting approval from the U.S. government of requests for equitable adjustment, which were retroactive, for managing more infrastructure than originally estimated by the government in its solicitation of bids for operation of the water and wastewater facilities at Fort Bragg in North Carolina and Fort Bliss in Texas.
- (2) Adjusted fully diluted EPS: This measure 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 measurement to EPS. Registrant has presented this information as we believe this measure is a useful benchmark in assessing its performance on a quarterly basis had the CPUC decision been in effect as of January 1, 2010. In 2008 and 2009 increased rates were in effect for the entire fiscal year.
- (3) During the third and fourth quarters of 2010, a pretax charge for the impairment of assets and loss contingencies were recorded totaling \$0.32 and \$0.23 per share, respectively.
- (4) The sum of the quarterly 2010 diluted earnings per share and adjusted fully diluted EPS do not agree to the yearly totals due to rounding.

On February 15, 2007, the CPUC issued a subpoena to GSWC in connection with an investigation of certain work orders and charges paid to a specific contractor used previously by GSWC for numerous construction projects estimated to total \$24.0 million completed over a period of 14 years. The CPUC's investigation focuses on whether GSWC was overcharged for these construction projects and whether these overcharges, if any, were included in customer rates.

Should the CPUC investigation result in a disallowance of certain previously capitalized costs, such costs, and potentially any return earned on such costs, may be required to be refunded to customers resulting in a charge to operating income. In addition to the disallowance of previously capitalized costs and the return earned on such costs, the CPUC also has the authority to assess fines and penalties. The staff of the CPUC has indicated to GSWC that it intends to seek such remedies, including possibly a fine and penalty. GSWC does not believe that a disallowance is required or that a penalty is justified. GSWC intends to vigorously defend the matter; however, proceedings such as this are difficult to predict and a final outcome is unknown. While reserving all rights, management believes it prudent to reserve for a probable loss related to this matter. The reserve estimates for this matter are subject to change as additional information becomes known. However, at this point, management does not expect increases in its recorded estimated reserve.

As a result of management's assessment of the CPUC subpoena matter and the disallowance by the CPUC of costs associated with certain construction projects in its final decision on the Region II, Region III and general office rate case, GSWC recorded a pretax charge for the impairment of assets and loss contingencies totaling \$16.6 million, or \$0.55 per share, in 2010. These reserve estimates may be adjusted as additional information becomes known.

For 2010, net income from continuing operations was \$31.1 million compared to \$29.4 million in 2009, an increase of 5.8%. Diluted earnings per share from continuing operations for 2010 were \$1.66 compared to \$1.61 in 2009, an increase of \$0.05 per share. Earnings for 2010 were largely impacted by: (i) a pretax charge of \$16.6 million, or \$0.55 per share, for the impairment of assets and loss contingencies discussed previously, and (ii) pretax income of \$6.1 million, or \$0.19 per share, recorded during the first quarter of 2010 reflecting approval from the U.S. government of requests for equitable adjustment, that were retroactive, for managing more infrastructure than originally estimated by the government in its solicitation of bids for operation of the water and wastewater facilities at Fort Bragg in North Carolina and Fort Bliss in Texas. Excluding the effects of these two significant items, adjusted fully diluted earnings from continuing operations (a non-GAAP measure) for 2010 would have been \$2.02 per share, an increase of \$0.41 per share.

Contributing to the remaining increase of \$0.41 per share were the following items, all of which are more fully discussed below: (i) an increase in the water dollar margin of \$16.0 million, or \$0.51 per share, during the year ended December 31, 2010 compared to the same period of 2009 due primarily to rate increases approved by the CPUC; (ii) an increase in the electric dollar margin of \$6.8 million, or \$0.21 per share, due primarily to rate increases approved by the CPUC; and (iii) an increase in interest income (net of interest expense) of \$1.3 million, or \$0.04 per share, related to a proposed settlement reached with the Internal Revenue Service related to AWR's refund claims associated with a tax-method change.

These increases to adjusted fully diluted earnings per share were partially offset by: (i) an increase in operating expenses, other than supply costs, at our water and electric utilities of \$6.3 million, or \$0.20 per share; (ii) a decrease in other income of \$684,000, or \$0.02 per share, due primarily to losses incurred at one of AWR's investments, accounted for by the equity method; (iii) a decrease in ASUS' pretax operating income of \$0.02 per share (excluding the impact of the approved requests for equitable adjustments previously discussed) due to higher allocated costs from the corporate headquarters and lower profit margins on certain capital projects at Fort Bragg and one of the military bases in Virginia due to higher than expected construction costs resulting from unexpected site conditions; (iv) a change in enacted state tax law during the first quarter of 2009 which resulted in a tax benefit of \$918,000, or \$0.05 per share which did not recur in 2010; (v) an increase in the effective tax rate (excluding the tax benefit previously discussed) for the year ended December 31, 2010 as compared to the same period in 2009, negatively impacting earnings by \$0.02 per share due primarily to changes between book and taxable income that are treated as flow-through adjustments in accordance with regulatory requirements and other nondeductible permanent items; and (vi) a decrease of \$0.04 per share due to an increase in the weighted average number of common shares outstanding resulting from the issuance of 1.1 million shares of AWR's Common Shares in a public offering completed in May 2009.

Income from discontinued operations of \$2.1 million for the year ended December 31, 2010 includes \$426,000 (net of tax) of legal and consulting costs related to the pending CCWC sale transaction. Excluding these transaction costs, CCWC's net income improved by \$2.4 million as compared to 2009 due primarily to: (i) an increase in the water margin of \$1.3 million due primarily to higher water rates implemented in October 2009 as a result of the approval by the ACC of CCWC's general rate case; (ii) lower depreciation expense of \$1.3 million as a result of reporting CCWC as a discontinued operation, resulting in no further depreciation being recorded in accordance with generally accepted accounting principles; (iii) a pretax loss of \$760,000 recorded in the third quarter of 2009 resulting from a decision issued by the ACC in October 2009 related to a settlement for removal of a well from service, that did not recur in 2010; and (iv) lower other operating costs, including maintenance expense.

## Summary Results by Segment

AWR has three reportable segments: water, electric and contracted services. Within the segments, AWR has two principal business units included in continuing operations: water and electric service utility operations conducted through GSWC, and contracted services conducted through ASUS and its subsidiaries. As previously discussed, in June 2010, AWR entered into a stock purchase agreement to sell all the common shares of CCWC. Accordingly, the results of operations of CCWC have been reported in discontinued operations. The tables below set forth summaries of the results by segment (in thousands) for AWR's continuing operations:

|                            | Operating Revenues |            |           |        | Pretax Operating Income |            |            |         |
|----------------------------|--------------------|------------|-----------|--------|-------------------------|------------|------------|---------|
|                            | Year               | Year       |           |        | Year                    | Year       |            |         |
|                            | Ended              | Ended      | \$        | %      | Ended                   | Ended      | \$         | %       |
|                            | 12/31/2010         | 12/31/2009 | CHANGE    | CHANGE | 12/31/2010              | 12/31/2009 | CHANGE     | CHANGE  |
| Water.....                 | \$ 290,781         | \$ 265,197 | \$ 25,584 | 9.6%   | \$ 57,018               | \$ 63,124  | \$ (6,106) | -9.7%   |
| Electric.....              | 35,801             | 28,922     | 6,879     | 23.8%  | 5,680                   | (553)      | 6,233      | 1127.1% |
| Contracted services.....   | 72,360             | 59,132     | 13,228    | 22.4%  | 11,487                  | 6,358      | 5,129      | 80.7%   |
| AWR parent.....            | -                  | -          | -         | -      | (366)                   | (87)       | (279)      | -320.7% |
| Totals from operation..... | \$ 398,942         | \$ 353,251 | \$ 45,691 | 12.9%  | \$ 73,819               | \$ 68,842  | \$ 4,977   | 7.2%    |

**Water** - For the year ended December 31, 2010, pretax operating income for water decreased by \$6.1 million, or 9.7%, primarily due to a \$16.6 million pretax charge for the impairment of assets and loss contingencies, previously discussed. There were also \$5.5 million in increases in other operating expenses (other than supply costs), largely due to additional depreciation expense as a result of the CPUC's final decision issued in November 2010 on the Region II, Region III and general office rate case. These increases in operating expenses were partially offset by a \$16.0 million increase in the dollar water margin, also largely as a result of the approved decision on the Region II, Region III and general office rate case.

**Electric** - For the year ended December 31, 2010, pretax operating income from electric operations increased by \$6.2 million due to increases in rates which went into effect in November 2009 and January 2010 and generated approximately \$5.7 million in revenues. In addition, as a result of the Base Revenue Requirement Adjustment Mechanism ("BRRAM"), which also went into effect in November 2009, BVES recorded additional revenues due to lower customer usage as compared to adopted levels authorized by the CPUC. Also, in March 2010, the CPUC approved for recovery a memorandum account which tracked the difference between the 2007 adopted general office cost allocation to BVES and the 1996 adopted general office cost allocation, effective and retroactive from June 4, 2009 to October 31, 2009. As a result, during the first quarter of 2010, BVES recorded a regulatory asset of \$958,000 and a corresponding increase to revenues for amounts included in this memorandum account.

**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, 2010, pretax operating income for contracted services increased by \$5.1 million, or \$0.16 per share, primarily due to contract modifications approved by the U.S. government during 2010 in connection with requests for equitable adjustment previously filed at Fort Bliss in Texas, Fort Jackson in South Carolina and Fort Bragg in North Carolina. In addition, there was a contract modification for an interim rate increase pending resolution of the first price redetermination which included approximately \$700,000 in retroactive management fee revenues at Andrews Air Force Base in Maryland. The approved REA's and contract modifications totaled \$7.0 million in additional revenues for 2010. In addition, there was an overall increase in construction activities as compared to the same period in 2009 at Fort Bragg and Fort Jackson. These increases were partially offset by decreased construction activity at Fort Bliss, Andrews Air Force Base, and the military bases in Virginia. Also, in 2009 the government approved a \$1.1 million REA related to Fort Jackson for emergency construction costs. Earnings and cash flows from modifications to the original 50-year contracts with the U.S. government for additional construction activity may or may not continue in future periods. For further discussion on the status of price redeterminations and requests for equitable adjustments, see section titled "Contracted Services" presented later.

The following discussion and analysis for the years ended December 31, 2010, 2009 and 2008 provides information on AWR's consolidated operations and assets and where necessary, includes specific references to AWR's individual segments and/or other continuing subsidiaries: GSWC and ASUS and its subsidiaries, and the discontinued operations of CCWC.

**Consolidated Results of Operations — Years Ended December 31, 2010 and 2009 (amounts in thousands):**

|                                                             | Year<br>Ended<br>12/31/2010 | Year<br>Ended<br>12/31/2009 | \$<br>CHANGE | %<br>CHANGE |
|-------------------------------------------------------------|-----------------------------|-----------------------------|--------------|-------------|
| OPERATING REVENUES                                          |                             |                             |              |             |
| Water.....                                                  | \$ 290,781                  | \$ 265,197                  | \$ 25,584    | 9.6%        |
| Electric.....                                               | 35,801                      | 28,922                      | 6,879        | 23.8%       |
| Contracted services.....                                    | 72,360                      | 59,132                      | 13,228       | 22.4%       |
| Total operating revenues.....                               | 398,942                     | 353,251                     | 45,691       | 12.9%       |
| OPERATING EXPENSES                                          |                             |                             |              |             |
| Water purchased.....                                        | 46,865                      | 44,973                      | 1,892        | 4.2%        |
| Power purchased for pumping .....                           | 9,113                       | 9,658                       | (545)        | -5.6%       |
| Groundwater production assessment.....                      | 11,473                      | 11,563                      | (90)         | -0.8%       |
| Power purchased for resale.....                             | 13,078                      | 12,853                      | 225          | 1.8%        |
| Supply cost balancing accounts.....                         | 20,622                      | 12,434                      | 8,188        | 65.9%       |
| Other operation expenses.....                               | 29,184                      | 28,808                      | 376          | 1.3%        |
| Administrative and general expenses.....                    | 87,135                      | 69,051                      | 18,084       | 26.2%       |
| Depreciation and amortization.....                          | 37,405                      | 31,531                      | 5,874        | 18.6%       |
| Maintenance.....                                            | 18,149                      | 17,012                      | 1,137        | 6.7%        |
| Property and other taxes.....                               | 14,165                      | 12,824                      | 1,341        | 10.5%       |
| ASUS construction expenses.....                             | 38,577                      | 33,717                      | 4,860        | 14.4%       |
| Net gain on sale of property.....                           | (643)                       | (15)                        | (628)        | 4186.7%     |
| Total operating expenses.....                               | 325,123                     | 284,409                     | 40,714       | 14.3%       |
| OPERATING INCOME.....                                       | 73,819                      | 68,842                      | 4,977        | 7.2%        |
| OTHER INCOME AND EXPENSES                                   |                             |                             |              |             |
| Interest expense.....                                       | (21,636)                    | (21,899)                    | 263          | -1.2%       |
| Interest income.....                                        | 2,406                       | 911                         | 1,495        | 164.1%      |
| Other.....                                                  | (463)                       | 221                         | (684)        | -309.5%     |
|                                                             | (19,693)                    | (20,767)                    | 1,074        | -5.2%       |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE | 54,126                      | 48,075                      | 6,051        | 12.6%       |
| Income tax expense.....                                     | 23,035                      | 18,701                      | 4,334        | 23.2%       |
| INCOME FROM CONTINUING OPERATIONS                           | 31,091                      | 29,374                      | 1,717        | 5.8%        |
| INCOME FROM DISCONTINUED OPERATIONS, NET OF TAX             | 2,106                       | 157                         | 1,949        | 1241.4%     |
| NET INCOME.....                                             | \$ 33,197                   | \$ 29,531                   | \$ 3,666     | 12.4%       |
| Basic earnings from continuing operations.....              | \$ 1.67                     | \$ 1.62                     | \$ 0.05      | 3.1%        |
| Basic earnings from discontinued operations.....            | 0.11                        | 0.01                        | 0.10         | 1000.0%     |
|                                                             | \$ 1.78                     | \$ 1.63                     | \$ 0.15      | 9.2%        |
| Diluted earnings from continuing operations.....            | \$ 1.66                     | \$ 1.61                     | \$ 0.05      | 3.1%        |
| Diluted earnings from discontinued operations.....          | 0.11                        | 0.01                        | 0.10         | 1000.0%     |
|                                                             | \$ 1.77                     | \$ 1.62                     | \$ 0.15      | 9.3%        |

Net income from continuing operations for the year ended December 31, 2010 was \$31.1 million, equivalent to \$1.67 and \$1.66 per common share on a basic and fully diluted basis, respectively, compared to \$29.4 million, or \$1.62 and \$1.61 per common share on a basic and fully diluted basis, respectively, for the year ended December 31, 2009. Impacting the comparability in the results of the two periods are the following items which increased diluted earnings per share by \$0.05:

- An increase in the water margin of \$16.0 million, or \$0.51 per share, during the year ended December 31, 2010 compared to the same period of 2009 due primarily to higher water rates approved by the CPUC effective January 1, 2010 in connection with the Region II, Region III and General Office rate case. Based on this decision, the approved revenue increases for 2010 totaled approximately \$33.0 million as compared to 2009 adopted revenues, which included an increase of \$14.0 million for supply costs, and was retroactive to January 1, 2010.
- An increase in the electric margin of \$6.8 million, or \$0.21 per share, during the year ended December 31, 2010 as compared to the same period of 2009. The increase was primarily due to: (i) increases in rates in November 2009 and January 2010 related to BVES' general rate case approved by the CPUC which generated an increase of approximately \$5.7 million in revenues; (ii) the recording of additional revenues in the BRRAM due to lower customer usage as compared to adopted levels authorized by the CPUC; and (iii) the CPUC approval in March 2010 for recovery of \$958,000 in a memorandum account which tracked the difference between the 2007 adopted general office cost allocation to BVES and the 1996 adopted general office cost allocation to BVES.
- A pretax charge of \$16.6 million, or \$0.55 per share, at GSWC for the impairment of assets and loss contingencies resulting from regulatory matters previously discussed, which may be adjusted as additional information becomes known.
- Excluding the pretax charge for the impairment of assets and loss contingencies discussed above, operating expenses, other than supply costs, increased by \$6.3 million, or \$0.20 per share, at our water and electric utility businesses for the year ended December 31, 2010. The increase was primarily due to an increase in: (i) administrative and general expenses of \$5.2 million due to higher labor and employee related costs as well as transportation expenses; (ii) depreciation and amortization expenses of \$5.7 million; (iii) maintenance and other operating expenses of \$1.7 million; and (iv) property and other taxes of \$1.1 million. These increases were partially offset by: (i) a \$3.8 million pretax charge during the fourth quarter of 2009 related to legal and settlement costs in connection with a settlement agreement reached between the Company and two former officers that did not recur in 2010; (ii) a decrease in pension expense of \$3.0 million largely due to the effect of implementing a two-way pension balancing account at GSWC's water regions; and (iii) an increase of \$628,000 in pretax gain on the sale of property primarily due to the sale in 2010 of a well in one of GSWC's water regions.
- An increase in pretax operating income for contracted services of \$5.1 million, or \$0.16 per share, for the year ended December 31, 2010 due primarily to contract modifications received from the U.S. government resolving requests for equitable adjustment and for retroactive interim increases in management fees. In addition, there was an increase in total construction activity during 2010 as compared to 2009.
- An increase in interest income (net of interest expense) of \$1.8 million, or \$0.05 per share, primarily related to a proposed settlement reached with the Internal Revenue Service related to AWR's refund claims associated with a tax-method change.
- A decrease in other income of \$684,000, or \$0.02 per share, due primarily to losses incurred at one of AWR's investments, accounted for by the equity method.
- An increase in income tax expense for the year ended December 31, 2010 as compared to the same period in 2009 primarily due to: (i) a change in enacted state tax law during the first quarter of 2009 which resulted in a tax benefit of \$918,000, or \$0.05 per share which did not recur in 2010; and (ii) an increase in the effective tax rate (excluding the tax benefit mentioned previously) for the year ended December 31, 2010 as compared to the same period in 2009, negatively impacting earnings by \$0.02 per share primarily resulting from changes between book and taxable income that are treated as flow-through adjustments in accordance with regulatory requirements and other nondeductible permanent items.
- A decrease of \$0.04 per share due to an increase in the weighted average number of common shares outstanding resulting from the issuance of 1.1 million shares of AWR's Common Shares in a public offering completed in May 2009.

Net income from discontinued operations for the year ended December 31, 2010 was \$2.1 million, equivalent to \$0.11 per common share on a fully diluted basis, compared to net income of \$157,000 or \$0.01 per common share on a basic and fully diluted basis, for the year ended December 31, 2009, an increase of \$0.10 per common share. The improved performance at CCWC was primarily due to rate increases approved by the ACC in October 2009 and a decrease in operating expenses as compared to 2009.

## ***Operating Revenues***

### ***Water***

For the year ended December 31, 2010, revenues from water operations increased by 9.6% to \$290.8 million, compared to \$265.2 million for the year ended December 31, 2009. As previously discussed, the final decision in the Region II, Region III and general office rate case increased water revenues by \$33.0 million as compared to the 2009 adopted revenue levels. Revenues also increased in 2010 as a result of the impact of a full year of the Water Revenue Adjustment Mechanism ("WRAM") in effect at Region I, which was implemented in September 2009. These increases were partially offset by the recording of \$3.1 million in the Water Conservation Memorandum Accounts for GSWC's water regions in 2009 and \$4.3 million in surcharges in effect that were approved by the CPUC to recover previously incurred under-collections in supply costs, both of which were not part of the original 2009 adopted revenues.

While water sales in 2010 continue to be impacted by state wide conservation and rationing efforts, earnings have not been negatively impacted by the reduction in water sales as GSWC has implemented the WRAM in all three water regions as authorized by the CPUC. During 2010, consumption was lower by 8.4% as compared to 2009. GSWC's revenue requirement and volumetric revenues will be adopted as part of a general rate case ("GRC") every three years. The recently approved Region II, Region III and general office GRC is effective for years 2010, 2011 and 2012. On December 16, 2010, the CPUC issued a final decision on GSWC's Region I GRC for new rates in 2011 and 2012. GSWC will file a GRC for all three water regions in July of 2011 with rates expected to be effective January 2013.

### ***Electric***

For the year ended December 31, 2010, revenues from electric operations increased by 23.8% to \$35.8 million compared to \$28.9 million for the year ended December 31, 2009 due primarily to rate increases implemented in November 2009 and January 2010 as approved by the CPUC which added approximately \$5.7 million in electric revenues in 2010 and the implementation of the Base Revenue Requirement Adjustment Mechanism, adopted in November 2009. Also, as previously discussed, in March 2010, the CPUC approved for recovery a memorandum account which tracked the difference between the 2007 adopted general office cost allocation to BVES and the 1996 adopted general office cost allocation, effective and retroactive from June 4, 2009 to October 31, 2009. As a result, during the first quarter of 2010, BVES recorded a \$958,000 increase to electric revenues for amounts included in this memorandum account.

Registrant's regulated businesses rely upon rate approvals by the CPUC to provide for a return on invested and borrowed capital used to fund utility plant additions. If adequate rate relief is not granted in a timely manner, operating revenues and earnings can be negatively impacted.

### ***Contracted Services***

Revenues from contracted services are comprised of management fees for operating and maintaining ("O&M") the water and/or wastewater systems at military bases and construction revenues (including renewals and replacements) on these systems. For the year ended December 31, 2010, revenues from contracted services increased by \$13.2 million, or 22.4%, to \$72.4 million compared to \$59.1 million for the year ended December 31, 2009 due to: (i) an increase of \$8.1 million in O&M management fees, and (ii) an increase of \$5.1 million in construction revenues.

For the year ended December 31, 2010, management fees increased by \$8.1 million due primarily to contract modifications received from the U.S. government for operating and maintaining the water and wastewater systems at Fort Bliss and Fort Bragg that resulted in the recording of O&M revenues totaling \$5.6 million, which were retroactive from the commencement of the contracts in October 2004 and March 2008, respectively, through December 31, 2009. The increased O&M fees established by the contract modification for Fort Bragg added an additional \$1.5 million in revenues related to 2010. There was also an increase in management fees at Andrews Air Force Base due primarily to the execution of a contract modification in August 2010 which provided for an interim adjustment pending resolution of the first price redetermination. As a result, there was a retroactive adjustment to the O&M revenue to February 2008, the first redetermination date, of approximately \$700,000 which was recorded during the third quarter of 2010. Some or the entire amount may be subject to refund depending on the outcome of the negotiations on the price redetermination. Finally, there was an increase in management fees of \$782,000 related to a contract with a municipality to provide billing and meter reading services. This contract will terminate effective April 1, 2011.

For the year ended December 31, 2010, construction revenues increased by \$5.1 million due primarily to an increase in construction activities at Fort Bragg in North Carolina and Fort Jackson in South Carolina, partially offset by decreases in construction revenues at the other military bases.

Earnings and cash flows from amendments and modifications to the original 50-year contracts with the U.S. government may or may not continue in future periods. ASUS relies upon price redeterminations and equitable adjustments by the U.S. government in order to recover operating expenses and profit margin. If adequate price redeterminations and adjustments are not granted in a timely manner, operating revenues and earnings can be negatively impacted.

### **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 (including the cost of natural gas) 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 31.1% and 32.2% of total operating expenses for the year ended December 31, 2010 and 2009, respectively.

The table below provides the amount of increases (decreases), percent changes in supply costs, and margins during the years ended December 31, 2010 and 2009 (amounts in thousands):

|                                                            | Year<br>Ended<br>12/31/2010 | Year<br>Ended<br>12/31/2009 | \$<br>CHANGE | %<br>CHANGE |
|------------------------------------------------------------|-----------------------------|-----------------------------|--------------|-------------|
| WATER OPERATING REVENUES <sup>1</sup>                      | \$ 290,781                  | \$ 265,197                  | \$ 25,584    | 9.6%        |
| WATER SUPPLY COSTS:                                        |                             |                             |              |             |
| Water purchased <sup>1</sup> .....                         | 46,865                      | 44,973                      | \$ 1,892     | 4.2%        |
| Power purchased for pumping <sup>1</sup> .....             | 9,113                       | 9,658                       | (545)        | -5.6%       |
| Groundwater production assessment <sup>1</sup> .....       | 11,473                      | 11,563                      | (90)         | -0.8%       |
| Water supply cost balancing accounts <sup>1</sup> .....    | 17,625                      | 9,296                       | 8,329        | 89.6%       |
| TOTAL WATER SUPPLY COSTS                                   | \$ 85,076                   | \$ 75,490                   | \$ 9,586     | 12.7%       |
| WATER MARGIN <sup>2</sup>                                  | \$ 205,705                  | \$ 189,707                  | \$ 15,998    | 8.4%        |
| PERCENT MARGIN - WATER                                     | 70.7%                       | 71.5%                       |              |             |
| ELECTRIC OPERATING REVENUES <sup>1</sup>                   | \$ 35,801                   | \$ 28,922                   | \$ 6,879     | 23.8%       |
| ELECTRIC SUPPLY COSTS:                                     |                             |                             |              |             |
| Power purchased for resale <sup>1</sup> .....              | 13,078                      | 12,853                      | \$ 225       | 1.8%        |
| Electric supply cost balancing accounts <sup>1</sup> ..... | 2,997                       | 3,138                       | (141)        | -4.5%       |
| TOTAL ELECTRIC SUPPLY COSTS                                | \$ 16,075                   | \$ 15,991                   | \$ 84        | 0.5%        |
| ELECTRIC MARGIN <sup>2</sup>                               | \$ 19,726                   | \$ 12,931                   | \$ 6,795     | 52.5%       |
| PERCENT MARGIN - ELECTRIC                                  | 55.1%                       | 44.7%                       |              |             |

- (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 is shown on AWR's Consolidated Statements of Income and totaled \$20,622,000 and \$12,434,000 for the years ended December 31, 2010 and 2009, respectively.
- (2) Water and electric margins do not include any depreciation and amortization, maintenance expense or other operating expenses.

Two of the principal factors affecting water supply costs 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. On August 21, 2008, the CPUC issued a final decision which approved the establishment of a modified cost balancing account or MCBA that allows recovery of supply costs for changes in water supply mix. GSWC implemented the MCBA in late November 2008 for Regions II and III and in September 2009 for Region I's rate-making areas in connection with the new conservation rate design and the implementation of a WRAM. 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. 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 regulatory asset or liability balancing account (tracked individually for each water ratemaking area).

For the year ended December 31, 2010, 34.7% of GSWC's water supply mix was purchased as compared to 36.9% purchased for the year ended December 31, 2009. However, as noted previously, GSWC implemented the MCBA which eliminates the effects on earnings of changes in the water supply mix. The adopted percentages of purchased water for the year ended December 31, 2010 at Regions I, II and III were 23.4%, 55.0% and 39.2%, respectively, as compared to actual purchased water of 20.7%, 39.5% and 41.3%, respectively, for 2010. Region I's supply mix consists primarily of pumped water. The variance in Region I's and Region II's actual mix compared to the mix approved by the CPUC resulted in an over-collection in the MCBA account. This caused an overall decrease in the water margin percentage to 70.7% for 2010 compared to 71.5% in 2009 since GSWC no longer receives any benefit from a more favorable supply mix than that approved by the CPUC.

Purchased water costs for the year ended December 31, 2010 increased by 4.2% to \$46.9 million as compared to \$45.0 million in 2009. The increase in purchased water costs was due to higher water rates charged by wholesale suppliers, partially offset by lower customer usage. GSWC's customer water usage decreased 8.4% in 2010 as compared to 2009.

For the year ended December 31, 2010, power purchased for pumping decreased to \$9.1 million, compared to \$9.7 million for 2009. This was due to lower customer demand, partially offset by increases in supplier rates. There were also changes in the actual supply mix, as discussed above. Groundwater production assessments were \$11.5 million in 2010, as compared to \$11.6 million in 2009. This slight decrease was due to lower customer usage offset by increases in assessment rates (pump tax rates) levied against groundwater production, effective July 2010. The MCBA tracks the changes in pump taxes for future recovery/refund in water rates.

An increase of \$8.3 million in the water supply cost balancing account provision during the year ended December 31, 2010 as compared to the same period in 2009, was primarily due to a \$6.0 million increase in the amortization of previously incurred supply costs from surcharges currently in effect at all three GSWC water regions. 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, resulting in no earnings impact. In addition, there was an increase of \$2.3 million in 2010 due to a lower actual supply mix compared to the mix approved by the CPUC, resulting in an over-collection in the MCBA accounts.

For the year ended December 31, 2010, the cost of power purchased for resale to customers in GSWC's BVES division increased slightly by 1.8% to \$13.1 million compared to \$12.9 million for the year ended December 31, 2009 reflecting a higher fixed energy price during 2010 pursuant to purchased power contracts effective January 1, 2009. The main product under the contracts provides for 13 MWs of electric energy at a fixed price of \$67.85 per MWh during 2010 as compared to \$63.75 per MWh during 2009. The difference between the price of purchased power and the \$77 per MWh as authorized by the CPUC is reflected in the electric supply cost balancing. The increase in energy cost was partially offset by a 3.1% decrease in electric usage by GSWC's electric customers.

### ***Other Operation Expenses***

The primary components of other operation 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 years ended December 31, 2010 and 2009, other operation expenses by segment consisted of the following (amounts in thousands):

|                                     | <b>Year<br/>Ended<br/>12/31/2010</b> | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|-------------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....                 | \$ 23,388                            | \$ 23,067                            | \$ 321               | 1.4%                |
| Electric Services.....              | 2,220                                | 2,324                                | (104)                | -4.5%               |
| Contracted Services.....            | 3,576                                | 3,417                                | 159                  | 4.7%                |
| Total other operation expenses..... | \$ 29,184                            | \$ 28,808                            | \$ 376               | 1.3%                |

For the year ended December 31, 2010, other operation expenses for water and electric services increased by \$217,000, or 0.9%, primarily due to an increase in water conservation educational materials and supplies of \$1.1 million as a result, in large part, to the expensing of these costs at Region III. In 2010, GSWC began expensing conservation costs in Region III pursuant to an agreement previously reached with the CPUC. Prior to 2010, conservation costs in Region III were capitalized and recovered in rate base. Regions I and II have expensed conservation costs since 2007. There was also an increase of \$340,000 in water treatment and other related supply costs. These increases were partially offset by a \$676,000 decrease in outside services, a \$487,000 decrease in labor and related benefits, and a decrease of \$60,000 in miscellaneous other operation expenses.

Contracted services experienced an increase in other operation expenses of \$159,000 due to an increase of \$866,000 in labor and related benefits costs resulting from addition of staff and annual performance-based wage adjustments effective January 1, 2010, partially offset by a decrease of \$685,000 in outside services costs (due to more work being performed internally) and \$22,000 in other miscellaneous operation expenses.

### ***Administrative and General Expenses***

Administrative and general expenses include payroll related to administrative and general functions, the related 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, 2010 and 2009, administrative and general expenses by segment, including AWR (parent), consisted of the following (amounts in thousands):

|                                                | <b>Year<br/>Ended<br/>12/31/2010</b> | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|------------------------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....                            | \$ 64,716                            | \$ 50,624                            | \$ 14,092            | 27.8%               |
| Electric Services.....                         | 7,950                                | 7,312                                | 638                  | 8.7%                |
| Contracted Services.....                       | 14,103                               | 11,028                               | 3,075                | 27.9%               |
| AWR (parent).....                              | 366                                  | 87                                   | 279                  | 320.7%              |
| Total administrative and general expenses..... | \$ 87,135                            | \$ 69,051                            | \$ 18,084            | 26.2%               |

For the year ended December 31, 2010, administrative and general expenses increased by \$14.1 million in water services compared to the year ended December 31, 2009 due primarily to a \$16.6 million pretax charge recorded in 2010 for the impairment of assets and loss contingencies related to regulatory matters previously discussed. There was also an increase in: (i) labor and other employee related benefits of \$3.0 million due primarily to higher wages; and (ii) transportation

expense of \$1.7 million due primarily to the higher depreciation rates for vehicles approved by the CPUC in the recent Regions II and III rate case. Depreciation expense on vehicles is included in transportation expenses in accordance with CPUC guidelines. These increases were partially offset by: (i) a decrease in pension expense of \$2.9 million as a result of the two-way pension balancing account implemented in 2010 authorized by the CPUC; (ii) a settlement agreement reached with two former officers of GSWC which resulted in a charge of \$3.8 million during the fourth quarter of 2009 for legal and settlement costs; (iv) a decrease in data transmission line costs of \$197,000; and (iv) a net decrease of \$303,000 in other miscellaneous administrative and general expenses.

For the year ended December 31, 2010, administrative and general expenses increased by \$638,000 in electric services compared to the year ended December 31, 2009. This was primarily due to a \$1.0 million settlement agreement reached with Mirant Energy Trading, LLC, the proceeds of which were recorded as a reduction of legal costs in 2009. There was also an increase of \$259,000 in labor costs and other related benefits. These increases were partially offset by: (i) a decrease of \$486,000 in regulatory and other consulting services resulting from the completion of the general rate case approved in October 2009; (ii) a decrease of \$104,000 in pension costs; and (iii) a \$31,000 decrease in other miscellaneous administrative expenses.

There was an increase of \$3.1 million in administrative and general expenses for contracted services due primarily to: (i) an increase of \$766,000 in legal and consulting services relating to filings with the U.S. government and responding to the grand jury subpoena discussed earlier; (ii) an increase of \$352,000 in labor costs and related employee benefits resulting from staff additions and annual performance-based wage adjustments effective January 1, 2010; (iii) an increase of \$1.6 million in allocation of costs from the corporate headquarters to ASUS; (iv) an increase of \$211,000 in supplies and material costs; and (v) an increase of \$146,000 in other miscellaneous expenses.

### ***Depreciation and Amortization***

For the years ended December 31, 2010 and 2009, depreciation and amortization by segment consisted of the following (amounts in thousands):

|                                          | <b>Year</b>       |                   | <b>Year</b>   |               |
|------------------------------------------|-------------------|-------------------|---------------|---------------|
|                                          | <b>Ended</b>      | <b>Ended</b>      | <b>\$</b>     | <b>%</b>      |
|                                          | <b>12/31/2010</b> | <b>12/31/2009</b> | <b>CHANGE</b> | <b>CHANGE</b> |
| Water Services.....                      | \$ 34,360         | \$ 28,609         | \$ 5,751      | 20.1%         |
| Electric Services.....                   | 2,240             | 2,258             | (18)          | -0.8%         |
| Contracted Services.....                 | 805               | 664               | 141           | 21.2%         |
| Total depreciation and amortization..... | \$ 37,405         | \$ 31,531         | \$ 5,874      | 18.6%         |

For the year ended December 31, 2010, depreciation and amortization expense for water and electric services increased by \$5.7 million to \$36.6 million compared to \$30.9 million for year ended December 31, 2009. This increase was due to higher composite depreciation rates for Regions II and III as a result of the CPUC's final decision issued in November 2010, which was retroactive to January 1, 2010. In addition, there were \$82.8 million of additions to utility plant during 2009. 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 CPUC will be recovered through water and electric rates.

There was an increase in depreciation and amortization expense for contracted services due primarily to the addition of fixed assets during 2009 and 2010.

### ***Maintenance***

For the years ended December 31, 2010 and 2009, maintenance expense by segment consisted of the following (amounts in thousands):

|                          | <b>Year<br/>Ended<br/>12/31/2010</b> | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|--------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....      | \$ 15,011                            | \$ 13,440                            | \$ 1,571             | 11.7%               |
| Electric Services.....   | 830                                  | 878                                  | (48)                 | -5.5%               |
| Contracted Services..... | 2,308                                | 2,694                                | (386)                | -14.3%              |
| Total maintenance.....   | \$ 18,149                            | \$ 17,012                            | \$ 1,137             | 6.7%                |

For the year ended December 31, 2010, maintenance expense for water services increased by \$1.6 million to \$15.0 million compared to \$13.4 million for the year ended December 31, 2009 due primarily to an increase in planned maintenance on wells, water supply and distribution facilities at all of GSWC's water regions.

There was a decrease of \$48,000 in maintenance expenses for electric services related to the 8.4 MW natural gas-fueled generation plant.

A decrease of \$386,000 in contracted services maintenance expense was due to lower labor and outside services costs. Internal labor activity for 2010 was focused more on operations-related work and less on maintenance activity.

### ***Property and Other Taxes***

For the years ended December 31, 2010 and 2009, property and other taxes by segment, consisted of the following (amounts in thousands):

|                                     | <b>Year<br/>Ended<br/>12/31/2010</b> | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|-------------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....                 | \$ 11,855                            | \$ 10,855                            | \$ 1,000             | 9.2%                |
| Electric Services.....              | 806                                  | 713                                  | 93                   | 13.0%               |
| Contracted Services.....            | 1,504                                | 1,256                                | 248                  | 19.7%               |
| Total property and other taxes..... | \$ 14,165                            | \$ 12,824                            | \$ 1,341             | 10.5%               |

For the year ended December 31, 2010, property and other taxes for water and electric services increased by \$1.1 million, due in part to a tax refund of \$488,000 recorded in the second quarter of 2009 resulting from lower reassessed property values that was not repeated in 2010. There was also an increase in payroll taxes due to increased labor costs and an increase in franchise fees as a result of an increase in water revenues.

Property and other taxes were higher in contracted services due primarily to an increase in gross receipts taxes at ONUS. This increase was due primarily to the \$3.0 million in management fees approved in the request for equitable adjustment recorded in the first quarter of 2010.

### ***ASUS Construction Expenses***

For the year ended December 31, 2010 ASUS construction expenses were \$38.6 million, increasing \$4.9 million compared to the same period in 2009. This was primarily due to \$19.7 million higher construction activity at Fort Bragg in North Carolina and Fort Jackson in South Carolina. These increases were partially offset by a decrease of \$14.8 million in construction expense at the other military bases. Construction activity will vary from base-to-base and year-to-year depending upon the availability of capital for infrastructure improvements at the various military bases.

### ***Net Gain on Sale of Property***

For the year ended December 31, 2010, Registrant recorded a pre-tax gain of \$643,000 primarily as the result of the sale of property in the water services segment compared to a \$15,000 pretax gain on a sale of property in 2009.

### ***Interest Expense***

For the years ended December 31, 2010 and 2009, interest expense by segment, including AWR (parent), consisted of the following (amounts in thousands):

|                                  | <b>Year<br/>Ended<br/>12/31/2010</b> | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|----------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water and Electric Services..... | \$ 21,196                            | \$ 21,398                            | \$ (202)             | -0.9%               |
| Contracted Services.....         | 287                                  | 358                                  | (71)                 | -19.8%              |
| AWR (parent).....                | 153                                  | 143                                  | 10                   | 7.0%                |
| Total interest expense.....      | \$ 21,636                            | \$ 21,899                            | \$ (263)             | -1.2%               |

For the year ended December 31, 2010, overall interest expense decreased \$263,000 compared to the same period in 2009. In August 2010, GSWC filed an advice letter with the CPUC for approval of a customer refund in connection with the interest rate balancing account based on the difference between the adopted cost of new debt in GSWC's authorized capital structure and the actual cost of new debt. In October 2010, the CPUC clarified the methodology to calculate the interest rate balancing account. As a result, GSWC's interest expense was reduced to reflect the CPUC's clarification. This decrease was partially offset by higher interest expense due to the issuance in March 2009 of \$40 million in senior notes, and an increase in short-term borrowings and interest rates. Average bank loan balances outstanding under the AWR credit facility were \$37.6 million as compared to an average of \$33.7 million during the same period of 2009. The average interest rate on short-term borrowings for the year ended December 31, 2010 was 1.40% as compared to an average of 1.18% during 2009.

### ***Interest Income***

For the years ended December 31, 2010 and 2009, interest income by segment, including AWR (parent) consisted of the following (amounts in thousands):

|                                  | <b>Year<br/>Ended<br/>12/31/2010</b> | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|----------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water and Electric Services..... | \$ 1,895                             | \$ 898                               | \$ 997               | 111.0%              |
| Contracted Services.....         | 511                                  | 7                                    | 504                  | 7200.0%             |
| AWR (parent).....                | -                                    | 6                                    | (6)                  | -100.0%             |
| Total interest income.....       | \$ 2,406                             | \$ 911                               | \$ 1,495             | 164.1%              |

Interest income increased by \$1.5 million for the year ended December 31, 2010 primarily due to interest on AWR's tax refund claims recorded in 2010. This was partially offset by interest income recorded in 2009 related to a property tax refund resulting from lower reassessed property values. In contracted services, there was \$510,000 in interest income in connection with the Fort Bliss inventory price adjustment contract modification issued by the U.S. government in March 2010.

### ***Other***

For the year ended December 31, 2010, other expenses increased \$684,000 primarily as a result of losses incurred on an investment, accounted for by the equity method.

### ***Income Tax Expense***

For the years ended December 31, 2010 and 2009, income tax expense by segment, including AWR (parent), consisted of the following (amounts in thousands):

|                                  | <b>Year<br/>Ended<br/>12/31/2010</b> | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|----------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water and Electric Services..... | \$ 18,634                            | \$ 17,437                            | \$ 1,197             | 6.9%                |
| Contracted Services.....         | 4,535                                | 2,226                                | 2,309                | 103.7%              |
| AWR (parent).....                | (134)                                | (962)                                | 828                  | -86.1%              |
| Total income tax expense.....    | \$ 23,035                            | \$ 18,701                            | \$ 4,334             | 23.2%               |

For the year ended December 31, 2010, income tax expense for water and electric services increased by 6.9% to \$18.6 million compared to \$17.4 million for the year ended December 31, 2009 due primarily to an increase in the effective tax rate. The effective tax rate ("ETR") for water and electric services for the year ended December 31, 2010 was 43.2% as compared to a 41.2% ETR applicable to the year ended December 31, 2009. The ETR deviates from the federal statutory rate primarily due to state taxes and changes between book and taxable income that are treated as flow-through adjustments in accordance with regulatory requirements (principally plant-, rate-case- and compensation-related items) and other nondeductible permanent items. Flow-through adjustments increase or decrease tax expense in one period, with an offsetting increase or decrease occurring in another period. Various items such as meals, entertainment, penalties, and certain charitable, lobbying, and political contributions may not be deductible for tax purposes.

Income tax expense for contracted services increased to \$4.5 million compared to \$2.2 million for the year ended December 31, 2009 primarily due to an increase in pretax income. The ETR for contracted services for the year ended December 31, 2010 was 38.7% as compared to a 37.1% ETR applicable to the same period in 2009. The 2010 ETR is higher than the 2009 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.

AWR (parent) receives a tax benefit for expenses incurred at the parent-company level. For year ended December 31, 2009, the taxes recorded at AWR (parent) also include the effect of changes in California law relating to state unitary tax principles during the first quarter of 2009. Management intends to elect, commencing with the 2011 tax year, an alternative apportionment method made available by tax law changes in 2009. As a result of management's intention to apply the alternative method, AWR adjusted its deferred tax balances in the first quarter of 2009 to reflect the expected amount at which it will realize its California deferred taxes consistent with the change in tax law, and refined certain related estimates. This resulted in the recording of a benefit of approximately \$918,000, or \$0.05 per share, during the first quarter of 2009. While the effect of the tax law changes will continue to affect AWR's state taxes, the future effects may be beneficial or detrimental depending on a combination of the profitability of AWR's non-California activities as well as the relative proportion of the factor(s) applied by its apportionment method. Periodically, management will assess its intention to apply the alternative method and will adjust its deferred tax balances accordingly. The consolidated ETR for the year ended December 31, 2010 was approximately 42.6% as compared to 38.9% for the same period in 2009. Absent the \$918,000 tax benefit, the consolidated ETR for the year ended December 31, 2009 would have been 40.8%.

### ***Income from Discontinued Operations***

Net income from discontinued operations for the year ended December 31, 2010 was \$2.1 million, equivalent to \$0.11 per common share on a basic and fully diluted basis, compared to net income of \$157,000 or \$0.01 per common share on a basic and fully diluted basis, for the year ended December 31, 2009, an increase of \$0.10 per common share. The improved performance at CCWC was primarily due to: (i) rate increases approved by the ACC in October 2009 which increased the water margin by \$1.3 million; (ii) a decrease in operating expenses as compared to 2009, including depreciation expense as a result of reporting CCWC as a discontinued operation, resulting in no further depreciation being recorded in accordance with generally accepted accounting principles; and (iii) a loss of \$760,000 recorded in the third quarter of 2009 resulting from a decision issued by the ACC in October 2009 related to a settlement for removal of a well from service, which did not recur in 2010. Income from discontinued operations in 2010 also includes \$426,000, net of tax, in direct legal and consulting costs related to the pending sale of CCWC to EPCOR Water (USA) Inc. The sale is expected to be approved by the ACC in 2011.

**Consolidated Results of Operations — Years Ended December 31, 2009 and 2008 (amounts in thousands):**

|                                                             | Year<br>Ended<br>12/31/2009 | Year<br>Ended<br>12/31/2008 | \$<br>CHANGE | %<br>CHANGE |
|-------------------------------------------------------------|-----------------------------|-----------------------------|--------------|-------------|
| OPERATING REVENUES                                          |                             |                             |              |             |
| Water.....                                                  | \$ 265,197                  | \$ 240,464                  | \$ 24,733    | 10.3%       |
| Electric.....                                               | 28,922                      | 28,424                      | 498          | 1.8%        |
| Contracted services.....                                    | 59,132                      | 42,358                      | 16,774       | 39.6%       |
| Total operating revenues.....                               | 353,251                     | 311,246                     | 42,005       | 13.5%       |
| OPERATING EXPENSES                                          |                             |                             |              |             |
| Water purchased.....                                        | 44,973                      | 45,815                      | (842)        | -1.8%       |
| Power purchased for pumping .....                           | 9,658                       | 9,819                       | (161)        | -1.6%       |
| Groundwater production assessment.....                      | 11,563                      | 10,623                      | 940          | 8.8%        |
| Power purchased for resale.....                             | 12,853                      | 13,616                      | (763)        | -5.6%       |
| Unrealized gain on purchased power contracts.....           | -                           | (1,554)                     | 1,554        | -100.0%     |
| Supply cost balancing accounts.....                         | 12,434                      | (387)                       | 12,821       | -3312.9%    |
| Other operation expenses.....                               | 28,808                      | 29,491                      | (683)        | -2.3%       |
| Administrative and general expenses.....                    | 69,051                      | 61,465                      | 7,586        | 12.3%       |
| Depreciation and amortization.....                          | 31,531                      | 29,510                      | 2,021        | 6.8%        |
| Maintenance.....                                            | 17,012                      | 15,964                      | 1,048        | 6.6%        |
| Property and other taxes.....                               | 12,824                      | 12,074                      | 750          | 6.2%        |
| ASUS construction expenses.....                             | 33,717                      | 23,872                      | 9,845        | 41.2%       |
| Net gain on sale of property.....                           | (15)                        | -                           | (15)         | 100.0%      |
| Total operating expenses.....                               | 284,409                     | 250,308                     | 34,101       | 13.6%       |
| OPERATING INCOME.....                                       | 68,842                      | 60,938                      | 7,904        | 13.0%       |
| OTHER INCOME AND EXPENSES                                   |                             |                             |              |             |
| Interest expense.....                                       | (21,899)                    | (20,877)                    | (1,022)      | 4.9%        |
| Interest income.....                                        | 911                         | 1,832                       | (921)        | -50.3%      |
| Other.....                                                  | 221                         | 70                          | 151          | 215.7%      |
|                                                             | (20,767)                    | (18,975)                    | (1,792)      | 9.4%        |
| INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE | 48,075                      | 41,963                      | 6,112        | 14.6%       |
| Income tax expense.....                                     | 18,701                      | 15,967                      | 2,734        | 17.1%       |
| INCOME FROM CONTINUING OPERATIONS                           | \$ 29,374                   | \$ 25,996                   | \$ 3,378     | 13.0%       |
| INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX      | 157                         | (3,991)                     | 4,148        | -103.9%     |
| NET INCOME.....                                             | \$ 29,531                   | \$ 22,005                   | \$ 7,526     | 34.2%       |
| Basic earnings from continuing operations.....              | \$ 1.62                     | \$ 1.50                     | \$ 0.12      | 8.0%        |
| Basic earnings from discontinued operations.....            | 0.01                        | (0.23)                      | 0.24         | 104.3%      |
|                                                             | \$ 1.63                     | \$ 1.27                     | \$ 0.36      | 28.3%       |
| Diluted earnings from continuing operations.....            | \$ 1.61                     | \$ 1.49                     | \$ 0.12      | 8.1%        |
| Diluted earnings from discontinued operations.....          | 0.01                        | (0.23)                      | 0.24         | 104.3%      |
|                                                             | \$ 1.62                     | \$ 1.26                     | \$ 0.36      | 28.6%       |

Net income from continuing operations for the year ended December 31, 2009 was \$29.4 million, equivalent to \$1.62 and \$1.61 per common share on a basic and fully diluted basis, respectively, compared to \$26.0 million or \$1.50 and \$1.49 per common share on a basic and fully diluted basis, respectively, for the year ended December 31, 2008. Impacting the comparability in the results of the two periods are the following items which increased diluted earnings per share by \$0.12:

- An increase in the water and electric margin of \$13.2 million, or \$0.43 per share, during the year ended December 31, 2009 compared to the same period of 2008 due primarily to: (i) higher water rates approved by the CPUC effective January 1, 2009; (ii) the water margin impact from an increase in the WRAM, net of the MCBA of approximately \$19.5 million as compared to the same period of 2008; and (iii) the recording of \$3.1 million of additional revenues due to the CPUC's approval in April 2009 of the WCMA. These increases were partially offset by lower water consumption of approximately 7% when compared to the same period in 2008.
- An unrealized gain on purchased power contracts in 2008 which increased pretax income by \$1.6 million, or \$0.05 per share. These purchased power contracts expired on December 31, 2008. GSWC began taking delivery of power under new contracts effective January 1, 2009. In May 2009, the CPUC authorized a memorandum account to track unrealized gains and losses. As a result, unrealized gains and losses on these new contracts do not impact earnings.
- A settlement agreement between GSWC and Mirant Energy Trading, LLC, which resulted in the recording of \$1.0 million, or \$0.03 per share, as a reduction to legal costs during the second quarter of 2009. There was no similar gain in 2008.
- An increase of \$12.1 million, or \$0.39 per share in operating expenses, other than supply costs and excluding the Mirant settlement discussed above, at GSWC's water and electric utility businesses for the year ended December 31, 2009. This was due to an increase in pension expenses, labor and other related benefits, an increase in outside services costs, maintenance expense, and higher depreciation and amortization expense. In addition, on February 15, 2010 a settlement was reached between GSWC and two former officers. As a result of the settlement, a pre-tax charge of \$3.8 million for legal and settlement costs was recorded to administrative and general expenses in the fourth quarter of 2009.
- An increase in pretax operating income for contracted services of \$7.3 million, or \$0.24 per share, during the year ended December 31, 2009 due primarily to: (i) an increase in construction projects at FBWS and ODUS, (ii) improved performance at PSUS and ONUS as compared to the prior year, and (iii) an additional \$1.1 million in construction revenues recorded at PSUS in the third quarter of 2009 as a result of a request for an equitable adjustment approved by the U.S. government relating to previously incurred emergency construction costs.
- An increase in interest expense net of interest income of \$1.9 million, or \$0.06 per share, due primarily to: (i) an increase in long-term debt from the issuance of \$40.0 million of notes in March 2009; (ii) GSWC's recording of \$480,000 interest income, during the second quarter of 2008 in connection with revisions to AWR's 2002 income tax return, with no similar gain in 2009; (iii) the recording of \$412,000 of interest expense in the interest rate balancing account approved by the CPUC in July 2009 in the cost of capital proceeding; and (iv) lower interest income in 2009 of \$392,000 accrued in the Aerojet litigation memorandum account balance.
- An increase in the effective tax rate ("ETR") during the year ended December 31, 2009 as compared to the same period in 2008 negatively impacted earnings by \$0.07 per share due primarily to changes between book and taxable income that are treated as flow-through adjustments in accordance with regulatory requirements. This increase in the ETR was partially offset by a tax benefit of \$918,000 recorded in the first quarter of 2009 resulting from new California apportionment laws as well as the refinement of certain related estimates. This increase favorably impacted earnings by \$0.05 per share.
- A decrease of \$0.06 per share due to an increase in the weighted average number of common shares outstanding resulting from the issuance of 1.1 million shares of AWR's Common Shares in a public offering completed in May 2009.

Income from discontinued operations of CCWC for the year ended December 31, 2009 was \$157,000, equivalent to \$0.01 per common share on the basic and fully diluted basis, compared to a loss of \$4.0 million, or \$0.23 per common share on a basic and fully diluted basis, for the year ended December 31, 2008. The increase in diluted earnings per share is primarily due to a goodwill impairment charge of \$7.7 million, or \$0.27 per share, recorded during the fourth quarter of 2008. There was no similar impairment charge in 2009. Excluding the effects of the goodwill impairment charge from 2008, CCWC's diluted earnings decreased by \$0.03 per share primarily due to a decision issued by the ACC in October of 2009 that resulted in the recording of a loss on the settlement for removal of wells for \$760,000.

## ***Operating Revenues***

### **Water**

For the year ended December 31, 2009, revenues from water operations increased by 10.3% to \$265.2 million, compared to \$240.5 million for the year ended December 31, 2008. Contributing to this increase were rate increases approved by the CPUC effective January 1, 2009, which added approximately \$8.3 million to water revenues in 2009. In addition, as a result of the implementation of the WRAM accounts for Regions II and III in late November of 2008 and in Region I's ratemaking areas in September 2009, GSWC recorded an increase of \$21.2 million of additional revenues for the year ended 2009 as compared to the same period in 2008. Furthermore, GSWC recorded a total of \$3.1 million in the WCMA accounts for GSWC's water regions. There also was an increase in water revenues of \$6.4 million due to surcharges approved by the CPUC in effect to recover under-collections in supply costs. These increases were primarily offset by approximately \$13.0 million resulting from a decrease in actual consumption of approximately 7% when compared to the year ended December 31, 2008. Although precipitation was overall lower in 2009 compared to the same period in 2008, water consumption was down due to the continued effects of state-wide customer conservation efforts. In addition, 2008 included approximately \$764,000 of additional revenues approved by the CPUC, which did not recur in 2009.

GSWC's revenue requirement and volumetric revenues will be adopted as part of a GRC every three years. In November 2010, the CPUC approved GSWC's Region II, Region III and the general office GRC for rates in 2010, 2011 and 2012. In December 2010, the CPUC approved GSWC's Region I GRC for rates in 2011 and 2012. GSWC will file a GRC for all three water regions in July of 2011 with rates effective January 2013.

### **Electric**

For the year ended December 31, 2009, revenues from electric operations increased by 1.8% to \$28.9 million compared to \$28.4 million for the year ended December 31, 2008 due primarily to rate increases approved by the CPUC and the implementation of the Base Revenue Requirement Adjustment Mechanism in November 2009.

### **Contracted Services**

Revenues from contracted services are comprised of construction revenues (including renewals and replacements) and management fees for operating and maintaining the water and/or wastewater systems at military bases. For the year ended December 31, 2009, revenues from contracted services increased by \$16.8 million, or 39.6%, to \$59.1 million compared to \$42.4 million for the year ended December 31, 2008 primarily due to higher construction revenues. Construction revenues increased by \$16.1 million primarily related to new construction projects at FBWS and ODUS, which increased construction revenues by \$6.6 million and \$7.8 million, respectively. Construction revenues for the year ended December 31, 2009 at PSUS and ONUS increased \$3.8 million, including an equitable adjustment of \$1.1 million recorded in 2009 for PSUS as previously discussed. Increased construction revenues at these four bases were partially offset by lower construction revenues of \$2.1 million at TUS. Earnings and cash flows from new construction projects may or may not continue in future periods.

Management fees for operating and maintaining the various systems increased by approximately \$600,000. In December 2008, the U.S. government authorized an interim adjustment at FBWS retroactive to October 2008, which increased the monthly water and wastewater fees by 50% and 59%, respectively, pending resolution of FBWS's request for an equitable adjustment due to higher inventory at FBWS than described in the request for proposal. This resulted in an increase of approximately \$877,000 to FBWS' management fees for operating and maintaining the water and wastewater systems for the year ended December 31, 2009 as compared to the same period of 2008. An additional \$933,000 in revenue was generated from management fees for operating and maintaining the water and wastewater systems under the contracts for Fort Jackson and Fort Bragg which commenced during the first quarter of 2008, as a result of a full year of operations in 2009. These increases were partially offset by \$1.3 million in one-time transition revenues for the start up of operations for Fort Jackson and Fort Bragg in 2008.

Registrant relies upon rate approvals by state regulatory agencies in California and Arizona to provide for a return on invested and borrowed capital used to fund utility plant additions, and price redeterminations and equitable adjustments by the U.S. government in order to recover operating expenses and profit margin. If adequate rate relief and price redeterminations and adjustments are not granted in a timely manner, operating revenues and earnings can be negatively impacted.

## 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 (including the cost of natural gas) 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 32.2% and 31.8% of total operating expenses for the years ended December 31, 2009 and 2008, respectively.

The table below provides the amount of increases (decreases), percent changes in supply costs, and margins during the years ended December 31, 2009 and 2008 (amounts in thousands):

|                                                            | Year<br>Ended<br>12/31/2009 | Year<br>Ended<br>12/31/2008 | \$<br>CHANGE | %<br>CHANGE |
|------------------------------------------------------------|-----------------------------|-----------------------------|--------------|-------------|
| WATER OPERATING REVENUES <sup>1</sup>                      | \$ 265,197                  | \$ 240,464                  | \$ 24,733    | 10.3%       |
| WATER SUPPLY COSTS:                                        |                             |                             |              |             |
| Water purchased <sup>1</sup> .....                         | \$ 44,973                   | \$ 45,815                   | \$ (842)     | -1.8%       |
| Power purchased for pumping <sup>1</sup> .....             | 9,658                       | 9,819                       | (161)        | -1.6%       |
| Groundwater production assessment <sup>1</sup> .....       | 11,563                      | 10,623                      | 940          | 8.8%        |
| Water supply cost balancing accounts <sup>1</sup> .....    | 9,296                       | (2,784)                     | 12,080       | -433.9%     |
| TOTAL WATER SUPPLY COSTS                                   | \$ 75,490                   | \$ 63,473                   | \$ 12,017    | 18.9%       |
| WATER MARGIN <sup>2</sup>                                  | \$ 189,707                  | \$ 176,991                  | \$ 12,716    | 7.2%        |
| PERCENT MARGIN - WATER                                     | 71.5%                       | 73.6%                       |              |             |
| ELECTRIC OPERATING REVENUES <sup>1</sup>                   | \$ 28,922                   | \$ 28,424                   | \$ 498       | 1.8%        |
| ELECTRIC SUPPLY COSTS:                                     |                             |                             |              |             |
| Power purchased for resale <sup>1</sup> .....              | \$ 12,853                   | \$ 13,616                   | \$ (763)     | -5.6%       |
| Electric supply cost balancing accounts <sup>1</sup> ..... | 3,138                       | 2,397                       | 741          | 30.9%       |
| TOTAL ELECTRIC SUPPLY COSTS                                | \$ 15,991                   | \$ 16,013                   | \$ (22)      | -0.1%       |
| ELECTRIC MARGIN <sup>2</sup>                               | \$ 12,931                   | \$ 12,411                   | \$ 520       | 4.2%        |
| PERCENT MARGIN - ELECTRIC                                  | 44.7%                       | 43.7%                       |              |             |

- (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 is shown on AWR's Consolidated Statements of Income and totaled \$12,434,000 and (\$387,000) for the years ended December 31, 2009 and 2008, 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. Prior to November 2008, changes in the water resource mix between water supplied from purchased sources and that supplied from GSWC'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 ("MCBA") that allows recovery of supply costs for changes in water supply mix. GSWC implemented the MCBA in late November 2008 for Regions II and III and in September 2009 for Region I's rate-making areas prospectively in connection with the new conservation rate design and the implementation of a WRAM. 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. 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 regulatory asset or liability balancing account (tracked individually for each water ratemaking area).

For the year ended December 31, 2009, 36.9% of GSWC's water supply mix was purchased as compared to 40.1% purchased for the year ended December 31, 2008. However, as noted previously, GSWC implemented the MCBA which eliminates the effects on earnings of changes in the water supply mix. The adopted percentages of purchased water for the year ended December 31, 2009 at Regions I, II and III were 24.6%, 61.7% and 43.7%, respectively, as compared to actual purchased water of 24.0%, 41.0% and 41.5%, respectively, for 2009. Region I's supply mix consists primarily of pumped water. The variance in Regions II's and Region III's actual mix compared to the mix approved by the CPUC resulted in an over-collection in the MCBA account. This caused an overall decrease in the water margin percentage to 71.5% for 2009 compared to 73.6% in 2008 since GSWC no longer receives any benefit from a more favorable supply mix than that approved by the CPUC.

Purchased water costs for the year ended December 31, 2009 decreased by 1.8% to \$45.0 million as compared to \$45.8 million in 2008. The decrease in purchased water costs was due to lower customer usage, partially offset by higher water rates charged from wholesale suppliers.

For the year ended December 31, 2009, power purchased for pumping decreased to \$9.7 million, compared to \$9.8 million for 2008. This was due to lower customer demand, partially offset by increases in supplier rates. There were also changes in the actual supply mix, as discussed above. Groundwater production assessments were higher by 8.8% due primarily to increases in assessment rates (pump tax rates) levied against groundwater production, effective July 2009. In particular, Region II's average pump tax rates increased by approximately 19% or \$1.1 million between the two periods. These increases in groundwater production assessments were partially offset by lower customer demand. The MCBA tracks the increases in pump tax rates for future recovery in water rates.

An increase of \$12.1 million in the water supply cost balancing account provision during the year ended December 31, 2009 as compared to the same period in 2008 was primarily caused by: (i) a \$6.4 million increase in the amortization of the water supply cost balancing accounts for surcharges currently in effect; (ii) the recording of \$1.7 million in the MCBA accounts; (iii) a net decrease of \$3.7 million of under-collections in 2009 (only related to Region I prior to its implementation of the MCBA on September 1, 2009) compared to 2008, and (iv) 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, 2009, the cost of power purchased for resale to customers in GSWC's BVES division decreased by 5.6% to \$12.9 million compared to \$13.6 million for the year ended December 31, 2008 reflecting lower customer demand. In addition, GSWC began receiving power under a new purchased power contract on January 1, 2009. The main product under the new contract provides for 13 MWs of electric energy at a fixed price of \$63.75 per MWh during 2009 as compared to \$74.65 during 2008. The decrease in the price of purchased power is reflected in the electric supply cost balancing account resulting in no change to the dollar margin for electric services.

#### ***Unrealized Gain on Purchased Power Contracts***

Pursuant to the accounting guidance for derivatives, the unrealized gain on purchased power contracts during 2008 represented gains recorded for GSWC's purchased power agreements. There was a \$1.6 million pretax unrealized gain on purchased power contracts for the year ended December 31, 2008. These contracts terminated on December 31, 2008 and GSWC began taking delivery under new purchased power contracts in January 2009. In May 2009, the CPUC issued a final decision approving the contract and authorizing a memorandum account to track unrealized gains and losses. Accordingly, a cumulative unrealized loss of \$7.3 million as of December 31, 2009 has been included in the memorandum account. This unrealized loss did not impact earnings.

### ***Other Operation Expenses***

The primary components of other operation expenses include payroll, materials and supplies, chemicals and water treatment, and outside service costs of operating the regulated systems of Registrant's continuing water business, 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, 2009 and 2008, other operation expenses by segment consisted of the following (amounts in thousands):

|                                     | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|-------------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....                 | \$ 23,067                            | \$ 22,647                            | \$ 420               | 1.9%                |
| Electric Services.....              | 2,324                                | 2,230                                | 94                   | 4.2%                |
| Contracted Services.....            | 3,417                                | 4,614                                | (1,197)              | -25.9%              |
| Total other operation expenses..... | \$ 28,808                            | \$ 29,491                            | \$ (683)             | -2.3%               |

For the year ended December 31, 2009, other operation expenses for water and electric services increased by \$514,000, or 2.1%, primarily due to higher operation labor and related benefits of \$502,000, and an increase of \$12,000 in other operation expenses.

Contracted services experienced decreases in other operation expenses of \$1.2 million primarily due to transition costs (some of which exceeded non-recurring transition revenues recovered pursuant to the terms of contracts executed by ASUS) of \$1.0 million incurred during the year ended December 31, 2008 as a result of the commencement of the operation of water and wastewater systems at Fort Jackson and Fort Bragg. There was also a decrease of approximately \$593,000 in outside services costs partly attributable to payments to a subcontractor that provided wastewater services to certain of ASUS' subsidiaries in 2008. 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, 2009, many of these services were performed internally, some of which are recorded in labor costs within maintenance expense. These decreases were partially offset by an increase of \$370,000 relating to operation labor and benefits, and an increase of \$26,000 in other miscellaneous operation expenses.

### ***Administrative and General Expenses***

Administrative and general expenses include payroll expenses related to administrative and general functions, the related 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, 2009 and 2008, administrative and general expenses by segment, including AWR (parent), consisted of the following (amounts in thousands):

|                                                | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|------------------------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....                            | \$ 50,624                            | \$ 43,785                            | \$ 6,839             | 15.6%               |
| Electric Services.....                         | 7,312                                | 6,857                                | 455                  | 6.6%                |
| Contracted Services.....                       | 11,028                               | 10,675                               | 353                  | 3.3%                |
| AWR (parent).....                              | 87                                   | 148                                  | (61)                 | -41.2%              |
| Total administrative and general expenses..... | \$ 69,051                            | \$ 61,465                            | \$ 7,586             | 12.3%               |

For the year ended December 31, 2009, administrative and general expenses increased by \$6.8 million in water services compared to the year ended December 31, 2008 due primarily to: (i) an increase of \$3.0 million in pension expenses resulting from a reduction in the fair value of plan assets in 2008 caused by market conditions at the time; (ii) a settlement

agreement reached with two former officers of GSWC which resulted in a pretax charge of \$3.8 million during the fourth quarter of 2009 for legal and settlement costs; and (iii) an increase of \$1.2 million in labor and other employee benefits. These increases were partially offset by \$590,000 of additional compensation expense incurred in 2008 relating to an agreement executed by GSWC with respect to the resignation of a GSWC officer effective September 26, 2008. This expense did not recur in 2009. There was also a decrease in travel costs of \$285,000 and a decrease of \$286,000 in miscellaneous administrative and general expenses.

For the year ended December 31, 2009, administrative and general expenses increased by \$455,000 in electric services compared to the year ended December 31, 2008 due primarily to: (i) a \$382,000 increase in labor costs and pension costs; (ii) a \$347,000 increase in outside consulting, legal and other services resulting from the current general rate case and the new purchased power contract; (iii) an increase in general rate case costs of \$363,000 not being recovered in customer rates related to BVES's rate case; (iv) an increase of \$336,000 in allocation of costs from the corporate headquarters to BVES; and (v) an increase of \$27,000 in other administrative expenses. These increases were partially offset by the recording of \$1.0 million as a reduction to previously incurred legal costs in connection with a settlement agreement reached with Mirant Energy Trading, LLC, as previously discussed.

There was an increase of \$353,000 in administrative and general expenses for contracted services due primarily to an increase of \$1.2 million in labor costs and related employee benefits due largely to personnel added to operate and maintain the systems at Fort Jackson and Fort Bragg, which began operation in the first quarter of 2008, as well as additional support staff added at ASUS during the latter part of 2008 and in 2009. This increase was partially offset by a decrease in legal and consulting services of \$823,000 resulting from reduced need for such services relating to filings with the U.S. government and costs incurred in 2008 related to the liquidated damages claim at FBWS, which was settled in February 2009. There was also a decrease of \$24,000 in other miscellaneous expenses.

### ***Depreciation and Amortization***

For the years ended December 31, 2009 and 2008, depreciation and amortization by segment consisted of the following (amounts in thousands):

|                                          | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|------------------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....                      | \$ 28,609                            | \$ 26,788                            | \$ 1,821             | 6.8%                |
| Electric Services.....                   | 2,258                                | 2,209                                | 49                   | 2.2%                |
| Contracted Services.....                 | 664                                  | 513                                  | 151                  | 29.4%               |
| Total depreciation and amortization..... | \$ 31,531                            | \$ 29,510                            | \$ 2,021             | 6.8%                |

For the year ended December 31, 2009, depreciation and amortization expense for water and electric services increased by \$1.9 million to \$30.9 million compared to \$29.0 million for year ended December 31, 2008 reflecting, among other things, \$69.1 million of additions to utility plant during 2008. 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 CPUC will be recovered through water and electric rates.

There was an increase in depreciation and amortization expense for contracted services due primarily to the addition of fixed assets associated with taking over the assets of ASUS' former subcontractor for wastewater services at FBWS, ODUS, and TUS and the purchase of wastewater cleaning vehicles at four of ASUS' military base operations.

### ***Maintenance***

For the years ended December 31, 2009 and 2008, maintenance expense by segment consisted of the following (amounts in thousands):

|                          | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|--------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....      | \$ 13,440                            | \$ 12,626                            | \$ 814               | 6.4%                |
| Electric Services.....   | 878                                  | 805                                  | 73                   | 9.1%                |
| Contracted Services..... | 2,694                                | 2,533                                | 161                  | 6.4%                |
| Total maintenance.....   | \$ 17,012                            | \$ 15,964                            | \$ 1,048             | 6.6%                |

For the year ended December 31, 2009, maintenance expense for water services increased by \$814,000 to \$13.4 million compared to \$12.6 million for the year ended December 31, 2008 due primarily to maintenance on GSWC's wells, water supply and distribution facilities at Regions II and III. GSWC's maintenance expense at its three water regions increased by \$806,000 during 2009 compared to 2008.

There was an increase of \$73,000 in maintenance expenses for electric services related to the 8.4 MW natural gas-fueled generation plant.

An increase of \$161,000 in contracted services maintenance expense was due primarily to increased maintenance costs of \$236,000 at FBWS and ODUS, resulting from higher internal labor costs associated with wastewater services performed by employees that were provided by a subcontractor prior to February 2008. These increases were partially offset by decreased maintenance costs at PSUS, which incurred higher emergency maintenance costs in 2008 as a result of the age and condition of the infrastructure upon commencement of operations at Fort Jackson in South Carolina. PSUS submitted a request for equitable adjustment based upon the additional costs incurred as a result of the age and condition of the infrastructure at Fort Jackson which is still pending resolution.

### ***Property and Other Taxes***

For the years ended December 31, 2009 and 2008, property and other taxes by segment, consisted of the following (amounts in thousands):

|                                     | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|-------------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water Services.....                 | \$ 10,855                            | \$ 10,403                            | \$ 452               | 4.3%                |
| Electric Services.....              | 713                                  | 530                                  | 183                  | 34.5%               |
| Contracted Services.....            | 1,256                                | 1,141                                | 115                  | 10.1%               |
| Total property and other taxes..... | \$ 12,824                            | \$ 12,074                            | \$ 750               | 6.2%                |

For the year ended December 31, 2009, property and other taxes for water and electric services increased by \$635,000, due to higher payroll taxes and franchise fees, partially offset by lower property taxes as a result of a tax refund of \$488,000 due to lower reassessed property values.

Property and other taxes were higher in contracted services due to an increase in payroll taxes resulting from an increase in the number of employees.

### **ASUS Construction Expenses**

For the year ended December 31, 2009, ASUS's construction expenses were \$33.7 million, increasing \$9.8 million compared to the same period in 2008 due primarily to new construction projects at FBWS and ODUS, which had increases of \$5.2 million and \$5.7 million, respectively, as compared to 2008. These increases were partially offset by a \$1.6 million decrease in construction expense at TUS and a \$688,000 decrease at PSUS. For the year ended December 31, 2008, PSUS incurred expenses of \$935,000 in emergency construction and \$379,000 in anticipated losses associated with certain construction projects at Fort Jackson. In 2009, emergency costs were lower and additional anticipated losses were not incurred. Construction costs at ONUS increased by \$1.2 million as compared to the same period in 2008. Construction activity will vary from depending upon the availability of capital for infrastructure improvements at the various military bases.

### **Net Gain on Sale of Property**

For the year ended December 31, 2009, Registrant recorded a pre-tax gain of \$15,000 on the sale of property in the water services segment. There was no similar gain in the same period of 2008.

### **Interest Expense**

For the years ended December 31, 2009 and 2008, interest expense by segment, including AWR (parent) consisted of the following (amounts in thousands):

|                                  | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|----------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water and Electric Services..... | \$ 21,398                            | \$ 19,651                            | \$ 1,747             | 8.9%                |
| Contracted Services.....         | 358                                  | 894                                  | (536)                | -60.0%              |
| AWR (parent).....                | 143                                  | 332                                  | (189)                | -56.9%              |
| Total interest expense.....      | \$ 21,899                            | \$ 20,877                            | \$ 1,022             | 4.9%                |

Overall, interest expense increased in 2009 reflecting an increase in long-term debt, partially offset by lower interest rates and lower short-term borrowings. On March 10, 2009, GSWC issued a senior note in the amount of \$40.0 million to CoBank due March 10, 2019 with an interest rate of 6.7%. In addition, the CPUC authorized GSWC to establish an interest rate balancing account to track interest costs of new debt in July 2009. This balancing account tracks any difference between the incremental cost of debt included in the cost of capital decision and the actual cost of debt for any long-term debt issued by GSWC from the effective date of the final decision. This difference totaled \$412,000 for the year ended December 31, 2009 and was included in the balancing account, increasing interest expense. These increases were partially offset by a decrease in short-term cash borrowings. Average bank loan balances outstanding under the AWR credit facility for the year ended December 31, 2009 were approximately \$33.7 million, as compared to an average of \$57.4 million during the same period of 2008. The average interest rate on short-term borrowings for the year ended December 31, 2009 was 1.18% as compared to an average of 3.32% during 2008.

### ***Interest Income***

For the years ended December 31, 2009 and 2008, interest income by segment, including AWR (parent) consisted of the following (amounts in thousands):

|                                  | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|----------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water and Electric Services..... | \$ 898                               | \$ 1,774                             | \$ (876)             | -49.4%              |
| Contracted Services.....         | 7                                    | 6                                    | 1                    | 16.7%               |
| AWR (parent).....                | 6                                    | 52                                   | (46)                 | -88.5%              |
| Total interest income.....       | \$ 911                               | \$ 1,832                             | \$ (921)             | -50.3%              |

Interest income decreased by \$921,000 for the year ended December 31, 2009 due to the recording in 2008 of \$480,000 in interest income in connection with the proposed settlement of Registrant's tax refund claim, with no similar income in 2009. In addition, lower interest rates for the year ended December 31, 2009 as compared to the same period of 2008 resulted in a decrease in interest income, including a decrease of \$392,000 in interest accrued on the uncollected balance of the Aerojet litigation memorandum account authorized by the CPUC.

### ***Other***

For the years ended December 31, 2009 and 2008, Registrant recorded other income of \$221,000 and \$70,000, respectively, as a result of Registrant's equity interest in an investment. In 2009, Registrant established a Rabbi Trust for the SERP Plan. Investment income earned in this Trust of \$109,000 was also included in other income during 2009.

### ***Income Tax Expense***

For the years ended December 31, 2009 and 2008, income tax expense by segment, including AWR (parent), consisted of the following (amounts in thousands):

|                                  | <b>Year<br/>Ended<br/>12/31/2009</b> | <b>Year<br/>Ended<br/>12/31/2008</b> | <b>\$<br/>CHANGE</b> | <b>%<br/>CHANGE</b> |
|----------------------------------|--------------------------------------|--------------------------------------|----------------------|---------------------|
| Water and Electric Services..... | \$ 17,437                            | \$ 16,931                            | \$ 506               | 3.0%                |
| Contracted Services.....         | 2,226                                | (726)                                | 2,952                | -406.6%             |
| AWR (parent).....                | (962)                                | (238)                                | (724)                | 304.2%              |
| Total income tax expense.....    | \$ 18,701                            | \$ 15,967                            | \$ 2,734             | 17.1%               |

For the year ended December 31, 2009, income tax expense for water and electric services increased by 3.0% to \$17.4 million compared to \$16.9 million for the year ended December 31, 2008 due primarily to an increase in pretax income. In addition, the ETR for water and electric services for the year ended December 31, 2009 increased to 41.2 % as compared to a 38.3% ETR applicable for the year ended December 31, 2008. The ETR deviates from the combined federal and state statutory rate primarily due to state taxes and changes between book and taxable income that are treated as flow-through adjustments in accordance with regulatory requirements (principally plant, rate case and compensation-related items). 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 increased to \$2.2 million compared to a tax benefit of \$726,000 for the year ended December 31, 2008 due primarily to an increase in pretax income. The ETR for contracted services for the year ended December 31, 2009 was 37.1% as compared to a 38.6% ETR applicable to the year ended December 31, 2008.

AWR (parent) receives a tax benefit for expenses incurred at the parent-company level. For the year ended December 31, 2009, the taxes recorded at AWR (parent) also include the effect of a change in California law during the first quarter of 2009. On February 20, 2009, California's governor signed two bills into law that amended and added several new provisions to California's Revenue and Taxation Code. One of the provisions in these bills changed the manner by which most taxpayers may compute the portion of their income derived from multiple jurisdictions that is subject to California taxation. During the first quarter of 2009, AWR applied the change in tax law resulting from enactment of the bills based on its understanding of the legislature's intent, which is to permit taxpayers to apply an alternative apportionment method commencing with the 2011 tax year. On October 11, 2009, California's governor signed a bill into law that conformed the new provision's language to the legislature's intent, consistent with AWR's understanding of that intent. As a result of management's intention to apply the alternative method, AWR adjusted its deferred tax balances in the first quarter of 2009 to reflect the expected amount at which it will realize its California deferred taxes consistent with the change in tax law, and refined certain related estimates. This resulted in the recording of a benefit of approximately \$918,000, or \$0.05 per share, during the first quarter of 2009. While the effect of the tax law change will continue to affect AWR's state taxes, the future effects may be beneficial or detrimental depending on a combination of the profitability of AWR's non-California activities as well as the relative proportion of the factor(s) applied by its apportionment method. Periodically, management will assess its intention to apply the alternative method and will adjust its deferred tax balances accordingly. Absent this tax benefit, the consolidated ETR for the year ended December 31, 2009 would have been 40.8%.

#### ***Income (Loss) from Discontinued Operations***

Income from discontinued operations of CCWC for the year ended December 31, 2009 was \$157,000, compared to a loss of \$4.0 million for the year ended December 31, 2008. During 2008, a charge of \$7.7 million was recorded to reflect the impairment of goodwill in accordance with accounting guidance related to goodwill and other intangible assets, for an impact of \$4.6 million, net of tax. During the 2008 impairment analysis, Registrant determined that revenue growth of CCWC was likely to be slower than originally projected due to down turns in overall economic conditions and lower than anticipated rate increases. The impairment analysis performed for 2009 did not indicate impairment for the \$3.3 million in goodwill for CCWC, and as such, no corresponding charge was recorded for 2009. Excluding the effects of the goodwill impairment charge from 2008, CCWC's diluted earnings decreased by \$0.03 per share primarily due to a decision by the ACC on October 8, 2009, that ordered CCWC to treat the settlement proceeds relating to removal of wells as a reduction to rate base. As a result, a loss of \$760,000 was recorded in 2009.

## **Critical Accounting Policies and Estimates**

Critical accounting policies and estimates are those that are important to the portrayal of AWR's financial condition, results of operations and cash flows, and require the most difficult, subjective or complex judgments of AWR's management. The need to make estimates about the effect of items that are uncertain is what makes these judgments difficult, subjective and/or complex. Management makes subjective judgments about the accounting and regulatory treatment of many items. The following are accounting policies that are critical to the financial statements of AWR. For more information regarding the significant accounting policies of Registrant, see Note 1 of "Notes to Financial Statements" included in Part II, Item 8 in Financial Statements and Supplementary Data.

**Accounting for Rate Regulation** — Because the Registrant operates extensively in a regulated business, it is subject to the authoritative guidance for accounting for the effects of certain types of regulation for its GSWC and CCWC subsidiaries. Application of this guidance requires accounting for certain transactions in accordance with regulations adopted by the regulatory commissions of the states in which operations are conducted. Utility companies defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the ratemaking process in a period different from the period in which they would have been reflected in income by an unregulated company. These deferred regulatory assets and liabilities are then reflected in the income statement in the period in which the same amounts are reflected in the rates charged for service. Regulation and the effects of regulatory accounting have the most significant impact on the financial statements. When either GSWC or CCWC file for adjustments to rates, the capital assets, operating costs and other matters are subject to review, and disallowances may occur. In the event that a portion of the Registrant's operations is no longer subject to the accounting guidance for the effects of certain types of regulation, Registrant is required to write-off related regulatory assets and liabilities that are not specifically recoverable and determine if other assets might be impaired. If a regulatory commission determines that a portion of the Registrant's assets are not recoverable in customer rates, Registrant is required to determine if it has suffered an asset impairment that would require a write-down in the assets' valuation. At December 31, 2010, the consolidated balance sheet included regulatory assets, less regulatory liabilities, of approximately \$136.0 million. Management continually evaluates the anticipated recovery of regulatory assets, liabilities, and revenues subject to refund and will provide for allowances and/or reserves as deemed necessary. In the event that Registrant's assessment as to the probability of the inclusion in the ratemaking process is incorrect, the associated regulatory asset or liability will be adjusted to reflect the change in our assessment or the impact of regulatory approval of rates.

As permitted by the CPUC, GSWC maintains water and electric supply cost balancing accounts to track under and over collections of revenues designed to recover such costs. These under-collections and over-collections are included in AWR's regulatory assets, net of regulatory liabilities and totaled approximately \$13.7 million as of December 31, 2010. Costs are recorded as expenses and charged to balancing accounts when such costs are incurred. The balancing accounts are reversed when such costs are recovered through rate adjustments or through refunds of previously incurred costs. The amounts included in these accounts primarily relate to increases in amounts charged to GSWC for purchased water, purchased power, and pump taxes that are different from amounts incorporated into the rates approved by the CPUC. GSWC accrues interest on its supply cost balancing accounts at the prevailing rate for 90-day commercial paper. The under-collections and over-collections are recorded as regulatory assets and liabilities in accordance with accounting guidance for the effects of certain types of regulation on a monthly basis. Reviews by the CPUC occur at the time of the filing of a rate case or an advice letter. Management continually evaluates the anticipated recovery of these under-collections and will provide for allowances and/or reserves as deemed necessary. In the event that Registrant's assessment as to the probability of the inclusion in the ratemaking process is incorrect, the associated regulatory asset will be adjusted to reflect the change in our assessment or change as a result of regulatory approval. Recent adjustments to the regulatory assets based on amounts approved by the CPUC have not been material.

With the adoption of the WRAM, GSWC also implemented the MCBA and 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. The balances in the WRAM and MCBA assets and liabilities accounts will fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of the WRAM is netted against the MCBA over- or under-collection for the corresponding rate-making area and is interest bearing at the current 90-day commercial paper rate. Under the current CPUC decision, when the net amount at the end of the calendar year for Regions II, III or any of the Region I ratemaking areas achieves a pre-determined level (i.e., at least 2.5 percent over- or under-recovery of the approved revenue requirement), GSWC will seek approval from the CPUC to refund or collect the balance in the accounts. In March 2011, GSWC filed for recovery of its 2010 WRAM/MCBA balances. Based on CPUC guidelines, recovery periods relating to the 2010 balances will range between 12 and 36 months. In

September 2010, GSWC, along with other California water utilities, filed an application with the CPUC to modify the recovery period of the WRAM/MCBA accounts to 24 months or less. A decision on this application is expected in 2011.

In March 2010, GSWC filed an advice letter with the CPUC for recovery of the Region II and III WRAM, net of the MCBA and supply cost balancing accounts, of \$18.3 million. A surcharge was put in place in March 2010 which is expected to recover the amounts accumulated as of December 31, 2009 in Regions II and III's WRAM, net of MCBA and supply cost balancing accounts. In April and May 2010, surcharges were implemented for recovery of \$2.1 million of the Region I WRAM accounts, net of the MCBA. For the year ended December 31, 2010, approximately \$6.2 million of surcharges were billed to customers to decrease previously incurred under-collections in the WRAM, net of MCBA balancing accounts. As of December 31, 2010, GSWC has a net aggregated regulatory asset of \$30.9 million which is comprised of a \$49.9 million under-collection in the WRAM accounts and \$19.0 million over-collection in the MCBA accounts. Management will evaluate the anticipated recovery of this under-collection and will provide for allowances and/or reserves as deemed necessary.

Effective November 2, 2009, with the adoption of the Base Revenue Requirement Adjustment Mechanism ("BRRAM") account, GSWC began recording the difference between what is billed to its electric customers and that which is authorized by the CPUC. The variance between adopted electric revenue and actual billed revenue will be recorded as a component of electric revenue with an offsetting entry to a current asset or liability balancing account. The variance amount may be positive or negative and represents amounts that will be billed or refunded to electric customers in the future and is interest bearing at the current 90-day commercial paper rate. When the amount of the under or over collection is equal to or greater than 5 percent of the revenue requirement established for the previous twelve months, GSWC intends to seek approval from the CPUC to refund or collect the balance in the account. As of December 31, 2010, GSWC has a regulatory asset of \$1.9 million related to the BRRAM. GSWC intends to file an advice letter with the CPUC for recovery of the balance as of December 31, 2010. Management will evaluate the anticipated recovery of this under-collection and will provide for allowances and/or reserves as deemed necessary.

**Revenue Recognition** — GSWC and CCWC record water and electric utility operating revenues when the service is provided to customers. Operating revenues include unbilled revenues that are earned (service has been provided) but not billed by the end of each accounting period. The historical actual unbilled revenues are calculated, from each customer billing record that was billed after the end of the accounting period, based on the number of days that the service had been provided. Unbilled revenues are recorded for both monthly and bi-monthly customers. The unbilled revenues are based on customer billings subsequent to year end which are used to compile the actual unbilled consumption as of the year end reporting period. In addition, with the adoption of the WRAM and BRRAM, GSWC records the difference between what is billed to its regulated customers and that which is authorized by the CPUC.

Revenues from contract operations and maintenance agreements are recognized when services have been rendered to the customers under such agreements. Revenues from firm, fixed-price construction contracts are recognized based on the percentage-of-completion method of accounting. In accordance with GAAP, revenue recognition under the percentage-of-completion method requires us to estimate the progress toward completion on a contract in terms of efforts (such as costs incurred) or in terms of results achieved (such as units constructed). We have consistently applied these approaches of measuring progress on each of our firm, fixed-price construction projects. These approaches are used because management considers it to be the best available measure of progress on these contracts. Revenues from cost-plus-profit contracts are recognized on the basis of costs incurred during the period plus the profit earned, measured by the cost-to-cost method. Construction costs include all direct material and labor costs charged by subcontractors and those indirect costs related to contract performance, such as indirect labor, supplies, and tools. The factors considered in including such costs in revenues and expenses are that ASUS and/or its subsidiaries: (i) are the primary obligor in these arrangements with the U.S. government; (ii) have latitude in establishing pricing; and (iii) bear credit risk in the collection of receivables from the U.S. government. Administrative and general costs are charged to expense as incurred. Precontract costs are generally expensed unless it is probable that we will be awarded the specific anticipated contract, in which case ASUS defers such costs. Capitalized precontract costs have been immaterial to date. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, change orders and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

**Income Taxes** — Registrant's income tax calculations require estimates due principally to the regulated nature of the operations of GSWC and CCWC, the multiple states in which Registrant operates, and potential future tax rate changes. Registrant uses the asset and liability method of accounting for income taxes under which deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or

settled. Changes in regulatory treatment, or significant changes in tax-related estimates, assumptions or law, could have a material impact on the financial position and results of operations of Registrant. As a regulated utility, GSWC treats certain temporary differences as flow-through adjustments in computing its income tax expense consistent with the income tax approach approved by the CPUC for ratemaking purposes. Flow-through adjustments increase or decrease tax expense in one period, with an offsetting increase or decrease occurring in another period. Giving effect to these temporary differences as flow-through adjustments typically results in a greater variance between the effective tax rate and the statutory federal income tax rate in any given period than would otherwise exist if GSWC were not required to account for its income taxes as a regulated enterprise. As of December 31, 2010, Registrant's total amount of unrecognized tax benefits was zero. See Note 10 (Income Taxes) of *Notes to Consolidated Financial Statements*.

***Impairment of Goodwill and Other Intangible Assets*** — In accordance with accounting guidance on goodwill and other intangible assets, goodwill is tested for impairment at least annually and more frequently if circumstances indicate that it may be impaired. Annually, we perform our testing for impairment of goodwill as of December 31. At December 31, 2010, ASUS has \$1.1 million of goodwill reflected under Other Property and Investments and CCWC has \$3.3 million included in Assets of discontinued operations in Registrant's consolidated balance sheets. Goodwill impairment testing is performed at the operating segment (or "reporting unit") level. The goodwill impairment model is a two-step process. First, it requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. Registrant uses the terminal multiple valuation method in estimating fair value which assumes a business will be sold at the end of the projection period at a specific terminal multiple. Earnings and discounted cash flows were developed from Registrant's internal forecasts. Additionally, management must make an estimate of a weighted average cost of capital to be used as a discount rate, which takes into account certain risk and size premiums, long-term bond yields, and the capital structure of the industry. Changes in these projections or estimates could result in a reporting unit either passing or failing the first step in the guidance on goodwill and other intangible assets impairment model, which could significantly change the amount of any impairment ultimately recorded.

Registrant also considers other qualitative and quantitative factors, including terminal multiples used in the water industry, the regulatory environment in which the reporting unit operates that can significantly impact future earnings and cash flows, and the effects of the volatile current economic environment. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. In this process, a fair value for goodwill is estimated, based in part on the fair value of the applicable reporting unit's assets and liabilities used in the first step, and are compared to its carrying value. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. The amount by which carrying value exceeds fair value represents the amount of goodwill impairment.

As a result of its impairment testing as of December 31, 2008, Registrant determined that CCWC's goodwill had been impaired resulting in a \$7.7 million charge during the fourth quarter of 2008. If changes in circumstances or events occur, or estimates and assumptions which were used in the impairment test change, Registrant might be required to record additional impairment charges for goodwill. As of December 31, 2010, ASUS has \$1.1 million of goodwill which may also be at risk for potential impairment if future price redeterminations and/or equitable adjustments are not granted by the U.S. government. As of December 31, 2010, CCWC has \$3.3 million of goodwill remaining. The impairment analysis performed for 2010 did not indicate any additional impairment for goodwill of CCWC or ASUS.

Registrant also reviews regulatory assets for the continued application of accounting for the effects of certain types of regulation, and assesses the recovery of such assets for any potential write-downs.

***Impairment of Long-Lived Assets and Loss Contingencies*** — Periodically, Registrant reviews for possible impairment of its utility plant in service in accordance with accounting guidance for regulated entities accounting for abandonments and disallowances of plant costs. In November 2010, the CPUC issued its final decision on the Region II, Region III and general office rate case, which resulted in impairment charges related to certain capital projects that were disallowed.

Registrant records loss contingencies when an unfavorable outcome of a matter is deemed to be probable and the loss is reasonably estimable. Registrant will accrue the most likely amount when such an amount can be reasonably estimated or, at least the minimum of the range of probable loss when a range of probable loss can be estimated. Management determines the likelihood of an unfavorable outcome based on many factors such as the nature of the matter, available defenses, progress of the matter, views and opinions of legal counsel and other advisors, among others.

On February 15, 2007, the CPUC issued a subpoena to GSWC in connection with an investigation of certain work orders and charges paid to a specific contractor used previously by GSWC for numerous construction projects estimated to total \$24.0 million. The CPUC's investigation focuses on whether GSWC was overcharged for these construction projects

and whether these overcharges were approved in customer rates. The construction projects completed by this specific contractor related primarily to work on water treatment and pumping plants which have been placed in service and are used and useful. In June 2007, GSWC received notification from the CPUC that it was instituting an audit to examine for the period 1994 to the present, GSWC's policies, procedures, and practices throughout its three water regions regarding the granting or awarding of construction contracts or jobs.

Should the CPUC investigation result in a disallowance of certain previously capitalized costs, such costs, and potentially any return earned on such costs, may be required to be refunded to customers, resulting in a charge to operating income. In addition to the disallowance of previously capitalized costs and the return earned on such costs, the CPUC also has the authority to assess fines and penalties. Although it does not believe a disallowance or penalty is justified, and reserving all rights, management believes it prudent to reserve for a probable loss related to this matter.

As a result of management's assessment of the CPUC subpoena and the CPUC's final decision on the Region II, Region III and general office rate case, Registrant recorded a charge for the impairment of assets and loss contingencies totaling \$16.6 million in 2010. These reserve estimates may be adjusted as additional information becomes known. Any increases in estimated reserves for additional disallowances, refunds to customers, assessments or fines, if imposed, could have a material adverse effect on AWR and GSWC.

***Pension and Post-Retirement Medical Benefits*** - Registrant's pension and post-retirement medical benefit obligations and related costs are calculated using actuarial concepts within the framework of accounting guidance for employer's accounting for pensions and post-retirement benefits other than pensions. Two critical assumptions, the discount rate and the expected return on plan assets, are important elements of expense and/or liability measurement. We evaluate these critical assumptions annually. Other assumptions include the healthcare cost trend rate and employee demographic factors such as retirement patterns, mortality, turnover and rate of compensation increase. The discount rate enables Registrant to state expected future cash payments for benefits as a present value on the measurement date. The guideline for setting this rate is a high-quality, long-term corporate bond rate. Registrant's discount rates were determined by considering the average of pension yield curves constructed using a large population of high quality corporate bonds. The resulting discount rates reflect the matching of plan liability cash flows to the yield curves. A lower discount rate increases the present value of benefit obligations and increases periodic pension expense. Conversely, a higher discount rate decreases the present value of benefit obligations and decreases periodic pension expense. To determine the expected long-term rate of return on the plan assets, Registrant considers the current and expected asset allocation, as well as historical and expected returns on each plan asset class. A lower expected rate of return on plan assets will increase pension and post-retirement expense. The long-term expected return on plan assets was 7.0% in 2010 and 2009, for both the pension and post-retirement medical plans.

***Pension Plan*** - For the pension plan obligation, Registrant decreased the discount rate to 5.55% as of December 31, 2010 from 6.05% as of December 31, 2009 to reflect market interest rate conditions at December 31, 2010. At December 31, 2010, the pension plan included a \$118.8 million projected benefit obligation ("PBO"), a \$99.3 million accumulated benefit obligation ("ABO") and \$90.2 million in plan assets stated at fair value. Total net period pension cost for 2010 was \$6.9 million. A 25 basis point decrease in the assumed discount rate would have increased total net periodic pension expense for 2010 by approximately \$496,000 or 7.2%, and would have increased the PBO and ABO at December 31, 2010 by \$4.6 million, or approximately 3.8%. A 25 basis point decrease in the long-term return on pension plan asset assumption would have increased 2010 pension cost by approximately \$188,000 or 2.7%.

In addition, changes in the fair value of plan assets will impact future pension cost and the Plan's funded status. Volatile market conditions have affected the value of AWR's trust established to fund its future long-term pension benefits. Any reductions in the value of plan assets will result in increased future expense, an increase in the underfunded position and increased future contributions.

In November 2010, the CPUC approved the implementation of a two way pension balancing account, which tracks the differences between forecasted annual pension expense adopted in rates and the actual annual expense to be recorded by GSWC in 2010, 2011 and 2012 in accordance with the accounting guidance for pension costs. These differences will be recorded as a regulatory asset or liability in those years for any shortfalls or excesses. As of December 31, 2010, Registrant recorded a \$1.8 million regulatory asset in the pension balancing account.

Funding requirements for qualified defined benefit pension plans are determined by government regulations. Registrant contributes the minimum required contribution as determined by government regulations or the forecasted annual pension cost authorized by the CPUC. In accordance with this funding policy, for 2011 the pension contribution is expected to be approximately \$6.6 million. The 2011 pension cost is estimated to be approximately \$7.0 million. As previously discussed, the difference between the forecasted annual pension costs in rates and the actual pension costs are included in the two-way pension balancing account. The Pension Protection Act of 2006 was signed into law in August 2006. In establishing the contribution amount, Registrant has considered the potential impact of funding rule changes under this Act.

In January 2011, the Board of Directors approved an amendment to the existing defined benefit pension plan, closing the plan to new employees hired after December 31, 2010. Employees hired or rehired after December 31, 2010 will be eligible to participate in a new defined contribution plan. Under the new plan, Registrant will provide a contribution of 5.25% of eligible pay each pay period into investment vehicles offered by the plan's trustee. Participants will be fully vested in this plan once the employee attains three years of service. Employees hired before January 1, 2011 will continue to participate in and accrue benefits under the terms of the defined benefit plan.

Post-Retirement Plan - The discount rate for the post-retirement medical benefit obligation was decreased to 5.20% as of December 31, 2010 from 5.85% as of December 31, 2009. At December 31, 2010, Registrant's post-retirement medical benefit plan reflected a \$12.1 million PBO and \$7.0 million in plan assets stated at fair value. Total expense for this plan was \$980,000 for 2010. A 25 basis point decrease in the assumed discount rate would have increased the net periodic cost for 2010 by a nominal amount and would increase the PBO and ABO at December 31, 2010 by approximately \$311,000 or approximately 2.6%. A 25 basis point decrease in the long-term return on post-retirement plan asset assumption would have increased 2010 post-retirement medical expense by approximately \$14,000. Furthermore, increasing the health care cost trend rate by one percentage point would increase the PBO and ABO as of December 31, 2010 by \$1.4 million and annual service and interest costs by \$78,000. Decreasing the health care cost trend rate by one percentage point would decrease the PBO and ABO as of December 31, 2010 by \$1.2 million and annual service and interest costs by \$116,000.

## **Liquidity and Capital Resources**

### **AWR**

Registrant's regulated business (primarily that of GSWC), is capital intensive and requires considerable capital resources. A portion of these capital resources are provided by internally generated cash flows from operations. When necessary, Registrant obtains funds from external sources in the capital markets and through bank borrowings. Access to external financing on reasonable terms depends on the credit ratings of AWR and GSWC and current business conditions, including that of the water utility industry in general as well as conditions in the debt or equity capital markets. Registrant also has access to a revolving credit facility that is currently utilized to support operations. On May 27, 2010, AWR entered into the Third Amendment to the Amended and Restated Credit Agreement in order to extend the term of the syndicated revolving credit facility to May 27, 2013 from June 3, 2010. The maximum amount that may be borrowed under this facility was decreased from \$115.0 million to \$100.0 million. AWR may, under the terms of the Amended and Restated Credit Agreement, elect to increase the aggregate bank commitments by up to \$40.0 million. The aggregate effective amount that may be outstanding under letters of credit has been increased to \$25.0 million from \$20.0 million. The rates (spreads to LIBOR) at which AWR may borrow under this facility have been increased due to market conditions. The lenders have consented to modifications to certain of the covenants in the Amended and Restated Credit Agreement requested by AWR. As of December 31, 2010, an aggregate of \$60.9 million in cash borrowings were included in current liabilities and \$11.0 million of letters of credit were outstanding under this facility. As of December 31, 2010, AWR had \$28.1 million available to borrow under the credit facility.

In July 2010, Standard & Poor's Ratings Services ("S&P") upgraded its corporate credit rating on AWR and GSWC from 'A' with a positive outlook to 'A+' with a stable outlook. S&P debt ratings range from AAA (highest rating possible) to D (obligation is in default). Securities ratings are not recommendations to buy, sell or hold a security and are subject to change or withdrawal at any time by the rating agency. Pursuant to the syndicated credit facility agreement, the upgrade to "A+ stable" resulted in a reduced interest rate spread on the facility from 125 basis points to 120 basis points. Registrant believes that AWR's sound capital structure and "A+ stable" credit rating, combined with its financial discipline, will enable AWR to access the debt and/or equity markets. However, unpredictable financial market conditions in the future may limit its access or impact the timing of when to access the market, in which case, Registrant may choose to temporarily reduce its capital spending. Capital expenditures were approximately \$79.1 million during 2010, an increase of \$1.6 million over the same period last year. Capital expenditures were used for infrastructure replacements and improvements. Capital expenditures during 2010 were funded primarily by internally generated cash, short-term borrowings and advances and contributions from developers. Registrant's capital expenditure budget for 2011 is estimated at approximately \$75 - \$80 million.

AWR filed a Registration Statement on August 10, 2009 with the Securities and Exchange Commission ("SEC") for the sale from time to time of debt and equity securities. As of December 31, 2010, \$115.0 million was available for issuance under this Registration Statement.

AWR funds its operating expenses and pays dividends on its outstanding common shares primarily through dividends from GSWC and through proceeds from equity issuances not invested in subsidiaries. The ability of GSWC to pay dividends to AWR is restricted by California law. Under restrictions of the California tests, at December 31, 2010, approximately \$141.1 million was available from the retained earnings of GSWC to pay dividends to AWR. GSWC is also subject to contractual restrictions on its ability to pay dividends. GSWC's maximum ability to pay dividends is restricted by certain Note Agreements to the sum of \$21.0 million plus 100% of consolidated net income from various 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, \$298.8 million was available to pay dividends to AWR as of December 31, 2010. GSWC is also prohibited from paying dividends if, after giving effect to the dividend, its total indebtedness to capitalization ratio (as defined) would be more than 0.6667 to 1. Dividends in the amount of \$19.6 million, \$19.4 million, and \$13.2 million were paid to AWR by GSWC during the years ended December 31, 2010, 2009 and 2008, respectively.

Registrant has paid common dividends for over 75 consecutive years. On February 1, 2011, AWR declared a regular quarterly dividend of \$0.260 per Common Share. The dividend, totaling approximately \$4.8 million, was paid on March 1, 2011 to common shareholders of record at the close of business on February 14, 2011. In 2010, 2009 and 2008, AWR paid quarterly dividends to shareholders, totaling approximately \$19.3 million, or \$1.04 per share, \$18.1 million or \$1.010 per share, and \$17.3 million or \$1.000 per share, respectively. AWR's ability to pay cash dividends on its Common Shares outstanding depends primarily upon cash flows from GSWC. AWR presently intends to continue paying quarterly cash dividends in the future, on or about March 1, June 1, September 1 and December 1, subject to earnings and financial condition, regulatory requirements and such other factors as the Board of Directors may deem relevant.

The Small Business Jobs Act of 2010 and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended 50% bonus depreciation for qualifying property through 2012 and created a new 100% bonus depreciation for qualifying property placed in service between September 9, 2010 and December 31, 2011. As a result of these law changes, Registrant's current tax expense for 2010 reflects a benefit of approximately \$16.2 million and estimates that its 2011 current tax expense will be reduced by approximately \$24.1 million. Although these law changes reduce AWR's current taxes payable, it does not reduce its total income tax expense or effective tax rate. In addition, the CPUC is currently evaluating the establishment of a memorandum account that would track the revenue effects associated with these law changes, which may reduce future revenue requirements in future rate case proceedings.

AWR anticipates that interest costs will increase in future periods due to the need for additional external capital to fund its construction program, and market interest rate increases. AWR believes that costs associated with capital used to fund construction at its regulated subsidiaries will continue to be recovered in water and electric rates charged to customers.

#### Cash Flows from Operating Activities:

Registrant's future cash flows from operating activities will be affected by utility regulation; infrastructure investment; maintenance expenses; inflation; compliance with environmental, health and safety standards; production costs; customer growth; per customer usage of water and electricity; weather and seasonality; and required cash contributions to pension and post-retirement plans. In addition, future cash flows from non-regulated subsidiaries will depend on new business activities, including military base operations and the construction of new and/or replacement infrastructure at the different military bases, timely redetermination of prices and requests for equitable adjustments of prices and timely collection of payments from the U.S. government.

Cash flows from operating activities have generally been sufficient to meet operating requirements and a portion of capital expenditure requirements. As previously discussed, AWR has access to a \$100.0 million revolving credit facility that is currently utilized to support operations. This revolving credit facility expires in May 2013.

Net cash provided by operating activities was \$53.8 million for the year ended December 31, 2010 as compared to \$72.6 million for the same period ended December 31, 2009. The decrease of \$18.8 million was primarily attributable to an 8.4% decrease in water consumption by GSWC's water customers as compared to 2009. The reduction in water usage reduces cash flow from operating activities and increases the need for short-term bank borrowings. The increase in other regulatory assets includes the WRAM which represents the revenue difference between what is billed to GSWC's water customers and that which is authorized by the CPUC. Surcharges have been implemented in 2010 and are expected to be in place through 2011 to recover the revenue shortfall tracked in the WRAM. Cash flows from operating activities for ASUS also decreased, primarily as a result of an increase in receivables for work performed on behalf of other prime contractors on the military bases in which ASUS operates.

#### Cash Flows from Investing Activities:

Net cash used in investing activities was \$78.2 million for the year ended December 31, 2010, compared to \$77.4 million for the same period in 2009. The increase reflected higher capital expenditures at GSWC which was partially offset by \$817,000 in proceeds from sale of property by GSWC in 2010.

Registrant intends to invest capital prudently to provide essential services to its regulated customer base, while working with its regulators to have the opportunity to earn a fair rate of return on investment. Registrant's infrastructure investment plan consists of both infrastructure renewal programs, where infrastructure is replaced, as needed, and major capital investment projects, where new water treatment and delivery facilities are constructed. The capital expenditures budget for 2011 is expected to be approximately \$75 - \$80 million. Projected capital expenditures and other investments are subject to periodic review and revision to reflect changes in economic conditions and other factors.

#### Cash Flows from Financing Activities:

Registrant's financing activities include primarily: (i) the issuance of Common Shares, long-term debt and bank borrowings; (ii) the repayments of long-term debt and notes payable to banks, primarily funded through the operations of its wholly owned subsidiary, GSWC; (iii) proceeds from stock option exercises; and (iv) the payment of dividends on Common Shares. In order to finance new infrastructure, Registrant also receives customer advances for and contributions in aid of construction (net of refunds). Short-term borrowings under Registrant's revolving credit line are used to fund capital expenditures until long-term financing is arranged.

Net cash provided by financing activities was \$28.3 million for the year ended December 31, 2010 as compared to net cash used of \$749,000 for the same period in 2009. The increase in cash provided by financing activities is primarily due to a \$43.5 million increase in notes payable to banks to fund operations partially offset by dividend payments of \$19.3 million during 2010. In 2009, AWR received net proceeds of \$35.8 million from the issuance of Common Shares and GSWC received \$39.8 million from the issuance of long-term debt. The proceeds were used to pay down short-term borrowings (notes payable to banks), which decreased cash flows from financing activities by \$57.3 million, and for dividend payments for shareholders totaling \$18.1 million.

### **GSWC**

GSWC funds the majority of its operating expenses, payments on its debt, and dividends on its outstanding common shares and a portion of its construction expenditures through internal sources. Internal sources of cash flow are provided primarily by retention of a portion of earnings from operating activities. Internal cash generation is influenced by factors such as weather patterns, environmental regulation, litigation, changes in supply costs and regulatory decisions affecting GSWC's ability to recover these supply costs, timing of rate relief, increases in maintenance expenses and capital expenditures. As of December 31, 2010, GSWC had \$100.0 million available for issuance of debt securities under a Registration Statement filed with the SEC.

GSWC relies on external sources, including equity investments and short-term borrowings from AWR, and long-term debt to help fund a portion of its construction expenditures. GSWC plans to issue public debt in 2011, depending on market conditions. Proceeds from the debt issuance are expected to be used to pay down short-term borrowings from AWR and other long-term debt. On May 26, 2010, the Board of Directors approved the issuance of eight additional GSWC Common Shares to AWR for \$20.0 million. Proceeds from the issuance were used to pay down GSWC's intercompany borrowings due to AWR. In addition, GSWC receives advances and contributions from customers, home builders and real estate developers to fund construction necessary to extend service to new areas. Advances for construction are refundable generally at rates ranging from 10% to 22% of the revenues received from the installation for which funds were advanced or in equal annual installments, generally over 40 years. Amounts which are no longer refundable are reclassified to contributions in aid of construction. Utility plant funded by advances and contributions is excluded from rate base. Generally, GSWC depreciates contributed property and amortizes contributions in aid of construction at the composite rate of the related property.

As is often the case with public utilities, GSWC's current liabilities generally exceed its current assets. Management believes that internally-generated funds along with the short-term borrowings under AWR's existing credit facility and the proceeds from the issuance of long-term debt and common shares will be adequate to provide sufficient working capital to enable GSWC to maintain normal operations and to meet its capital and financing requirements pending recovery of costs in rates.

In December 2010, the CPUC issued a decision on GSWC's Region I general rate case for 2011 and 2012. The decision authorized, among other things, approximately \$18.5 million of capital projects to be filed for revenue recovery with advice letters when those projects are completed. During the time that projects are under development and construction, GSWC may accrue an allowance for funds used during construction ("AFUDC") on the accrued expenditures to offset the cost of financing project construction. The advice letter projects are expected to be done over a two year period.

#### *Cash Flows from Operating Activities:*

Net cash provided by operating activities was \$49.0 million for the year ended December 31, 2010 as compared to \$62.8 million for the same period in 2009. This decrease is due primarily to lower water consumption by customers of approximately 8.4% as compared to 2009 consumption. The reduction in water usage reduces cash flow from operating activities and increases the need for short-term bank borrowings. The increase in other regulatory assets includes the WRAM which represents the revenue difference between what is billed to GSWC's water customers and that which is authorized by the CPUC. Surcharges have been implemented in 2010 and are expected to be in place through 2011 to recover the revenue shortfall tracked in the WRAM. The timing of cash receipts and disbursements related to other working capital items also affected the changes in net cash provided by operating activities.

#### *Cash Flows from Investing Activities:*

Net cash used in investing activities increased to \$76.1 million for the year ended December 31, 2010 as compared to \$74.6 million for the same period in 2009. This increase was due to higher capital expenditures consistent with GSWC's 2010 capital improvement plan. GSWC is expected to incur capital expenditures in 2011 of approximately \$75 - \$80 million, primarily for upgrades to its water supply and distribution facilities and for computer software and related implementation.

In addition, GSWC received \$817,000 in proceeds from the sale of property in its water regions.

### Cash Flows from Financing Activities:

Net cash provided by financing activities was \$27.6 million for the year ended December 31, 2010 as compared to \$9.0 million for the same period in 2009. The increase in net cash provided by financing activities was primarily due to: (i) the issuance of eight additional shares of GSWC Common Shares to AWR for \$20.0 million, and; (ii) a \$25.4 million increase in intercompany borrowings during 2010. In 2009, GSWC received net proceeds of \$39.8 million from the issuance of long-term debt. The proceeds were used to pay down inter-company borrowings, which decreased cash flows from financing activities by \$10.6 million, and fund capital expenditures.

### **CCWC and ASUS**

CCWC funds the majority of its operating expenses, payments on its debt and dividends, if any, through internal operating sources or short-term borrowings from AWR. CCWC also relies on external sources, including long-term debt, contributions-in-aid-of-construction, advances for construction and install-and-convey advances, to fund the majority of its construction expenditures. ASUS funds its operating expenses primarily through internal operating sources and investments by or loans from AWR. ASUS, in turn, provides funding to its subsidiaries.

### **Contractual Obligations, Commitments and Off Balance Sheet Arrangements**

Registrant has various contractual obligations which are recorded as liabilities in the consolidated financial statements. Other items, such as certain purchase commitments and operating leases are not recognized as liabilities in the consolidated financial statements, but are required to be disclosed.

In addition to contractual maturities, Registrant has certain debt instruments that contain annual sinking fund or other principal payments. Registrant believes that it will be able to refinance debt instruments at their maturity through public issuance, or private placement, of debt or equity. Annual payments to service debt are generally made from cash flow from operations.

The following table reflects Registrant's contractual obligations and commitments to make future payments pursuant to contracts as of December 31, 2010. All obligations and commitments are obligations and commitments of AWR unless otherwise noted.

| (\$ in thousands)                    | Payments/Commitments Due by Period (1) |                  |            |           |               |
|--------------------------------------|----------------------------------------|------------------|------------|-----------|---------------|
|                                      | Total                                  | Less than 1 Year | 1-3 Years  | 4-5 Years | After 5 Years |
| Notes/Debentures (2)                 | \$ 173,100                             | \$ —             | \$ 3,100   | \$ —      | \$ 170,000    |
| Private Placement Notes (3)          | 108,000                                | —                | —          | —         | 108,000       |
| Tax-Exempt Obligations (4)           | 18,402                                 | 104              | 226        | 6,257     | 11,815        |
| Other Debt Instruments (5)           | 713                                    | 272              | 254        | 98        | 89            |
| Total GSWC Long-Term Debt            | 300,215                                | 376              | 3,580      | 6,355     | 289,904       |
| Chaparral City Water Co. Debt (6)    | 5,645                                  | 345              | 755        | 835       | 3,710         |
| Total AWR Long-Term Debt             | \$ 305,860                             | \$ 721           | \$ 4,335   | \$ 7,190  | \$ 293,614    |
| Interest on Long-Term Debt (7)       | \$ 354,243                             | \$ 21,135        | \$ 42,160  | \$ 41,727 | \$ 249,221    |
| Advances for Construction (8)        | 82,929                                 | 3,160            | 6,270      | 6,251     | 67,248        |
| Purchased Power Contracts (9)        | 23,864                                 | 8,993            | 14,871     | —         | —             |
| Capital Expenditure Commitments (10) | 26,107                                 | 26,107           | —          | —         | —             |
| Water Purchase Agreements (11)       | 53,964                                 | 17,367           | 32,656     | 418       | 3,523         |
| Operating Leases (12)                | 7,737                                  | 3,270            | 3,542      | 925       | —             |
| Employer Contributions (13)          | 19,180                                 | 6,563            | 12,617     | —         | —             |
| Chaparral City Water Co. (14)        | 535                                    | 134              | 267        | 134       | —             |
| SUB-TOTAL                            | \$ 568,559                             | \$ 86,729        | \$ 112,383 | \$ 49,455 | \$ 319,992    |
| Other Commitments (15)               | 68,821                                 |                  |            |           |               |
| TOTAL                                | \$ 943,240                             |                  |            |           |               |

(1) Excludes dividends and facility fees.

(2) The Notes and Debentures are issued under an Indenture dated as of September 1, 1993, as amended in December 2008. The Notes and Debentures do not contain any financial covenants that Registrant believes to be material or cross default provisions.

(3) Private Placement Notes in the amount of \$28 million were issued pursuant to the terms of note purchase agreements

with substantially similar terms. These agreements contain restrictions on the payment of dividends, minimum interest coverage requirements, a maximum debt to capitalization ratio and a negative pledge. Pursuant to the terms of these agreements, GSWC must maintain a minimum interest coverage ratio of two times interest expense. In addition, senior notes in the amount of \$40 million were issued in October 2005, and again for \$40 million in March 2009 to CoBank. Under the terms of these senior notes, GSWC may not incur any additional debt or pay any distributions to its shareholders if, after giving effect thereto, it would have a debt to capitalization ratio in excess of 0.6667 to 1 or a debt to Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") ratio of more than 8 to 1. GSWC is in compliance with these covenant provisions as of December 31, 2010. GSWC does not currently have any outstanding mortgages or other encumbrances on its properties.

(4) Consists of obligations under a loan agreement supporting \$7.8 million in outstanding debt issued by the California Pollution Control Financing Authority, \$6.0 million in obligations supporting \$6.0 million in certificates of participation issued by the Three Valleys Municipal Water District and \$4.6 million of obligations incurred by GSWC with respect to its 500 acre-foot entitlement to water from the State Water Project ("SWP"). These obligations do not contain any financial covenants believed to be material to Registrant or any cross default provisions. GSWC's obligations with respect to the certificates of participation issued by the Three Valleys Municipal Water District are supported by a letter of credit issued by Wells Fargo Bank. In regards to its SWP entitlement, GSWC has entered into agreements with various developers for 422 acre-feet, in the aggregate, of its 500 acre-foot entitlement to water from the SWP.

(5) Consists of \$346,000 outstanding under a fixed rate obligation incurred to fund construction of water storage and delivery facilities with the Three Valleys Municipal Water District, \$268,000 outstanding under a variable rate obligation incurred to fund construction of water delivery facilities with the Three Valleys Municipal Water District and an aggregate of \$99,000 outstanding under capital lease obligations. These obligations do not contain any financial covenants believed to be material to Registrant or any cross default provisions.

(6) Consists of \$5.6 million of outstanding obligations under a loan agreement supporting Industrial Development Revenue Bonds. The loan agreement contains provisions that establish a maximum of 65% debt in the capital structure of CCWC, limits cash distributions when the percentage of debt in the capital structure of CCWC exceeds 55% and requires a debt service coverage ratio of two times interest expense for CCWC. As previously discussed, on June 7, 2010, AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. to sell all of the common shares of CCWC for a total purchase price of \$35.0 million, including the assumption of these Industrial Development Revenue Bonds.

(7) Consists of expected interest expense payments based on the assumption that Registrant's long-term debt remains outstanding until maturity. Current interest rates were used to estimate expected interest expense payments on variable rate long-term debt.

(8) Advances for construction represent annual contract refunds to developers for the cost of water systems paid for by the developers. The advances are generally refundable in equal annual installments over periods of time ranging from 10 to 40-year periods, or at rates ranging from 10% to 22% of the revenue received from the installation for which funds were advanced. Included in the \$82.9 million is \$4.6 million related to CCWC.

(9) Consists of purchased power contracts executed in October 2008 with Shell Energy North America (US), LP ("Shell") that began providing power to BVES effective January 1, 2009 at a fixed cost over three and five year terms depending on the amount of power and period during which the power will be purchased under the contracts.

(10) Consists of noncancelable commitments primarily for capital projects under signed contracts at GSWC. Most of ASUS' capital commitments of approximately \$30.0 million will be funded by the U.S. government.

(11) Water purchase agreements consist of: (i) contracts with various governmental entities to purchase imported water for an aggregate remaining commitment of \$48.4 million, which expire on an agreement by agreement basis commencing in 2011 through 2013 (GSWC intends to renew the terms of these contracts upon expiration of the agreements); (ii) a remaining amount of \$2.2 million under an agreement with the City of Claremont to lease water rights that were ascribed to the City as part of the Six Basins adjudication (the initial term expires in 2028 with an option to renew this agreement for 10 more years), and (iii) an aggregate amount of \$3.4 million of other water purchase commitments with other third parties. In some cases, the amount of the commitment is estimated based on current rates per acre-foot of water purchased. These rates may be changed annually.

(12) Reflects Registrant's future minimum payments under noncancelable operating leases.

(13) Consists of Registrant's minimum required contribution under the Employee Retirement Income Security Act (ERISA) to its pension plan for years 2011 through 2013. These amounts are estimates and are subject to change based on, among other things, the limits established for federal tax deductibility (pension plan), and the significant impact that returns on plan assets and changes in discount rates have on such amounts.

(14) CCWC has a long-term water supply contract with the Central Arizona Conservation District (the "District") through September 2033, and is entitled to take 8,909 acre-feet of water per year from CAP. There is an annual charge based on the

amount of CCWC's entitlement. This charge does not depend upon the amount of water delivered. The rate for this charge is set by the District and is subject to annual increases. The estimated remaining commitment under this contract is \$535,000 as of December 31, 2010.

(15) Other commitments consist of: (i) a \$100.0 million syndicated revolving credit facility, of which \$60.9 million was outstanding as of December 31, 2010; (ii) a \$2.9 million asset retirement obligation that reflects principally the retirement of wells, which by law need to be properly capped at the time of removal; (iii) \$296,000 with respect to a \$6,296,000 irrevocable letter of credit issued by Wells Fargo Bank to support the certificates of participation of Three Valleys Municipal Water District (the other \$6.0 million is reflected under tax-exempt obligations); (iv) irrevocable letters of credit in an aggregate amount of \$540,000 for the deductible in Registrant's business automobile insurance policy; (v) an irrevocable letter of credit in the amount of \$585,000 as security for the purchase of power, under an energy scheduling agreement with Automated Power Exchange and (vi) an irrevocable letter of credit in the amount of \$3.6 million pursuant to a settlement agreement with Edison to cover GSWC's commitment to pay the settlement amount. All of the letters of credit are issued pursuant to the syndicated revolving credit facility. The syndicated revolving credit facility contains restrictions on prepayments, disposition of property, mergers, liens and negative pledges, indebtedness and guaranty obligations, transactions with affiliates, minimum interest coverage requirements, a maximum debt to capitalization ratio, and a minimum debt rating. Pursuant to the Credit Agreement, AWR must maintain a minimum interest coverage ratio of 3.25 times interest expense, a maximum total funded debt ratio of 0.65 to 1.00 and a minimum debt rating of Baa3 or BBB-.

In January 2006, ASUS, entered into a water purchase agreement to acquire 5,000 acre-feet of water rights from Natomas for a base price of \$2,500 per acre-foot of water payable in payments contingent on achievement of specific milestones and events. Because the contingencies for the purchase of this water have not been met, this agreement has not been included in the table above.

In October 2009, GSWC entered into an agreement with the California Department of Health ("CDPH") whereby CDPH agreed to loan GSWC up to \$9.0 million under the American Recovery and Reinvestment Act. Proceeds of the loan will be used to reimburse GSWC for the costs to convert customers in GSWC's Cordova water system from non-metered service to metered service by retrofitting approximately 7,400 water meters. The loan bears interest at a rate of 2.5% and is payable over 20 years following completion of the conversion project. Pursuant to the agreement, as reimbursements are filed, GSWC will issue letters of credit to CDPH equal to 80% of the amount loaned to GSWC (up to an aggregate of \$7.2 million). As of December 31, 2010, GSWC had expended \$2.6 million for retrofitting of the water meters and included in construction work in progress. On February 11, 2011, a request for reimbursement was filed with the CDPH for \$1.7 million of the incurred costs. GSWC intends to submit requests for reimbursement of the remaining amount, along with the additional costs incurred during 2011, to CDPH throughout 2011. As of December 31, 2010, no letters of credit had been issued to CDPH as no requests for reimbursement had been filed with CDPH as of that time. Work on the meter project is estimated to be completed in 2011.

### **Off-Balance Sheet Arrangements**

As noted above, Registrant has various contractual obligations which are recorded as liabilities in the consolidated financial statements. Other items, such as certain purchase commitments and operating leases are not recognized as liabilities in the consolidated financial statements, but are required to be disclosed. Except for those disclosed above in the table, Registrant does not have any other off-balance sheet arrangements.

### **Effects of Inflation**

The rates of GSWC and CCWC are established to provide recovery of costs and a fair return on shareholders' investment. Recovery of the effects of inflation through higher water rates is dependent upon receiving adequate and timely rate increases. However, authorized rates charged to customers are usually based on a forecast of expenses and capital costs for GSWC and on historical expenses and capital costs for CCWC. Rates may lag increases in costs caused by inflation. During periods of moderate to low inflation, as has been experienced for the past several years, the effects of inflation on operating results have not been significant. Furthermore, in California, the CPUC allows the use of projections for a future test year in general rate cases which reduces the impact of inflation to the extent that GSWC's inflation forecasts are accurate.

For the Military Utility Privatization Subsidiaries, under the terms of the contracts with the U.S. government, the contract price is subject to price redetermination two years after commencement of operations and every three years thereafter to the extent provided in each of the contracts. These price redeterminations include adjustments to reflect changes in operating conditions, as well as inflation in costs. Like GSWC and CCWC, recovery of the effects of inflation is dependent upon receiving adequate and timely price redeterminations. ASUS has experienced and continues to experience delays in the redetermination of prices at the various bases.

## **Climate Change**

### **Water:**

Based on historical data for greenhouse gas (“GHG”) emissions generated from its water operations, GSWC has developed a baseline carbon footprint. GSWC intends to compare this baseline to the GHG emissions generated by its water operations annually as part of monitoring our carbon footprint and making efforts to reduce it. GSWC will begin voluntary reporting of its 2010 emissions to the Climate Registry in 2011. GSWC’s efforts to reduce its carbon footprint for water operations will focus on power used for pumping water and GSWC’s vehicle fleet.

In addition, as part of the planning process, GSWC will continue to assess the possible impact climate change may have on its water supply and operations.

### **Electric:**

As part of the Global Warming Solutions Act of 2006, the California Air Resources Board (“CARB”) has promulgated the Mandatory Reporting of GHG Emissions Regulation and the Climate Change Scoping Plan to reduce GHG’s. These rules apply to electric generating facilities and retail providers. BVES is required to report its emissions of GHG’s in 2011 for 2010 emissions. Registrant believes that CARB will adopt regulations applicable to the energy sector starting in 2012 based on measures set forth in CARB’s Change Scoping Plan.

GSWC’s BVES division is also required to comply with the CPUC’s emission performance standards regarding GHG emissions. Under these standards, GSWC must file an annual attestation with the CPUC stating that all new long-term commitments for base load generation to serve California customers are with power plants that have emissions no greater than a combined cycle gas turbine plant, or 1,100 pounds of carbon dioxide per megawatt-hour. The terms of BVES’s purchased power contracts with Shell are less than 5 years, so these contracts are not subject to CPUC GHG emission standards. However, the CPUC only permits a one-time extension of existing contracts. As a result, GSWC anticipates that BVES will need to enter into new contracts meeting the CPUC’s emission limitations to replace the Shell Energy North America (US) (“Shell”), LP base load contracts in 2012.

## **Bear Valley Electric Service of GSWC**

As of December 31, 2010, GSWC has accrued \$10.3 million in under-collected power costs. GSWC is authorized to include up to a weighted annual energy purchase cost of \$77 per MWh each year in its electric supply cost balancing account. To the extent that actual weighted average annual costs for power purchased exceeds the \$77 per MWh amount, GSWC is not be able to include these amounts in its balancing account and such amounts must be expensed. BVES began receiving power under a purchased power contract with Shell on January 1, 2009. The main product under these contracts provides for 13 MWs of electric energy at a fixed price of \$67.85 per MWh during 2010 as compared to \$63.75 per MWh during 2009. The reduction in the actual price of purchased power helps decrease the under-collection balance in the electric supply cost balancing account.

### ***Power Supply Arrangements at GSWC’s Bear Valley Electric Service Area***

Most of the electric energy sold by GSWC to customers in its BVES area is purchased from others. During the California energy crisis of 2000 and 2001, GSWC entered into a forward purchase contract with Mirant Marketing for 15 MWs of electric energy at a price of \$95 per MWh beginning April 1, 2001 through December 31, 2006 to stabilize our purchased energy costs for the electric division. The contract with Mirant Marketing had physical delivery requirements and hence did not require derivative accounting treatment. However, in an attempt to take advantage of the lower energy prices in 2002, GSWC also entered into blended and extended purchased power contracts effective November 2002, which expired on December 31, 2008. As required by the accounting guidance on derivatives, gains and losses on these contracts affected GSWC’s earnings.

The Shell contracts are also subject to the accounting guidance on derivatives, and require mark-to-market derivative accounting. The CPUC has authorized GSWC to establish a regulatory asset and liability memorandum account to offset the entries required by the accounting guidance on derivatives. Accordingly, all unrealized gains and losses generated from the new purchased power contract are deferred on a monthly basis into a non-interest bearing regulatory memorandum account that tracks the changes in fair value of the derivative throughout the term of the contracts. Gains and losses on the Shell contract do not impact earnings.

In addition to the purchased power contracts, GSWC buys additional energy to meet peak demand and sells surplus power as needed. The average cost of power purchased, including the transactions in the spot market, was approximately \$66.00 per MWh for the year ended December 31, 2010 as compared to \$60.21 per MWh for the same period of 2009. GSWC’s average energy costs are impacted by pricing fluctuations on the spot market.

### ***Generation Facility***

As a means of meeting the increasing demands for energy, GSWC constructed a natural gas-fueled 8.4 MW generation facility that was placed into service in 2005.

The average summer load in BVES' customer service area has been approximately 15 MWs. The average winter load has been 21 MWs with a winter peak of approximately 44 MWs when the snowmaking machines at the ski resorts are operating.

### **Construction Program**

Registrant's businesses require significant annual capital expenditures. GSWC maintains an ongoing water distribution main replacement program throughout its customer service areas based on the age and type of distribution system materials, priority of leaks detected, remaining productive life of the distribution system and an underlying replacement schedule. In addition, GSWC upgrades its electric and water supply facilities in accordance with industry standards, local requirements and CPUC requirements. As of December 31, 2010, GSWC has unconditional purchase obligations for capital projects of approximately \$26.1 million. In addition, GSWC is expected to incur capital expenditures in 2011 of approximately \$75 - \$80 million primarily for upgrades to its water supply and distribution facilities as well as for computer software and related implementation. During the years ended December 31, 2010, 2009 and 2008, GSWC had capital expenditures of \$77.0 million, \$74.6 million, and \$73.1 million, respectively. A portion of these capital expenditures is funded by developers through either advances, which must be repaid, or contributions in aid of construction, which are not required to be repaid.

CCWC's capital budget for 2011 anticipates capital expenditure of approximately \$625,000, compared to capital expenditures of \$688,000, \$1.5 million, and \$2.6 million in 2010, 2009 and 2008, respectively.

ASUS is expected to incur capital expenditures in 2011 of approximately \$39.7 million, over \$38.0 of which will be funded by the U.S. government. During the years ended December 31, 2010, 2009 and 2008, ASUS had capital expenditures of \$1.4 million, \$1.4 million and \$1.3 million, respectively. In certain circumstances, the U.S. government may request that ASUS finance the cost of selected construction projects. ASUS will consider financing such projects. The terms of any such financing, including the interest rate, will be determined on a case-by-case basis.

## **Contracted Services**

The timely receipt of price redeterminations continues to be critical in order for ASUS to recover increasing costs for operating and maintaining the water and/or wastewater systems at the military bases. In addition, higher expenses from the corporate office and ASUS headquarters allocated to the Military Utility Privatization Subsidiaries were not contemplated at the time the contracts with the U.S. government were negotiated and may 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, unless otherwise agreed to by the parties to a contract. In the event that ASUS is managing more assets at specific military bases than were included in the U.S. government's Request for Proposal or if the assets are in substandard condition, ASUS is permitted to file, and has filed, a Request for Equitable Adjustment ("REA").

Below is a summary of price redetermination and requests for equitable adjustment filings by ASUS subsidiary.

- FBWS – In connection with the inventory settlement with the U.S. government reached in January 2010, FBWS and the government agreed to waive the first and second price redeterminations for Fort Bliss required under the original 50-year contract. The third price redetermination is scheduled to be filed in 2012.
- TUS –The first price redetermination for Andrews Air Force Base was filed in December 2007. In June 2010, TUS received notification from the U.S. government that its price redetermination filing was deficient. TUS is currently in discussions with the government on the resolution of the first price redetermination. Pending such resolution, the U.S. government approved a retroactive adjustment of \$1.0 million during the third quarter of 2010 resulting in approximately \$700,000 of additional O&M revenues and pretax operating income, and \$300,000 of renewal and replacement costs. A prospective 18.9% increase in the contract rates is also in effect on an interim basis pending finalization of the price redetermination.
- ODUS – In June 2010, ODUS received notification from the U.S. government that its first price redetermination filings for the Virginia bases were deficient. ODUS received a contract modification in February 2011 resolving the O&M portion of the first price redetermination for one of its two contracts which may result in a refund to the government of \$235,000 (the majority of which was reflected in deferred revenue as of the end of 2010). ODUS is still in discussions with the U.S. government on the resolution of the first price redetermination for the other contract. An interim increase of 16.9% has been in effect for this contract since 2008.
- PSUS – PSUS filed an REA in the second quarter of 2009 with the U.S. government in connection with costs incurred in response to an emergency sanitary sewer overflow at Fort Jackson in South Carolina. In September 2010, the government approved the REA, resulting in \$689,000 in additional construction revenues and pretax operating income recorded in the third quarter of 2010. PSUS also filed an REA in connection with the substandard condition of the inventory assumed at Fort Jackson as compared to what was presented in the government's Request for Proposal. Resolution of this REA is expected in 2011. Finally, the first price redetermination for Fort Jackson is expected to be filed in the second quarter of 2011. An interim increase of 3.4% is currently in effect.
- ONUS - In April 2009 and December 2010, ONUS filed REAs with the government in connection with costs associated with initial system deficiency work. Resolution of this request is expected in 2011. The first price redetermination for ONUS is expected to be filed in the second quarter of 2011. An interim increase of 3.6% is currently in effect.

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 to help offset increased costs and provide Registrant the opportunity to continue to generate positive operating income at its Military Utility Privatization Subsidiaries. As of December 31, 2010, ASUS has \$1.1 million of goodwill, which may be at risk for potential impairment if requested price redeterminations and equitable adjustments at some of the subsidiaries are not approved.

On July 22, 2010, ASUS was served with a subpoena issued in connection with a Grand Jury investigation related to ODUS' water and wastewater privatization contracts. On January 10, 2011, ASUS received official notification that the U.S. government had determined to close the matter.

## **Regulatory Matters**

### ***Certificates of Public Convenience and Necessity***

GSWC holds Certificates of Public Convenience and Necessity granted by the CPUC in each of the ratemaking areas it serves. CCWC holds Certificates of Public Convenience and Necessity granted by the ACC for the areas in which it serves. FBWS holds a Certificate of Public Convenience and Necessity from the Texas Commission on Environmental Quality. The Virginia State Corporation Commission exercises jurisdiction over ODUS as a public service company. The Maryland Public Service Commission conditionally approved the right of TUS to operate as a water and wastewater utility at Andrews Air Force Base, Maryland. The South Carolina Public Service Commission exercises jurisdiction over PSUS as a public service company. ONUS is regulated by the North Carolina Public Service Commission.

### ***Rate Regulation***

GSWC is subject to regulation by the CPUC, which has broad authority over service and facilities, rates, classification of accounts, valuation of properties, the purchase, disposition and mortgaging of properties necessary or useful in rendering public utility service, the issuance of securities, the granting of certificates of public convenience and necessity as to the extension of services and facilities and various other matters. CCWC is subject to comparable regulation by the ACC.

Rates that GSWC and CCWC are authorized to charge are determined by the CPUC and the ACC, respectively, in general rate cases and are derived using rate base, cost of service and cost of capital, as projected for a future test year in California and using a historical test year, as adjusted, in Arizona. Rates charged to customers vary according to customer class and rate jurisdiction and are generally set at levels allowing for recovery of prudently incurred costs, including a fair return on rate base. In California, rate base generally consists of the original cost of utility plant in service, plus certain other assets, such as working capital and inventory, less accumulated depreciation on utility plant in service, deferred income tax liabilities and certain other deductions.

GSWC is required to file a general rate case ("GRC") application every three years for each of its water rate-making areas according to a schedule established by the CPUC. GRC's typically include an increase in the first test year with inflation rate adjustments for the second and third years of the GRC cycle for expenses. For capital projects, there are two test years. Rates are based on a forecast of expenses and capital costs for the test year. According to the CPUC's water rate case plan adopted in May 2007, GSWC will migrate to a rate case schedule that brings all three Regions of GSWC within a single triennial rate case. GSWC's Regions II and III plus the general office were filed as a single case for rates in years 2010, 2011 and 2012. Region I's most recent rate case was approved in December 2010 for rates in years 2011 and 2012. GSWC will file for all three water regions plus the general office in July 2011 for years 2013, 2014, and 2015. The new consolidated GRC is expected to have an 18-month processing schedule.

The CPUC has approved a four-year rate case cycle plan for BVES. GSWC will file the next BVES rate case in 2011 for rates in years 2013 through 2016.

In California, rates may also be increased by offsets for certain expense increases, including but not limited to supply cost offset and balancing account amortization, advice letter filings related to certain plant additions and other operating cost increases. Offset rate increases and advice letter filings typically have a two- to four- month regulatory processing lag.

Under the rate case plan adopted by the CPUC in May 2007, GSWC is required to file a separate application to review the rate of return authorized by the CPUC.

GSWC filed its first cost of capital application under the new rate case plan on May 1, 2008. In May 2009, the CPUC issued a final decision in the Phase I cost of capital proceeding, authorizing a Return on Equity ("ROE") of 10.2%. On July 30, 2009, the CPUC approved Phase II of the cost of capital application which adopts an automatic adjustment mechanism called the Water Cost of Capital Mechanism to adjust ROE and rate of return on rate base between the every three year cost of capital proceedings. Rates to customers will be adjusted only if there is a positive or negative change of more than 100 basis points in the average of the Moody's Aa utility bond rate as measured over the period October 1 through September 30. If the average interest rate of the Moody's Aa utility bond for October 1, 2010 through September 30, 2011 changes by over 100 basis points from the benchmark, the ROE will be adjusted by one half of the difference. There was no change of over 100 basis points from the benchmark between October 1, 2009 through September 30, 2010.

Neither the operations nor rates of AWR and ASUS are directly regulated by the CPUC or the ACC. The CPUC and the ACC do, however, regulate certain transactions between GSWC and its affiliates. In addition, the Military Utility Privatization Subsidiaries are regulated by their respective commissions in the states in which they operate. However, the amounts charged by the Military Utility Privatization Subsidiaries for water and/or wastewater services at military bases are based upon the terms of 50-year contracts with the U.S. government and supplemental firm fixed price construction contracts. The operations and maintenance contracts provide that prices will be redetermined at the end of two years after commencement of operations at each military base and every three years thereafter. In addition, prices may be equitably adjusted for changes in law, wage and benefit increases and other circumstances. ASUS has, however, experienced delays in the redetermination of rates and the processing of equitable adjustment requests. For construction activity under contract modifications with the U.S. government, prices may be changed through the change order process if significant unforeseen issues arise during the construction process.

### ***Changes in Rates***

The following table provides information on year-over-year increases in water and electric revenues for GSWC as approved by the CPUC during 2010, 2009 and 2008 (in thousands):

| <b>Year</b> | <b>Supply<br/>Cost<br/>Offset</b> | <b>Balancing<br/>Account<br/>Amortization</b> | <b>General<br/>and Step<br/>Increases</b> | <b>Advice<br/>Letters</b> | <b>Total</b> |
|-------------|-----------------------------------|-----------------------------------------------|-------------------------------------------|---------------------------|--------------|
| 2010        | \$ 2,528                          | \$ —                                          | \$ 39,497                                 | \$ —                      | \$ 42,025    |
| 2009        | 5,477                             | 673                                           | 9,102                                     | 1,840                     | 17,092       |
| 2008        | —                                 | 7,165                                         | 12,951                                    | 867                       | 20,983       |

### ***Recent Changes in Rates***

#### **Rate increases in 2011:**

In January 2011, the CPUC approved rate increases for Region II and Region III effective January 1, 2011. The authorized rate increases represent increases of approximately \$1.6 million for Region II, and approximately \$2.4 million for Region III as compared to 2010 adopted revenues. These estimates of additional revenues are based upon normalized sales levels approved by the CPUC, effective January 1, 2011.

In January 2011, the CPUC approved attrition year rate increases for BVES effective January 1, 2011. The authorized rate increase is expected to provide GSWC with additional annual revenues of approximately \$209,000 for BVES. In addition, the CPUC has authorized rate increases to cover higher general office costs allocated to BVES. This is expected to add additional revenues to BVES of \$1.4 million in 2011 as compared to 2010.

In December 2010, the CPUC issued a final decision on GSWC's Region I rate case, approving revenue increases for 2011 and 2012. On a year to year basis, the increase in 2011 revenues represents an increase of approximately \$1.9 million over 2010 adopted revenues. The projected increase for 2012 is \$0.1 million. The CPUC also authorized approximately \$18.5 million of capital projects to be filed for revenue recovery with advice letters when those projects are completed. During the time that such projects are under development and construction, GSWC may accrue an allowance for funds used during construction ("AFUDC") on the accrued expenditures to offset the cost of financing project construction. A majority of these projects are expected to be completed over a 2-year period. A general rate case will be filed for all of GSWC's water regions and the general office in July 2011 with rates expected to be effective January 2013.

#### **Rate increases in 2010:**

On November 19, 2010, the CPUC approved rate increases for the Region II and Region III service areas, and to recover general office expenses at the corporate headquarters. Based on this decision, the approved revenue increases for 2010 totaled approximately \$33.0 million as compared to 2009 adopted revenues, and included an increase of \$14.0 million for supply costs. Rate increases were retroactive to January 1, 2010. The \$33.0 million revenue increase included approximately \$12.2 million already collected as of the issuance of the decision through a supply cost offset surcharge (in effect since 2009). A surcharge is in place effective January 1, 2011 through December 31, 2012 to collect the remaining uncollected retroactive portion of the revenue increase of approximately \$19.5 million.

Among other things, the decision affirmed GSWC's past practice and allowed for recovery of its rate case expenditures incurred in connection with the preparation and processing of the general rate case. The rate case costs will be amortized and recovered over the three year rate case cycle. Additionally, GSWC was also authorized to establish a two-way balancing account to track fluctuations in the forecasted annual pension expenses adopted in rates and the actual annual expense to be recorded by GSWC in 2010, 2011, and 2012 in accordance with the accounting guidance for pension costs. The approved decision also resulted in impairment charges related to certain capital projects that were disallowed. Finally,

the decision also imposed an increased allocation of corporate headquarters' expenses to ASUS. This resulted in an increase in expenses allocated to ASUS. This adjustment is also retroactive to January 1, 2010 and was made in the fourth quarter, thus negatively impacting ASUS' pretax income by approximately \$1.3 million for the year ended December 31, 2010. The Division of Ratepayer Advocates has filed a request for rehearing on the Region II, Region III and general office rate case related to the following items: (i) La Serena Plant Improvements Capital Project; (ii) the inclusion of number of customers in the four factor method used in determining the percentage allocation of general office charges to ASUS; and (iii) GSWC's practice of deferring rate case expenses. At this time, management is unable to predict the outcome of this matter.

In December 2009, the CPUC approved escalation rate increases for GSWC's Region I water ratemaking area effective January 1, 2010. The authorized rate increases provided GSWC with additional annual revenues of approximately \$76,000 for Region I.

#### Rate increases in 2009:

In January 2009, the CPUC approved escalation/attrition year rate increases for all three GSWC water ratemaking areas effective January 1, 2009. The authorized rate increases provided GSWC with additional annual revenues of approximately \$9.4 million. The CPUC also issued its final decision in the cost of capital proceeding in June 2009. In that decision, the CPUC authorized a 10.2% ROE and a corresponding Return on Rate Base of 8.90% to be implemented into rates for all GSWC water ratemaking areas.

During the third quarter of 2008, BVES filed an amended application to request CPUC approval of a new purchased power contract and regulatory accounting treatment for all unrealized gains and losses on the new contract due to derivative accounting. A final decision on this application was issued in May 2009 approving the contract and authorizing the memorandum account to track derivative gains and losses.

In June 2008, GSWC's BVES division filed its general rate case with the CPUC's electric division. The filing was the first full general rate case for BVES since 1996. Costs incurred in connection with the construction of BVES' 8.4 megawatt generating facility were reviewed by the CPUC as part of the 2008 general rate case. On October 15, 2009, the CPUC issued a final decision regarding the BVES general rate case. The decision authorizes an ROE of 10.5% with a corresponding Return on Rate Base of 9.15% for GSWC's electric utility operations. The incremental annual revenue increases approved in the decision are \$4.8 million for 2009, \$1.2 million for 2010, \$0.2 million for 2011 and \$0.2 million in 2012. All increases are prospective. Based on the decision, BVES is also allowed to establish a Base Revenue Requirement Adjustment Mechanism ("BRRAM") to decouple usage from revenue. As of December 31, 2010, GSWC has a \$1.9 million under-collection related to the BRRAM.

In March 2010, the CPUC approved for recovery a memorandum account for the general office allocation to BVES through a surcharge over a 24-month period. This memorandum account totaling \$958,000 was effective and retroactive from June 4, 2009 to October 31, 2009. Accordingly, during the first quarter of 2010, GSWC recorded a \$958,000 regulatory asset and a corresponding increase to earnings for amounts included in this memorandum account. As of December 31, 2010, there was \$726,000 remaining of this regulatory asset.

#### CCWC

CCWC filed a rate case with the ACC in August 2004 for its water system in Fountain Hills, Arizona. In September 2005, the ACC approved a rate increase for CCWC. The rate increase was effective on October 1, 2005 and generated additional annual revenues of approximately \$1.1 million, an 18% increase over 2004 revenues. CCWC filed its next rate case during the fourth quarter of 2007. On October 8, 2009, the ACC issued a final decision approving a rate increase for CCWC, which was effective on October 15, 2009 and generated additional annual revenues of approximately \$1.7 million, a 23% increase over prior revenues. In addition, despite its previous rulings, the ACC also ordered CCWC to treat the gain from a settlement agreement with the Fountain Hills Sanitary District ("FHSD") as a reduction to rate base. As a result, CCWC recognized a loss of \$760,000 during the third quarter of 2009. In November 2009, CCWC filed an application for rehearing on several issues including the treatment of this gain from the settlement proceeds. The ACC granted CCWC's request to hold a rehearing on the issues. A final decision is expected in 2011. At this time, management cannot predict the outcome of this matter.

### ***Pending Rate Requests***

#### **GSWC**

In March 2011, GSWC implemented surcharges for recovery of its 2010 WRAM balances, net of MCBA and supply cost balancing accounts of approximately \$19.6 million. This amount covered by the surcharges in place are subject to routine CPUC review. Management believes that this amount is probable of recovery.

In August 2009, GSWC filed an application with the CPUC requesting authorization to implement corrective measures to address water quality problems in its Bay Point water system. These corrective measures include: (i) retiring an existing water treatment plant and purchasing total system demand from Contra Costa Water District ("CCWD"); (ii) entering into an asset lease agreement with CCWD for 4.4 million gallons per day of treated water for a one-time lease price of \$4.7 million; (iii) recovering costs associated with the purchase of additional treated water to replace purchased raw water; and (iv) amending tariffs to appropriately charge GSWC's Bay Point customers for the cost of the asset lease agreement with CCWD. GSWC expects a decision early in the second quarter of 2011.

### ***Other Regulatory Matters***

#### **New Service Territory Application, Sutter County**

GSWC filed for a Certificate of Public Convenience and Necessity ("CPCN") with the CPUC on May 31, 2006 to provide retail water service in a portion of Sutter County, California within the Natomas service area. CPUC's review of the application was deferred pending completion of an environmental assessment for the proposed new water service territory. On September 29, 2008, GSWC filed an amended application which included the Proponent's environmental assessment. On October 3, 2008, Sutter County and the DRA protested the application. Following limited briefing on the first phase of the proceeding, the parties (including the Sutter Pointe Developers, who were granted party status on October 22, 2009) entered into settlement discussions, and stipulated to continue the hearing dates to facilitate these settlement discussions. Settlement discussions are ongoing.

#### **New Service Territory Application, Westborough Development, Sacramento County**

On April 7, 2006, GSWC filed an advice letter with the CPUC to incorporate the Westborough development in Sacramento County into the Rancho Cordova service area and to provide water service to that new development. The City of Folsom filed a protest of GSWC's advice letter on April 27, 2006. On January 30, 2007, the CPUC rejected the advice letter without prejudice, and invited GSWC to re-file the advice letter once the City of Folsom protest was resolved, or file an application for CPUC approval of the service territory expansion.

In June 2007, GSWC signed an agreement with the City of Folsom. The City of Folsom agreed not to contest GSWC's providing water service to Westborough and relinquished all claims concerning GSWC's providing water service to the area. As compensation to the City of Folsom to resolve its claim, GSWC agreed to pay the City of Folsom \$550,000. Aerojet-General Corporation ("Aerojet"), through a settlement agreement with GSWC (which is further discussed in Note 2 of the Notes to Consolidated Financial Statements), agreed to reimburse GSWC for 50%, or \$275,000, of the settlement payment. As of December 31, 2010, GSWC has recorded an obligation of \$550,000 to the City of Folsom and an additional receivable of \$275,000 from Aerojet for the amount to be reimbursed.

During the third quarter of 2007, GSWC filed a second advice letter after resolving the issue with the City of Folsom. That advice letter was subsequently protested by the Sacramento County Water Agency ("SCWA"). During the second quarter of 2008, the objections raised by SCWA in their protest were removed. GSWC intends to file again with the CPUC to incorporate the Westborough development in Sacramento County into the Rancho Cordova service area and to provide water service to that new development following completion of the development of a regional water supply solution for the area.

#### **Conservation Rate Design and Revenue Adjustment Mechanisms**

On August 21, 2008, the CPUC authorized GSWC to implement an increasing block rate design in GSWC's Regions II and III as a means to encourage water conservation. In addition, GSWC was authorized to establish a WRAM to track revenue shortfalls for subsequent recovery from customers, and an MCBA that would include recovery/refund for changes in water supply mix. In accordance with the CPUC's administrative processing rules, GSWC implemented tiered increasing block rates in late November 2008 and began recording in the WRAM accounts the difference between what is billed to its regulated customers in Regions II and III and that which is authorized by the CPUC. GSWC provided customers with conservation rate notices as a bill insert and explained to them the impact of conservation rates on customers' bills. In March 2010, surcharges were implemented for recovery of the Region II and Region III WRAM balances, net of the MCBA and supply cost balancing accounts. As of December 31, 2010, GSWC has a net aggregated regulatory asset of \$24.0 million

in Regions II and III, comprised of a \$41.2 million under-collection in the WRAM accounts and \$17.2 million over-collection in the MCBA accounts. Management believes that this amount is probable of recovery.

The CPUC also approved an advice letter filing in a separate proceeding to allow GSWC to create and implement a Water Conservation Memorandum Account ("WCMA") to track the extraordinary expenses and revenue shortfall associated with the conservation measures in conjunction with the declared drought in California. The WCMA was effective August 18, 2008 and was used to track the revenue shortfall until the WRAM was implemented on November 25, 2008 for Regions II and III, and September 1, 2009 for Region I. The CPUC approved the WCMA and authorized GSWC to establish a surcharge to customers' bills for recovery of the balances in the WCMA totaling \$3.2 million. As of December 31, 2010, GSWC has an aggregate \$1.4 million remaining in the WCMA accounts being recovered through these surcharges.

#### **Supply Cost Memorandum/Balancing Accounts**

Prior to the implementation of the MCBA, GSWC maintained water supply cost balancing accounts for GSWC to account for under-collections and over-collections of revenues designed to recover such costs. These supply cost balancing accounts tracked 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. Under-collections (recorded as regulatory assets) occurred when the current cost exceeded the amount in rates for these items and, conversely, over-collections (recorded as regulatory liabilities) occurred when the current cost of these items were less than the amount in rates. Typically, under-collections or over-collections, when they occur, were tracked in the supply cost balancing accounts for future recovery through a surcharge (in the event of an under-collection) or refund through a surcredit (in the event of an over-collection) on customers' bills. GSWC accrues interest on its supply cost balancing accounts at the rate prevailing for 90-day commercial paper. As of December 31, 2010, there is an approximately \$3.4 million net under-collection in the water supply cost balancing accounts. Of this amount, approximately \$2.1 million relates to GSWC's Region I customer service area. The remaining \$1.3 million net under-collections in the water supply cost balancing accounts relates primarily to GSWC's Region III's ratemaking area. Currently, there is a surcharge in place to recover Region I's under-collections. In March 2011, GSWC filed for recovery of its 2010 WRAM balances, net of MCBA and remaining supply cost balancing accounts in Regions II and III. Management believes that it is probable that the CPUC will permit GSWC to continue recovering in rates the net under-collections in supply costs.

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 an asset or liability balancing account (tracked individually for each rate-making area). Unlike the WRAM, the MCBA applies to all customer classes. This account replaced the water supply cost balancing account procedure for costs incurred after the modified supply cost balancing account was implemented. As of December 31, 2010, there is an aggregate \$19.0 million over-collection in the MCBA for all GSWC water regions.

#### **Santa Maria Groundwater Basin Adjudication**

GSWC has incurred costs of approximately \$7.2 million as of December 31, 2010, including legal and expert witness fees, in defending its groundwater supply in the Santa Maria Groundwater Basin. Such costs had been recorded in utility plant for future rate recovery. In February 2006, GSWC filed an application with the CPUC for recovery of \$5.5 million of these costs, representing the amount of the costs that had been incurred as of December 31, 2005. In February 2007, GSWC reached a settlement with the DRA authorizing recovery of the \$5.5 million requested in GSWC's application. The settlement deferred review of the remaining legal costs pending final resolution of the lawsuit. In May 2007, the CPUC issued a decision that approved the settlement with the DRA. Pursuant to the decision, GSWC was authorized to place in rate base \$2.7 million of the \$5.5 million of previously incurred litigation costs. GSWC was also authorized to amortize, with interest, the remaining \$2.8 million of the \$5.5 million in rates over a ten-year period. This amount has been transferred into a separate memorandum account included within regulatory assets and a surcharge was implemented in the third quarter of 2007 for recovery of these costs.

All litigation costs, including interest that have been incurred since December 31, 2005 totaling approximately \$1.7 million, have also been transferred from rate base to a separate new memorandum account, subject to a reasonableness review by the CPUC in a subsequent phase of this proceeding or in a new proceeding. In April 2008, the Administrative Law Judge closed the proceeding without ruling on the stipulation or authorizing recovery of the remaining costs. The ruling directed GSWC to file a new application. In accordance with this ruling, GSWC filed a new application as part of its Region I general rate case filed with the CPUC in January 2010, requesting an extension of the memorandum accounts. As part of the CPUC's final decision on Region I's rate case, GSWC's request was granted. The decision also authorized the memorandum account to be interest bearing at the ten-year U.S. Treasury note rate.

### **CPUC Subpoena**

On February 15, 2007, the CPUC issued a subpoena to GSWC in connection with an investigation of certain work orders and charges paid to a specific contractor used previously by GSWC for numerous construction projects estimated to total \$24.0 million completed over a period of 14 years. The CPUC's investigation focuses on whether GSWC was overcharged for these construction projects and whether these overcharges, if any, were included in customer rates. The construction projects completed by this specific contractor related primarily to work on water treatment and pumping plants which have been placed in service and are used and useful. In June 2007, GSWC received notification from the CPUC that it was instituting an audit to examine for the period 1994 to the present, GSWC's policies, procedures, and practices throughout its three water regions regarding the granting or awarding of construction contracts or jobs.

Should the CPUC investigation result in a disallowance of certain previously capitalized costs, such costs, and potentially any return earned on such costs, may be required to be refunded to customers, resulting in a charge to operating income. In addition to the disallowance of previously capitalized costs and the return earned on such costs, the CPUC also has the authority to assess fines and penalties. The staff of the CPUC has indicated to GSWC that it intends to seek such remedies including possibly a fine and penalty. GSWC does not believe that a disallowance is required or that a penalty is justified. GSWC intends to vigorously defend the matter; however, proceedings such as this are difficult to predict and a final outcome is unknown. While reserving all rights, management believes it prudent to reserve for a probable loss related to this matter. The reserve estimates for this matter are subject to change as additional information becomes known. However, at this point, management does not expect increases in its recorded estimated reserve.

In January 2009, the ACC staff requested information regarding the CPUC subpoena and on-going audit. GSWC has provided the responsive materials that are relevant to CCWC. Although the ACC has issued a decision in the CCWC general rate case in October 2009, they have held the proceeding open pending resolution of the staff review of the CPUC subpoena documents.

### **Disposition of Chaparral City Water Company**

On June 7, 2010, the AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. to sell all of the common stock of CCWC. The consummation of the transaction contemplated by the agreement is subject to customary conditions, including among other things, regulatory approval by the ACC. In July 2010, AWR filed for approval of the transaction with the ACC. The approval is anticipated to be received in 2011.

### **Affiliate Transaction Rules**

On October 19, 2010, the CPUC issued a decision regarding affiliate transactions and the use of regulated assets for non-tariff utility services. The new affiliate rules are intended to establish a standard set of rules to govern transactions between a regulated water utility, its parent, and other affiliated companies. Registrant monitors its cost allocation and management of the regulated and non-regulated segments to ensure the affiliate transactions are in compliance with the CPUC rules and regulations.

### **Bear Valley Electric Service**

BVES has not achieved interim target purchase levels of renewable energy resources established by the CPUC. Under the flexible compliance rules established by the CPUC for small electric utilities, BVES is required to continue its efforts to procure renewable resources each year, and where that may prove difficult because the market for such resources is very constrained, BVES will be required to describe in detail the problems that warrant deferral of compliance. Under the CPUC's flexible compliance rules, the CPUC deferred compliance by BVES with the interim target purchase levels for the years 2004 through 2007. Management believes that the CPUC's decision effectively forecloses any exposure to financial penalties for the year 2007 and earlier. For years subsequent to 2007, BVES has not met the interim targets and expects that the CPUC will waive any potential fines in accordance with the flexible compliance rules so long as BVES continues its efforts to procure renewable resources each year and, to the extent that it is unable to meet established target purchase levels, because the market for such resources is constrained, it describes in detail the problems encountered in meeting the targets. Accordingly, no provision for loss has been recorded in the financial statements as of December 31, 2010, 2009 or 2008.

In November 2009, GSWC entered into a ten-year contract with the Los Angeles County Sanitation District ("LACSD") to purchase renewable energy created from landfill gas and a ten-year contract with a vendor to purchase biogas to power BVES's gas-fueled 8.4 MW generation facility. Applications were filed with the CPUC in June and July of 2010 for approval.

In February 2011, GSWC was notified that the landfill gas-generated energy contract with the LACSD could potentially be terminated should LACSD determine to shut down the landfill gas generator. GSWC continues to work with

LACSD to determine alternative resolutions. GSWC has informed the CPUC of the potential termination for consideration of the renewable energy resource approvals and the flexible compliance requirements.

In November 2010, the contracted bioenergy vendor for the purchase of biogas advised GSWC that the biogas production will be suspended due to financial constraints. As a result of the suspension, BVES has negotiated a Biogas Option Agreement instead with this vendor for the purchase of future production of biogas. On February 10, 2011, the Biogas Option Agreement was provided to the DRA and the CPUC for approval.

Given the recent developments with the renewable energy vendors, BVES believes that it will not be subject to fines under the CPUC's flexible compliance rules for not meeting interim targets.

#### **Customer Information/Customer Relationship Management System (CIS/CRM)**

In October 2008, GSWC filed an advice letter with the CPUC requesting authorization to enter into a contract with a vendor to provide implementation services for a new Customer Information/Customer Relationship Management System (CIS/CRM) and to expend funds in excess of the amount authorized previously by the CPUC in 2007. The total costs of the project under the contract are estimated at \$11.6 million, before overhead, of which \$3.0 million are currently in rates. In January 2009, the CPUC issued a resolution authorizing GSWC to move forward with the CIS/CRM system. The resolution grants the request of GSWC to enter into a contract for the new CIS/CRM system. The CPUC authorized GSWC to spend an additional \$6.0 million above the \$3.0 million currently in rates. The CPUC also authorized GSWC to track the remaining \$2.6 million in a memorandum account. GSWC is authorized to request the recovery of these memorandum account costs in rates by filing an advice letter. These costs currently are estimates and as of December 31, 2010, GSWC has incurred \$11.6 million in costs including overhead, related to the CIS/CRM project.

#### **Pension Costs Balancing Account**

The CPUC authorized GSWC to establish a two-way balancing account, effective January 1, 2010, for its three water regions and the general office to track differences between the forecasted annual pension expenses adopted in rates for 2010, 2011 and 2012 and the actual annual expense to be recorded by GSWC in accordance with the accounting guidance for pension costs. The two-way balancing account is interest bearing at the current 90-day commercial paper rate. Once this balancing account achieves a pre-determined level (i.e., at least 2.5 percent over- or under-recovery of the approved revenue requirement), GSWC will seek approval from the CPUC to refund or collect the balance in the account. As of December 31, 2010, GSWC has included in other regulatory assets a \$1.8 million under-collection in the two-way pension balancing account.

#### **Catastrophic Event Memorandum Accounts**

In January 2010, the City of Big Bear and surrounding areas of San Bernardino County experienced a series of snow storms, which damaged BVES power lines, poles, transformers, and other facilities and caused temporary interruption of service to some BVES customers. As a result of these storms, BVES has incurred additional operating costs to repair equipment and restore electric service to its customers. While service has been restored to BVES customers, costs are still being incurred to repair equipment affected by the storms. In February 2010, GSWC informed the CPUC it will track these costs in a catastrophic event memorandum account ("CEMA"). Once all work resulting from these storms is completed, GSWC intends to file an advice letter with the CPUC for recovery of these costs through a surcharge. As of December 31, 2010, approximately \$327,000 has been incurred as a result of the storms and has been included in the CEMA account. We believe these incremental costs will be approved by the CPUC for recovery.

On November 19, 2010, GSWC issued a "Do Not Drink" water advisory to its customers in the Barstow service area notifying them that perchlorate had been detected in GSWC's water supply. On November 20, 2010, a state of emergency was issued by the Governor. One of GSWC's wells in service in the service area showed perchlorate levels above the maximum contaminant level. The contaminated well was shut down and the distribution system was flushed to remove contaminants in the distribution system. GSWC provided customers with bottled water during the "Do Not Drink" water advisory period. By November 24, 2010, the alert was lifted for all of GSWC's Barstow area customers. The incremental costs associated with handling the emergency (including the distribution of bottled water), remediation and clean-up efforts are being tracked in a CEMA account, GSWC expects to receive authorization from the CPUC to recover these costs, subject to a prudency review. As of December 31, 2010, GSWC has included approximately \$553,000 in a CEMA account for this matter. We believe these incremental costs will be approved by the CPUC for recovery.

## **Environmental Matters**

The U.S. Environmental Protection Agency ("EPA") regulates contaminants that may have adverse health effects that are known or likely to occur at levels of public health concern, and the regulation of which will provide a meaningful opportunity for health risk reduction. The California Department of Public Health ("CDPH"), acting on behalf of the EPA, administers the EPA's program in California. Similar state agencies administer these rules in the other states in which we operate.

GSWC and CCWC currently test their water supplies and water systems according to, among other things, requirements listed in the Federal Safe Drinking Water Act ("SDWA"). In compliance with the SDWA and to assure a safe drinking water supply to its customers, GSWC and CCWC have incurred increased operating costs for testing to determine the levels, if any, of the constituents in their sources of supply and additional expense to treat contaminants in order to meet the maximum contaminant limits ("MCL") standards and also to meet state and local standards and consumer demands. GSWC and CCWC expect to incur additional capital costs as well as increased operating costs to maintain or improve the quality of water delivered to their customers in light of anticipated stress on water resources associated with watershed and aquifer pollution as well as to meet future water quality standards. The CPUC and ACC ratemaking processes provide GSWC and CCWC with the opportunity to recover prudently incurred capital and operating costs in future filings associated with achieving water quality standards. Management believes that such incurred and expected future costs should be authorized for recovery by the CPUC and ACC, as applicable.

In 2010, the EPA announced that it intends to address contaminants in groups rather than one at a time. In January 2011, the EPA identified carcinogenic volatile organic compounds as the first group that the EPA plans to address. In February, 2011, the EPA announced that it has decided to regulate perchlorate under the SDWA.

The Office of Environmental Health Hazard Assessment ("OEHHA") of the State of California is responsible for developing Public Health Goals ("PHGs") for contaminants. The PHGs are not a set of enforceable standards. However, once the PHGs for a contaminant are developed, CDPH is required by law to set the MCL for that contaminant based on the PHGs. The MCL is required to be as close to the PHG as possible for that contaminant considering technologies and costs. Recently, OEHHA has published PHGs for several contaminants that are significantly lower than the current state MCL for such contaminants, including perchlorate. OEHHA also developed PHGs for several currently unregulated contaminants, including hexavalent chromium.

### ***Matters Relating to GSWC's Bay Point Water System***

GSWC routinely monitors for the presence of drinking water contaminants, including total trihalomethanes ("TTHM"). The TTHM samples taken in GSWC's Bay Point water system in the first quarter of 2008 exceeded the MCL for TTHM. Studies conducted by GSWC indicate that source water quality is the predominate factor in this situation. Water imported from the Sacramento-San Joaquin Delta experienced salt water intrusion and had high levels of organic compounds from agricultural drainage during the first quarter of 2008. These compounds form TTHM during the treatment process. To remedy the situation, GSWC increased the purchase of chloraminated water from the Contra Costa Water District beginning in March 2008 and throughout 2008. Chloramination is an accepted and widely used method to mitigate TTHM. Water samples collected by GSWC in the second quarter of 2008, were below the MCL for TTHM.

GSWC has filed an advice letter with the CPUC to allow GSWC to establish a memorandum account to recover future additional costs associated with the purchase of chloraminated water for its Bay Point Water System and requesting authorization to implement corrective measures to address water quality problems in its Bay Point Water System. On December 20, 2010, the CPUC issued its decision in GSWC's Region 1 GRC, which deferred this issue to a separate decision. GSWC expects a decision early in the second quarter of 2011 regarding this matter.

### ***Matters Relating to GSWC's Arden-Cordova Water System***

In GSWC's Arden-Cordova system, five wells prior to 2006 had previously been removed from service and destroyed due to contamination from perchlorate or trichloroethylene. During 2006, another three wells were destroyed that had been previously impacted from either perchlorate and/or nitrosodimethylamine ("NDMA") contamination. GSWC has replaced the water supply for these wells. Five additional wells are currently out of service due to either perchlorate levels above the CDPH MCL of 6 parts per billion ("ppb") or NDMA levels over the notification level of 10 parts per trillion ("ppt"). GSWC continues to monitor all of its active groundwater wells in the Arden-Cordova system for perchlorate and NDMA, along with other constituents.

Aerojet has, in the past, used ammonium perchlorate in oxidizing rocket fuels. NDMA is an additional by-product from the production of rocket fuels and it is believed that contamination in GSWC's Arden-Cordova service area is also related to the activities of Aerojet.

In 2000, GSWC filed suit against Aerojet for contamination of GSWC's groundwater supply in its Arden-Cordova system. On October 12, 2004, GSWC and Aerojet reached a final settlement, relating to this contamination. Under the terms of the settlement, Aerojet paid GSWC \$8.7 million in the first quarter of 2004 and agreed to pay GSWC an additional \$8 million over a period of five years commencing in December 2009, plus interest accruing from January 1, 2004. These payments, if made, will offset GSWC's costs of utility plant and purchased water by \$16 million and \$735,000, respectively. On December 23, 2010, GSWC received from Aerojet \$2.5 million including interest as payment of the second annual installment under the terms of the 2004 settlement agreement. As of December 31, 2010, the unpaid portion of the note receivable is \$6.1 million, comprised of \$4.8 million in principal and \$1.3 million in accrued interest.

In January 2010, Standard & Poor's ("S&P") upgraded the credit rating of GenCorp the parent of Aerojet, to B- from CCC+ with a stable outlook. This is a non-investment grade rating assigned by S&P to companies whose financial situation varies. On March 26, 2010, Moody's Investor Services ("Moody's") upgraded its corporate family rating from B3 to B2. This is a non-investment grade rating assigned by Moody's to obligations that are speculative and subject to high credit risk and of generally poor credit quality. At this time, management believes that Aerojet will be able to fulfill its contractual obligations and has not provided a reserve for uncollectible amounts as of December 31, 2010.

Aerojet, Sacramento County Water Agency, the City of Folsom and GSWC are currently negotiating the best alternatives to meet the water supply needs of each agency and to ensure a continued reliable and safe water supply for GSWC's Rancho Cordova customers within the Arden-Cordova service area as well as supply for the new Westborough development area owned by Aerojet.

#### ***Matters Relating to GSWC's Florence Graham Water System***

Perchlorate has been detected in five wells servicing GSWC's Florence-Graham System. Two of these wells have been removed from service due to exceedance of the perchlorate drinking water standard. Continued monitoring shows that perchlorate levels are increasing in the three wells that remain in service. The Water Replenishment District of Southern California is partnering with the Department of Toxic Substances Control to examine the perchlorate contamination in this area and are trying to determine the source(s) of the plume. GSWC will follow this process closely in an effort to identify potential funding sources for addressing the issue. Concurrently, GSWC is developing an internal action plan to maintain reliable water supply within the Florence-Graham system.

#### ***Matters Relating to GSWC's Norwalk Water System***

Volatile Organic Compounds ("VOCs") have been detected in eight wells in GSWC's Norwalk Water System. Seven of these wells are equipped with granular activated carbon filter treatment for VOC removal. These wells are located within a Superfund site that the EPA has designated as the Omega Operable Unit 2. EPA is currently working on a remediation project to clean up the VOC plume. Recent modeling data have shown that at least three GSWC wells, and potentially more, are impacted by the Omega plume. EPA has requested permission to perform additional sampling from four GSWC wells in order to refine their model. If it is determined that the Omega plume has impacted GSWC wells, GSWC will work closely with the EPA to ensure that their proposed remediation remedy will not negatively affect GSWC's well production capabilities.

#### ***Matters Relating to GSWC's San Gabriel Water Systems***

Perchlorate and/or VOCs have been detected in five wells servicing GSWC's San Gabriel System. As previously discussed, GSWC filed suit in federal court, along with two other affected water purveyors and the San Gabriel Basin Water Quality Authority against some of those responsible for the contamination. For more details see *Item 3 – Legal Proceedings*.

#### ***Matters Relating to Barstow Water System***

On November 19, 2010, GSWC issued a "Do Not Drink" water advisory to its customers in the Barstow service area notifying them that perchlorate had been detected in GSWC's water supply. On November 20, 2010, a state of emergency was issued by the Governor. One of GSWC's wells in service in the service area showed perchlorate levels above the maximum contaminant level. The contaminated well was shut down and the distribution system was flushed to remove contaminants in the distribution system. GSWC provided customers with bottled water during the "Do Not Drink" water advisory period. By November 24, 2010, the alert was lifted for all of GSWC's Barstow area customers. The incremental costs associated with handling the emergency (including the distribution of bottled water), remediation and clean-up efforts are being tracked in a Catastrophic Event Memorandum ("CEMA") Account and GSWC expects to receive authorization from the CPUC to recover these costs, subject to a prudence review. As of December 31, 2010, GSWC has included in other regulatory assets \$553,000 related to the Barstow CEMA account.

### ***Matters Relating to Environmental Clean-Up***

#### ***Chadron Plant:***

GSWC removed a tank from the ground at its Chadron Plant site in July 1990, along with the dispenser and ancillary piping. As required at the time, a tank removal report was submitted to the Los Angeles Department of Public Works ("DPW"). At the request of DPW, soil samples were collected beneath the tank and the results indicated gasoline impacted soil in the northern portion of the former tank pit. Quarterly monitoring began in July 1994. Between July 1994 and November 1995, additional monitoring wells were installed and pilot remediation tests were conducted. A site assessment report was completed in April 1996.

In January 1998, a plan for the underground storage tank site remediation and closure was prepared. The remediation system plan was installed and became fully operational in 1998 with an estimated two years thereafter to obtain site closure. This plan was approved by the Los Angeles Regional Water Quality Control Board of the California Environmental Protection Agency ("LARWQCB"). In November 2002, the LARWQCB commented on the methodology selected for cleanup of dissolved contaminants in the groundwater. Data from operation of the technology implemented at the subject site for the past several years indicated that the technology did not work well. With the technology implemented no longer performing as expected, in 2006 an evaluation of the current remedial system was conducted to look for potential alternatives. This engineering evaluation was completed in April 2006 and was made based on currently available information from quarterly reports.

In February 2007, additional site assessment work was conducted. The site assessment showed that there was more gasoline at higher concentrations spread over a larger area than previously measured. In October 2007, LARWQCB approved an interim remedial action plan. In March 2008, a Phase I multi-phase extraction remediation system started operation. The second phase, which includes the cleanup of the groundwater, is expected to begin as soon as the extraction phase is completed. GSWC expects remediation to take at least two more years, followed by two years of monitoring and reporting.

As of December 31, 2010, the total spent to clean-up and remediate GSWC's plant facility is approximately \$3.5 million, of which \$1.5 million has been paid by the State of California Underground Storage Tank Fund. In addition, GSWC also has an accrued liability for the estimated additional cost of \$1.2 million to complete the clean-up at the site. The ultimate cost may vary as there are many unknowns in remediation of underground gasoline spills and this is an estimate based on currently available information. Management also believes it is probable that the additional costs of remediation will be approved in rate-base by the CPUC.

#### ***Ballona Plant:***

During the first quarter of 2008, hydrocarbon contaminated soil was found at a plant site ("Ballona Plant") located in GSWC's Southwest customer service area where an abandoned water tank was demolished. All contaminated soil was removed and replaced with clean soil. The clean-up was completed during the first quarter of 2010. The final Removal Action Completion Report ("RACR") was submitted to the Site Mitigation Unit ("SMU") on May 10, 2010. The SMU reviewed the RACR and issued a no further action letter. The letter states that the SMU concurs with the contents of the RACR, which states that the site contamination has been satisfactorily mitigated for the current use and no further action is required at the subject site. Clean-up costs incurred through December 31, 2010, totaled approximately \$337,000. Historically, the costs for this type of cleanup have been included in rate base for recovery.

### ***Matters Relating to Military Privatization Contracts***

Each of the Military Utility Privatization Subsidiaries is responsible for testing the water and wastewater systems on the military bases on which it operates in accordance with applicable law.

Each of the Military Utility Privatization Subsidiaries has the right to seek an equitable adjustment to its contract in the event that there are changes in environmental laws, a change in the quality of water used in providing water service or wastewater discharged by the U.S. government or contamination of the air or soil not caused by the fault or negligence of the Military Utility Privatization Subsidiary. The U.S. government is responsible for environmental contaminant due to its fault or negligence and for environmental contamination that occurred prior to the execution of the contracts.

## **Security Issues**

GSWC has implemented measures to increase security in accordance with a vulnerability assessment of its water systems and has upgraded its facilities to enhance the safety of water system operations.

GSWC periodically revises its Emergency Response Plan and periodically conducts operational security exercises for all of its water systems. GSWC also considers advances in security technology and relevant industry developments in developing its capital improvement plans. GSWC intends to seek approval of the CPUC to recover any additional costs that it incurs in enhancing the security of its water systems.

The Military Utility Privatization Subsidiaries operate facilities within the boundaries of secure military bases thereby limited access to the general public. To further enhance security, certain upgrades are being completed at various military bases through contract modifications funded by the U.S. government.

## **Water Supply**

### ***GSWC's Water Supply***

During 2010, GSWC delivered over 70,658,000 hundred cubic feet ("ccf") of water to its customers, which is about 444 acre-feet per average day. (An acre-foot is about 326,000 gallons). Approximately 65% came from groundwater production wells situated throughout GSWC's service areas. GSWC supplemented groundwater production with wholesale purchases from regional water suppliers (roughly 35% of total demand) and with authorized diversions from rivers (roughly 6%) under contracts with the United States Bureau of Reclamation ("Bureau") and the Sacramento Municipal Utility District ("SMUD"). During 2009, GSWC supplied 77,800,000 ccf of water, approximately 55% of which was produced from groundwater sources, 40% was purchased from regional wholesalers, and the remainder was obtained from surface water diversions under contracts with the Bureau and SMUD.

Approximately 65% of GSWC's water supply comes from its own groundwater production wells situated throughout its service areas. GSWC purchases about 32% of its total demand from the Metropolitan Water District of Southern California ("MWD") member agencies. In light of restrictions on imported water supplies and drought conditions in southern California more fully described below, GSWC has been engaging in a comprehensive and on-going assessment of its water rights and groundwater storage assets. In addition, GSWC aggressively pursues voluntary and mandatory conservation measures among its customers and has implemented customer education initiatives to help to deal with supply variability and the general scarcity of water supplies.

### ***Groundwater***

Over the years, population growth in GSWC's service areas and increases in the amount of groundwater used have resulted in both cooperative and judicially-enforced regimes for owning water rights and managing groundwater basins for long-term sustainability. GSWC management actively participates in efforts to protect groundwater basins from over-use and from contamination and to protect its water rights. In some periods, these efforts require reductions in groundwater pumping and increased reliance on alternative water resources.

GSWC owns approximately 117,800 acre-feet of water rights, mostly groundwater, to help meet supply requirements. The productivity of GSWC's groundwater resources varies from year to year depending upon a variety of factors, including the amount and location of rainfall, the availability of imported replenishment water, the amount of water previously stored in groundwater basins, the amount and seasonality of water use by our customers and others, evolving challenges to water quality, and a variety of legal limitations on use, if a groundwater basin is in an over-drafted condition.

### ***Imported Water***

GSWC also manages a portfolio of water supply arrangements with water wholesalers to insure the reliability, quality and affordability of water. For example, GSWC has contracts with various governmental entities (principally MWD's member agencies) and other parties to purchase water for distribution to customers. The MWD is a public agency organized and managed to provide a supplemental, imported supply to its member public agencies. There are 26 such member agencies, consisting of 14 cities, 11 municipal water districts, and one county water authority. GSWC has 58 connections to MWD's water distribution facilities and those of member agencies. GSWC purchases MWD water through six separate member agencies aggregating more than 75,000 acre-feet annually. MWD's principal sources of water are the Colorado River and the State Water Project ("SWP") which conveys water from northern California.

To meet its water supply needs, GSWC has contracts with MWD member agencies, various governmental entities and other parties to purchase water or water rights for an aggregate amount of \$54.0 million as of December 31, 2010. Included in this amount as of December 31, 2010, is \$48.4 million for minimum purchases under take or pay contracts, based

on current wholesale rates, over the next five years. The wholesale rates are expected to increase over the term of the agreements. The current contracts expire on an agreement-by-agreement basis between 2011 through 2013. GSWC intends to renew these contracts as they expire. The terms and conditions vary under each contract. GSWC plans to purchase for its customers' use at least the minimum water requirement under each of the respective contracts in order to supplement its own groundwater resources. GSWC is also committed to purchase \$2.2 million of groundwater production rights from the City of Claremont pursuant to a long-term lease which expires in 2028 with an option to renew for an additional ten years. GSWC also has an aggregate of \$3.4 million of other water purchase commitments with other third parties.

### ***State Water Project***

Water supplies available to the Metropolitan Water District of Southern California ("MWD") through the State Water Project ("SWP") vary from year to year based on weather. However, MWD has generally been able to provide sufficient quantities of water to satisfy the needs of its member agencies and their customers.

A key link in the SWP is the Sacramento/San Joaquin River Delta adjacent to the San Francisco Bay ("Delta"). The fresh water pathway through the Delta is supported by earthen levees, and the reliability of those levees has been called into question based on assessments by various federal, state and local agencies. In addition, many native fish species are in decline, resulting in restrictions on pumping through the Delta. GSWC continues to participate in and monitor developments related to the Delta and efforts to craft a workable solution to the risks presented by reliance on the Delta for its southern California water supplies.

Legislation was approved in 2009 to address the overall needs of the Delta. A key component of this legislation is bonds which must be approved by voters in California. A bond initiative seeking approval of these bonds has been postponed until at least 2012.

Every year, DWR establishes the SWP allocation for water deliveries to state water contractors. DWR generally establishes a percentage allocation of delivery requests based on a number of factors, including weather patterns, snow pack levels and reservoir levels. The percent allocation given to state contractors varies throughout the year depending upon weather and other factors. In 2010, the SWP delivered 50% of contractor requests. DWR initially estimated that it would be able to deliver of 5% of delivery requests in 2010. In January 2011, DWR announced an increase in its projected 2011 deliveries to 60% of delivery requests.

### ***Colorado River***

On October 17, 2003, the Federal government, acting through the Bureau in its capacity as Colorado River watermaster, the State of California, and four Southern California water agencies, including MWD, reached an agreement, known as the Quantification Settlement Agreement ("QSA"). The QSA allocates California's annual 4.4 million acre-feet ("MAF") share of the Colorado River among those agencies and provides the framework for accounting and transfers among them. Under the QSA, MWD will continue to have access to its base allotment of Colorado River water each year, as well as excess Colorado River water until October 2016, and up to 1.6 MAF of additional water that the Imperial Irrigation District proposes to conserve and sell to the state for use by MWD members. The QSA has been subject to ongoing litigation. A trial court has ruled that the QSA is invalid to the extent that it relies upon an unconditional appropriation from the State of California to fund environmental mitigation. MWD and the other Southern California water agencies have appealed. There is no expected disruption in water supplies while the case awaits resolution of the appeal.

### ***Wholesale Water Supplier Responses***

Under its Integrated Resources Plan, MWD estimates that it can meet its member agencies' demands over at least the next 20 years. However, in light of pressure on all of its sources of imported water, MWD adopted a Water Supply Allocation Plan ("the Plan") on February 12, 2008. MWD implemented the Plan effective July 1, 2009, at a Level 3, requiring a regional reduction in delivery of 10%. GSWC has implemented mandatory and voluntary actions in areas relying on MWD as a supply. Increases in prices from wholesalers such as MWD flow through the modified cost balancing account for GSWC.

GSWC is closely monitoring developments and working with its water suppliers to safeguard the supply and evaluate potential emergency responses to prolonged reductions in imported supplies.

### ***Agreement with Cadiz Inc.***

In June 2010, GSWC signed an agreement with Cadiz Inc. to proceed with the Cadiz Water Conservation & Storage Project ("Cadiz Project") and participate in the Cadiz Project's environmental review. GSWC agreed to commit funds to the environmental review and has committed to the goal of a general "environmental benefit" for the operation of the project. Under the terms of the agreement, GSWC has the right to acquire an annual supply of 5,000 acre-feet of water at a pre-

determined formula once the environmental review is complete. In addition, GSWC has the option to acquire storage rights in the Cadiz Project to allow GSWC to manage the supply as part of its overall water supply portfolio. Cadiz Inc. is a publicly-held renewable resources company that owns 70 square miles of property with significant water resources and clean energy potential in eastern San Bernardino County, California.

### ***CCWC's Water Supply***

CCWC obtains its water supply from two operating wells and from the Colorado River water delivered by the Central Arizona Project ("CAP"). CCWC has been given a Municipal and Industrial ("M&I") designation for purposes of determining priority for allocations of water from the CAP. The first curtailment of CAP deliveries in the event of shortage would occur to non-Indian agricultural users. Such users accounted for a third of CAP deliveries in 2004, creating a buffer for M&I users such as CCWC. The priority for M&I users of CAP, such as CCWC, provides an improved outlook for CCWC supplies. In addition to its supplies from the CAP, CCWC produces water from two operating wells. The majority of CCWC's water supply is obtained from its CAP allocation. Well water is used for peaking capacity in excess of treatment plant capability, during treatment plant shutdown, and to keep the wells in optimal operating condition.

CCWC has an assured water supply designation, by decision and order of the Arizona Department of Water Resources stating that 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.

CCWC has a long-term water supply contract with the Central Arizona Conservation District (the "District") through September 2033, and is entitled to take 8,909 acre-feet of water per year from CAP. In connection with this long-term water supply contract, CCWC pays an annual charge based on its full allocation regardless of the amount of water delivered. The rate for such charge is set by the District and is subject to annual increases. Based on the District's published new rate schedules, the estimated remaining commitment under this contract is \$535,000 as of December 31, 2010.

The quantity of water CCWC supplies to some or all of its customers may be interrupted or curtailed, pursuant to the provisions of its tariffs.

### ***Military Utility Privatization Subsidiaries***

The U.S. government is responsible for providing the source of supply for all water on each of the bases served by the Military Utility Privatization Subsidiaries at no cost to the Military Utility Privatization Subsidiaries.

### **New Accounting Pronouncements**

Registrant is subject to newly issued requirements as well as changes in existing requirements issued by the Financial Accounting Standards Board. Differences in financial reporting between periods could occur unless and until the CPUC and the ACC approve such changes for conformity through regulatory proceedings. See *Note 1 of Notes to Consolidated Financial Statements*.

## **Item 7A. Quantitative and Qualitative Disclosures About Market Risk**

Registrant is exposed to certain market risks, including fluctuations in interest rates, and commodity price risk primarily relating to changes in the market price of electricity. Market risk is the potential loss arising from adverse changes in prevailing market rates and prices.

### **Interest Rate Risk**

A significant portion of Registrant's capital structure is comprised of fixed-rate debt and some long-term variable rate debt. Market risk related to our fixed-rate debt is deemed to be the potential increase in fair value resulting from a decrease in interest rates. At December 31, 2010, the fair value of Registrant's long-term debt was \$361.6 million, including CCWC. A hypothetical ten percent decrease in market interest rates would have resulted in a \$20.0 million increase in the fair value of Registrant's long-term debt.

Market risk related to Registrant's variable-rate debt is estimated as the potential decrease in pretax earnings resulting from an increase in interest rates. The interest rates applicable to variable-rate debt are based on weekly market rates. At December 31, 2010, the weekly market rate was approximately 0.4%. Based on \$6.3 million of variable-rate debt outstanding as of December 31, 2010, a hypothetical one percent rise in interest rates would not result in a material impact to earnings.

At December 31, 2010, Registrant did not believe that its short-term debt was subject to interest rate risk, due to the fair market value being approximately equal to the carrying value.

The July 2009 decision in the GSWC cost of capital proceeding authorized an interest rate balancing account to track interest costs of new debt. This balancing account tracks any difference between the forecast incremental cost of debt included in the cost of capital adopted and the actual cost of debt for any long-term debt issued by GSWC from the effective date of the final decision.

### **Commodity/Derivative Risk**

Registrant is exposed to commodity price risk primarily relating to changes in the market price of electricity for BVES. To manage its exposure to energy price risk, during 2001 and 2002 GSWC entered into certain block-forward purchase power contracts that qualified as derivative instruments under the accounting guidance for derivatives. A derivative financial instrument or other contract derives its value from another investment or designated benchmark. The power purchased under these contracts was only used to service electric customers' demand and GSWC did not and does not engage in trading of purchased power. Certain of these contracts did qualify as an exception provided under the accounting guidance for derivatives for activities that were considered normal purchases and normal sales. These contracts have been reflected in the statements of income at the time of contract settlement. Contracts that did not qualify for the normal purchases and normal sales exception have been recognized at fair market value on the balance sheet as an asset or liability and an unrealized gain or loss against earnings. On a monthly basis, the related asset or liability was adjusted to reflect the fair market value at the end of the month. As these contracts settled, the realized gains or losses were recorded in power purchased for resale, and the unrealized losses were reversed. As a result, GSWC recognized a pretax unrealized gain of \$1.6 million for the year ended December 31, 2008. The increases and decreases in energy prices throughout the terms of these contracts resulted in significant fluctuations to GSWC's results of operations. The market prices for energy used to determine the fair value for this derivative instrument were estimated based on independent sources such as broker quotes and publications. The contracts entered into in 2001 and 2002 have all expired as of December 31, 2008.

In October 2008, GSWC executed a new purchased power contract that permits GSWC to purchase power at a fixed cost over three and five year terms depending on the amount of power and period during which the power will be purchased under the contract. The new contract is also subject to the accounting guidance for derivatives and requires mark-to-market derivative accounting. GSWC began receiving power under this contract on January 1, 2009. In May 2009, the CPUC issued a final decision approving the contract and authorized GSWC to establish a regulatory asset and liability memorandum account to offset the entries required by the accounting guidance. Accordingly, all unrealized gains and losses generated from the new purchased power contract are deferred on a monthly basis into the non-interest bearing regulatory memorandum account that tracks the changes in fair value of the derivative throughout the term of the contract. As of December 31, 2010, \$6.9 million of cumulative unrealized losses have been included in this memorandum account. Unrealized gains and losses on this account do not impact earnings.

Except as discussed above, Registrant has no other derivative financial instruments, financial instruments with significant off-balance sheet risks or financial instruments with concentrations of credit risk.

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

### **American States Water Company**

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**AMERICAN STATES WATER COMPANY  
CONSOLIDATED BALANCE SHEETS**

| (in thousands)                                                              | December 31,       |                    |
|-----------------------------------------------------------------------------|--------------------|--------------------|
|                                                                             | 2010               | 2009               |
| <b>Assets</b>                                                               |                    |                    |
| <b>Utility Plant, at cost</b>                                               |                    |                    |
| Regulated utility plant, at cost                                            |                    |                    |
| Water                                                                       | \$1,108,205        | \$1,061,345        |
| Electric                                                                    | 68,814             | 67,248             |
| Total                                                                       | 1,177,019          | 1,128,593          |
| Non utility property, at cost                                               | 5,795              | 4,510              |
| Total utility plant, at cost                                                | 1,182,814          | 1,133,103          |
| Less — accumulated depreciation                                             | (378,055)          | (354,123)          |
|                                                                             | 804,759            | 778,980            |
| Construction work in progress                                               | 50,197             | 43,047             |
| Net utility plant                                                           | 854,956            | 822,027            |
| <b>Other Property and Investments</b>                                       |                    |                    |
| Goodwill                                                                    | 1,116              | 1,116              |
| Other property and investments                                              | 10,981             | 10,989             |
| Total other property and investments                                        | 12,097             | 12,105             |
| <b>Current Assets</b>                                                       |                    |                    |
| Cash and cash equivalents                                                   | 4,197              | 1,557              |
| Accounts receivable-customers, less allowance for doubtful accounts         | 17,507             | 16,193             |
| Unbilled revenue                                                            | 20,348             | 17,835             |
| Receivable from U.S. government, less allowance for doubtful accounts       | 3,689              | 4,245              |
| Other accounts receivable, less allowance for doubtful accounts             | 7,808              | 8,334              |
| Income taxes receivable                                                     | 12,342             | 4,159              |
| Materials and supplies                                                      | 2,161              | 1,895              |
| Regulatory assets — current                                                 | 34,152             | 12,267             |
| Prepayments and other current assets                                        | 6,157              | 3,165              |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 36,924             | 19,766             |
| Deferred income taxes — current                                             | 8,816              | 5,307              |
| Assets of discontinued operations (Note 19)                                 | 50,883             | 50,177             |
| Total current assets                                                        | 204,984            | 144,900            |
| <b>Regulatory and Other Assets</b>                                          |                    |                    |
| Regulatory assets                                                           | 101,801            | 110,420            |
| Other accounts receivable                                                   | 3,777              | 5,717              |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 5,824              | 7,933              |
| Deferred income taxes                                                       | 495                | 220                |
| Other                                                                       | 8,101              | 9,971              |
| Total regulatory and other assets                                           | 119,998            | 134,261            |
| <b>Total Assets</b>                                                         | <b>\$1,192,035</b> | <b>\$1,113,293</b> |

*The accompanying notes are an integral part of these consolidated financial statements.*

**AMERICAN STATES WATER COMPANY  
CONSOLIDATED BALANCE SHEETS**

| (in thousands)                                                              | December 31, |             |
|-----------------------------------------------------------------------------|--------------|-------------|
|                                                                             | 2010         | 2009        |
| <b>Capitalization and Liabilities</b>                                       |              |             |
| <b>Capitalization</b>                                                       |              |             |
| Common shareholders' equity                                                 | \$377,541    | \$359,430   |
| Long-term debt                                                              | 299,839      | 300,221     |
| Total capitalization                                                        | 677,380      | 659,651     |
| <b>Current Liabilities</b>                                                  |              |             |
| Notes payable to banks                                                      | 60,900       | 17,400      |
| Long-term debt — current                                                    | 376          | 365         |
| Accounts payable                                                            | 36,155       | 33,746      |
| Income taxes payable                                                        | 2,277        | 72          |
| Accrued employee expenses                                                   | 8,084        | 7,262       |
| Accrued interest                                                            | 3,256        | 3,263       |
| Regulatory liabilities — current                                            | —            | 113         |
| Deferred income taxes — current                                             | 88           | —           |
| Unrealized loss on purchased power contracts                                | 6,850        | 7,338       |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 16,808       | 6,315       |
| Other                                                                       | 17,017       | 23,047      |
| Liabilities of discontinued operations (Note 19)                            | 27,031       | 27,006      |
| Total current liabilities                                                   | 178,842      | 125,927     |
| <b>Other Credits</b>                                                        |              |             |
| Advances for construction                                                   | 78,325       | 79,443      |
| Contributions in aid of construction — net                                  | 95,460       | 91,519      |
| Deferred income taxes                                                       | 101,917      | 94,341      |
| Unamortized investment tax credits                                          | 2,063        | 2,154       |
| Accrued pension and other post-retirement benefits                          | 42,152       | 40,158      |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 8,618        | 11,580      |
| Other                                                                       | 7,278        | 8,520       |
| Total other credits                                                         | 335,813      | 327,715     |
| <b>Commitments and Contingencies (Notes 13 and 14)</b>                      |              |             |
| <b>Total Capitalization and Liabilities</b>                                 | \$1,192,035  | \$1,113,293 |

*The accompanying notes are an integral part of these consolidated financial statements.*

**AMERICAN STATES WATER COMPANY**  
**CONSOLIDATED STATEMENTS OF CAPITALIZATION**

| (in thousands, except share data)                                    | December 31,            |                         |
|----------------------------------------------------------------------|-------------------------|-------------------------|
|                                                                      | 2010                    | 2009                    |
| <b>Common Shareholders' Equity:</b>                                  |                         |                         |
| Common Shares, no par value, no stated value:                        |                         |                         |
| Authorized: 30,000,000 shares                                        |                         |                         |
| Outstanding: 18,630,846 shares in 2010 and 18,532,321 shares in 2009 | \$227,385               | \$223,066               |
| Earnings reinvested in the business                                  | 150,156                 | 136,364                 |
|                                                                      | <u>377,541</u>          | <u>359,430</u>          |
| <b>Long-Term Debt (All are of GSWC)</b>                              |                         |                         |
| Notes/Debentures:                                                    |                         |                         |
| 6.64% notes due 2013                                                 | 1,100                   | 1,100                   |
| 6.80% notes due 2013                                                 | 2,000                   | 2,000                   |
| 6.87% notes due 2023                                                 | 5,000                   | 5,000                   |
| 7.00% notes due 2023                                                 | 10,000                  | 10,000                  |
| 7.55% notes due 2025                                                 | 8,000                   | 8,000                   |
| 7.65% notes due 2025                                                 | 22,000                  | 22,000                  |
| 6.81% notes due 2028                                                 | 15,000                  | 15,000                  |
| 6.59% notes due 2029                                                 | 40,000                  | 40,000                  |
| 7.875% notes due 2030                                                | 20,000                  | 20,000                  |
| 7.23% notes due 2031                                                 | 50,000                  | 50,000                  |
| Private Placement Notes:                                             |                         |                         |
| 9.56% notes due 2031                                                 | 28,000                  | 28,000                  |
| 5.87% notes due 2028                                                 | 40,000                  | 40,000                  |
| 6.70% notes due 2019                                                 | 40,000                  | 40,000                  |
| Tax-Exempt Obligations:                                              |                         |                         |
| 5.50% notes due 2026                                                 | 7,785                   | 7,835                   |
| Variable Rate Obligation due 2014                                    | 6,000                   | 6,000                   |
| State Water Project due 2035                                         | 4,617                   | 4,685                   |
| Other Debt Instruments:                                              |                         |                         |
| 8.50% fixed rate obligation due 2012                                 | 346                     | 541                     |
| Variable Rate Obligation due 2018                                    | 268                     | 303                     |
| Capital lease obligations                                            | 99                      | 122                     |
|                                                                      | <u>300,215</u>          | <u>300,586</u>          |
| Less: Current maturities                                             | (376)                   | (365)                   |
|                                                                      | <u>299,839</u>          | <u>300,221</u>          |
| <b>Total Capitalization</b>                                          | <u><u>\$677,380</u></u> | <u><u>\$659,651</u></u> |

*The accompanying notes are an integral part of these consolidated financial statements.*

**AMERICAN STATES WATER COMPANY**  
**CONSOLIDATED STATEMENTS OF INCOME**

| (in thousands, except per share amounts)                           | For the years ended December 31, |                  |                 |
|--------------------------------------------------------------------|----------------------------------|------------------|-----------------|
|                                                                    | 2010                             | 2009             | 2008            |
| <b>Operating Revenues</b>                                          |                                  |                  |                 |
| Water                                                              | \$ 290,781                       | \$ 265,197       | \$ 240,464      |
| Electric                                                           | 35,801                           | 28,922           | 28,424          |
| Contracted services                                                | 72,360                           | 59,132           | 42,358          |
| Total operating revenues                                           | <u>398,942</u>                   | <u>353,251</u>   | <u>311,246</u>  |
| <b>Operating Expenses</b>                                          |                                  |                  |                 |
| Water purchased                                                    | 46,865                           | 44,973           | 45,815          |
| Power purchased for pumping                                        | 9,113                            | 9,658            | 9,819           |
| Groundwater production assessment                                  | 11,473                           | 11,563           | 10,623          |
| Power purchased for resale                                         | 13,078                           | 12,853           | 13,616          |
| Unrealized gain on purchased power contracts                       | —                                | —                | (1,554)         |
| Supply cost balancing accounts                                     | 20,622                           | 12,434           | (387)           |
| Other operation expenses                                           | 29,184                           | 28,808           | 29,491          |
| Administrative and general expenses                                | 87,135                           | 69,051           | 61,465          |
| Depreciation and amortization                                      | 37,405                           | 31,531           | 29,510          |
| Maintenance                                                        | 18,149                           | 17,012           | 15,964          |
| Property and other taxes                                           | 14,165                           | 12,824           | 12,074          |
| Construction expenses                                              | 38,577                           | 33,717           | 23,872          |
| Net gain on sale of property                                       | (643)                            | (15)             | —               |
| Total operating expenses                                           | <u>325,123</u>                   | <u>284,409</u>   | <u>250,308</u>  |
| <b>Operating Income</b>                                            | <u>73,819</u>                    | <u>68,842</u>    | <u>60,938</u>   |
| <b>Other Income and Expenses</b>                                   |                                  |                  |                 |
| Interest expense                                                   | (21,636)                         | (21,899)         | (20,877)        |
| Interest income                                                    | 2,406                            | 911              | 1,832           |
| Other                                                              | (463)                            | 221              | 70              |
| Total other income and expenses                                    | <u>(19,693)</u>                  | <u>(20,767)</u>  | <u>(18,975)</u> |
| <b>Income from continuing operations before income tax expense</b> | 54,126                           | 48,075           | 41,963          |
| Income tax expense                                                 | 23,035                           | 18,701           | 15,967          |
| <b>Income from continuing operations</b>                           | <u>31,091</u>                    | <u>29,374</u>    | <u>25,996</u>   |
| <b>Income (loss) from discontinued operations, net of tax</b>      | <u>2,106</u>                     | <u>157</u>       | <u>(3,991)</u>  |
| <b>Net Income</b>                                                  | <u>\$ 33,197</u>                 | <u>\$ 29,531</u> | <u>\$22,005</u> |
| <b>Basic Earnings Per Common Share</b>                             |                                  |                  |                 |
| Income from continuing operations                                  | \$ 1.67                          | \$1.62           | \$ 1.50         |
| Income (loss) from discontinued operations, net of tax             | 0.11                             | 0.01             | (0.23)          |
| Net Income                                                         | <u>\$1.78</u>                    | <u>\$1.63</u>    | <u>\$ 1.27</u>  |
| <b>Fully Diluted Earnings Per Share</b>                            |                                  |                  |                 |
| Income from continuing operations                                  | \$ 1.66                          | \$1.61           | \$ 1.49         |
| Income (loss) from discontinued operations, net of tax             | 0.11                             | 0.01             | (0.23)          |
| Net Income                                                         | <u>\$ 1.77</u>                   | <u>\$1.62</u>    | <u>\$ 1.26</u>  |
| <b>Weighted Average Number of Shares Outstanding</b>               | 18,585                           | 18,052           | 17,262          |
| <b>Weighted Average Number of Diluted Shares</b>                   | 18,736                           | 18,188           | 17,394          |
| <b>Dividends Declared Per Common Share</b>                         | \$ 1.04                          | \$ 1.01          | \$ 1.00         |

*The accompanying notes are an integral part of these consolidated financial statements.*

**AMERICAN STATES WATER COMPANY**  
**CONSOLIDATED STATEMENTS OF CHANGES**  
**IN COMMON SHAREHOLDERS' EQUITY**

| (in thousands)                                                         | Common Shares          |            | Earnings<br>Reinvested<br>in the<br>Business | Total      |
|------------------------------------------------------------------------|------------------------|------------|----------------------------------------------|------------|
|                                                                        | Number<br>of<br>Shares | Amount     |                                              |            |
| <b>Balances at December 31, 2007</b>                                   | 17,231                 | \$ 181,796 | \$ 120,333                                   | \$ 302,129 |
| Add:                                                                   |                        |            |                                              |            |
| Net income                                                             |                        |            | 22,005                                       | 22,005     |
| Issuance of Common Shares                                              | 42                     | 1,173      |                                              | 1,173      |
| Exercise of stock options                                              | 28                     | 690        |                                              | 690        |
| Tax benefit from employee stock options                                |                        | 150        |                                              | 150        |
| Compensation on stock-based awards                                     |                        | 1,613      |                                              | 1,613      |
| Dividend equivalent rights on stock-based awards not paid<br>in cash   |                        | 77         |                                              | 77         |
| Deduct:                                                                |                        |            |                                              |            |
| Dividends on Common Shares                                             |                        |            | 17,257                                       | 17,257     |
| Dividend equivalent rights on stock based awards, net of<br>tax effect |                        |            | 77                                           | 77         |
| <b>Balances at December 31, 2008</b>                                   | 17,301                 | 185,499    | 125,004                                      | 310,503    |
| Add:                                                                   |                        |            |                                              |            |
| Net income                                                             |                        |            | 29,531                                       | 29,531     |
| Issuance of Common Shares                                              | 1,218                  | 35,797     |                                              | 35,797     |
| Exercise of stock options                                              | 13                     | 309        |                                              | 309        |
| Tax benefit from employee stock options                                |                        | 80         |                                              | 80         |
| Compensation on stock-based awards                                     |                        | 1,308      |                                              | 1,308      |
| Dividend equivalent rights on stock-based awards not paid<br>in cash   |                        | 73         |                                              | 73         |
| Deduct:                                                                |                        |            |                                              |            |
| Dividends on Common Shares                                             |                        |            | 18,098                                       | 18,098     |
| Dividend equivalent rights on stock based awards, net of<br>tax effect |                        |            | 73                                           | 73         |
| <b>Balances at December 31, 2009</b>                                   | 18,532                 | 223,066    | 136,364                                      | 359,430    |
| Add:                                                                   |                        |            |                                              |            |
| Net income                                                             |                        |            | 33,197                                       | 33,197     |
| Issuance of Common Shares                                              | 68                     | 1,838      |                                              | 1,838      |
| Exercise of stock options                                              | 31                     | 857        |                                              | 857        |
| Tax benefit from employee stock options                                |                        | 111        |                                              | 111        |
| Compensation on stock-based awards                                     |                        | 1,434      |                                              | 1,434      |
| Dividend equivalent rights on stock-based awards not paid<br>in cash   |                        | 79         |                                              | 79         |
| Deduct:                                                                |                        |            |                                              |            |
| Dividends on Common Shares                                             |                        |            | 19,326                                       | 19,326     |
| Dividend equivalent rights on stock based awards, net of<br>tax effect |                        |            | 79                                           | 79         |
| <b>Balances at December 31, 2010</b>                                   | 18,631                 | \$ 227,385 | \$ 150,156                                   | \$ 377,541 |

*The accompanying notes are an integral part of these consolidated financial statements.*

**AMERICAN STATES WATER COMPANY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| (in thousands)                                                                    | For the years ended December 31, |                 |                 |
|-----------------------------------------------------------------------------------|----------------------------------|-----------------|-----------------|
|                                                                                   | 2010                             | 2009            | 2008            |
| <b>Cash Flows From Operating Activities:</b>                                      |                                  |                 |                 |
| Net income                                                                        | \$33,197                         | \$29,531        | \$22,005        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                  |                 |                 |
| Depreciation and amortization                                                     | 38,167                           | 33,557          | 31,562          |
| Net gain on sale of property                                                      | (643)                            | (15)            | —               |
| Provision for doubtful accounts                                                   | 1,069                            | 1,012           | 885             |
| Deferred income taxes and investment tax credits                                  | 6,689                            | 7,583           | 1,957           |
| Unrealized gain on purchased power contracts                                      | —                                | —               | (1,554)         |
| Equity loss (earnings) from investment                                            | 612                              | (111)           | (71)            |
| Stock-based compensation expense                                                  | 1,482                            | 1,333           | 1,499           |
| Impairment and other charges                                                      | 16,634                           | —               | —               |
| Loss on settlement for removal of wells                                           | —                                | 760             | —               |
| Goodwill impairment charge                                                        | —                                | —               | 7,700           |
| Other — net                                                                       | 6                                | 1,237           | 522             |
| Changes in assets and liabilities:                                                |                                  |                 |                 |
| Accounts receivable — customers                                                   | (2,230)                          | (3,308)         | 884             |
| Unbilled revenue                                                                  | (2,509)                          | (241)           | (1,923)         |
| Other accounts receivable                                                         | 2,345                            | 367             | (786)           |
| Receivables from the U.S. government                                              | 556                              | 3,849           | (372)           |
| Materials and supplies                                                            | (267)                            | 209             | (533)           |
| Prepayments and other current assets                                              | (1,193)                          | (405)           | (185)           |
| Regulatory assets - supply cost balancing accounts                                | 20,622                           | 12,434          | (387)           |
| Other assets (including other regulatory assets)                                  | (42,045)                         | (19,684)        | (737)           |
| Costs and estimated earnings in excess of billings on uncompleted contracts       | (15,049)                         | (8,966)         | (12,607)        |
| Accounts payable                                                                  | 3,154                            | (529)           | 7,532           |
| Income taxes receivable/payable                                                   | (2,678)                          | (3,566)         | (890)           |
| Billings in excess of costs and estimated earnings on uncompleted contracts       | 7,531                            | 5,935           | 7,282           |
| Accrued pension and other post-retirement benefits                                | (542)                            | 1,029           | 687             |
| Other liabilities                                                                 | (11,144)                         | 10,583          | (324)           |
| Net cash provided                                                                 | <u>53,764</u>                    | <u>72,594</u>   | <u>62,146</u>   |
| <b>Cash Flows From Investing Activities:</b>                                      |                                  |                 |                 |
| Capital expenditures                                                              | (79,050)                         | (77,459)        | (77,018)        |
| Business acquisition                                                              | —                                | —               | (2,298)         |
| Proceeds from sale of property                                                    | 820                              | 16              | —               |
| Net cash used                                                                     | <u>(78,230)</u>                  | <u>(77,443)</u> | <u>(79,316)</u> |
| <b>Cash Flows from Financing Activities:</b>                                      |                                  |                 |                 |
| Proceeds from issuance of Common Shares, net of issuance costs                    | 1,838                            | 35,797          | 1,173           |
| Proceeds from stock option exercises                                              | 857                              | 309             | 690             |
| Tax benefits from exercise of stock-based awards                                  | 111                              | 80              | 150             |
| Receipt of advances for and contributions in aid of construction                  | 6,069                            | 3,450           | 4,892           |
| Refunds on advances for construction                                              | (3,837)                          | (3,876)         | (3,603)         |
| Retirement or repayments of long-term debt                                        | (701)                            | (611)           | (663)           |
| Proceeds from issuance of long-term debt, net of issuance costs                   | —                                | 39,750          | —               |
| Net change in notes payable to banks                                              | 43,500                           | (57,300)        | 37,500          |
| Dividends paid                                                                    | (19,326)                         | (18,098)        | (17,257)        |
| Other                                                                             | (236)                            | (250)           | (127)           |
| Net cash provided (used)                                                          | <u>28,275</u>                    | <u>(749)</u>    | <u>22,755</u>   |
| <b>Net increase (decrease) in cash and cash equivalents</b>                       | <u>3,809</u>                     | <u>(5,598)</u>  | <u>5,585</u>    |
| Cash and cash equivalents, beginning of year                                      | <u>1,685</u>                     | <u>7,283</u>    | <u>1,698</u>    |
| <b>Cash and cash equivalents, end of year</b>                                     | <u>5,494</u>                     | <u>1,685</u>    | <u>7,283</u>    |
| <b>Less cash and cash equivalents of discontinued operations</b>                  | <u>1,297</u>                     | <u>128</u>      | <u>213</u>      |
| <b>Cash and cash equivalents of continuing operations</b>                         | <u>\$ 4,197</u>                  | <u>\$ 1,557</u> | <u>\$ 7,070</u> |

*The accompanying notes are an integral part of these consolidated financial statements.*

**GOLDEN STATE WATER COMPANY  
BALANCE SHEETS**

| (in thousands)                                                      | December 31,       |                    |
|---------------------------------------------------------------------|--------------------|--------------------|
|                                                                     | 2010               | 2009               |
| <b>Assets</b>                                                       |                    |                    |
| <b>Utility Plant, at cost</b>                                       |                    |                    |
| Water                                                               | \$1,108,205        | \$1,061,345        |
| Electric                                                            | 68,814             | 67,248             |
|                                                                     | 1,177,019          | 1,128,593          |
| Less — accumulated depreciation                                     | (375,740)          | (352,574)          |
|                                                                     | 801,279            | 776,019            |
| Construction work in progress                                       | 50,088             | 43,025             |
| Net utility plant                                                   | 851,367            | 819,044            |
| <b>Other Property and Investments</b>                               | 8,899              | 8,738              |
|                                                                     | 8,899              | 8,738              |
| <b>Current Assets</b>                                               |                    |                    |
| Cash and cash equivalents                                           | 1,541              | 1,096              |
| Accounts receivable-customers, less allowance for doubtful accounts | 17,507             | 16,193             |
| Unbilled revenue                                                    | 20,348             | 17,835             |
| Inter-company receivable                                            | 2,057              | 372                |
| Other accounts receivable, less allowance for doubtful accounts     | 6,174              | 8,044              |
| Income taxes receivable from Parent                                 | 7,421              | 2,496              |
| Materials and supplies                                              | 1,779              | 1,679              |
| Regulatory assets — current                                         | 34,152             | 12,267             |
| Prepayments and other current assets                                | 5,695              | 3,144              |
| Deferred income taxes — current                                     | 7,814              | 5,146              |
| Total current assets                                                | 104,488            | 68,272             |
| <b>Regulatory and Other Assets</b>                                  |                    |                    |
| Regulatory assets                                                   | 101,801            | 110,420            |
| Other accounts receivable                                           | 3,777              | 5,717              |
| Other                                                               | 8,146              | 9,654              |
| Total regulatory and other assets                                   | 113,724            | 125,791            |
| <b>Total Assets</b>                                                 | <b>\$1,078,478</b> | <b>\$1,021,845</b> |

*The accompanying notes are an integral part of these financial statements.*

**GOLDEN STATE WATER COMPANY  
BALANCE SHEETS**

| (in thousands)                                         | December 31, |             |
|--------------------------------------------------------|--------------|-------------|
|                                                        | 2010         | 2009        |
| <b>Capitalization and Liabilities</b>                  |              |             |
| <b>Capitalization</b>                                  |              |             |
| Common shareholder's equity                            | \$358,295    | \$331,530   |
| Long-term debt                                         | 299,839      | 300,221     |
| Total capitalization                                   | 658,134      | 631,751     |
| <b>Current Liabilities</b>                             |              |             |
| Long-term debt — current                               | 376          | 365         |
| Accounts payable                                       | 25,463       | 26,829      |
| Inter-company payable                                  | 34,575       | 7,551       |
| Accrued employee expenses                              | 7,212        | 6,338       |
| Accrued interest                                       | 3,251        | 3,256       |
| Regulatory liabilities — current                       | —            | 113         |
| Unrealized loss on purchased power contracts           | 6,850        | 7,338       |
| Other                                                  | 16,032       | 22,136      |
| Total current liabilities                              | 93,759       | 73,926      |
| <b>Other Credits</b>                                   |              |             |
| Advances for construction                              | 78,325       | 79,443      |
| Contributions in aid of construction — net             | 95,460       | 91,519      |
| Deferred income taxes                                  | 101,474      | 94,418      |
| Unamortized investment tax credits                     | 2,063        | 2,154       |
| Accrued pension and other post-retirement benefits     | 42,152       | 40,158      |
| Other                                                  | 7,111        | 8,476       |
| Total other credits                                    | 326,585      | 316,168     |
| <b>Commitments and Contingencies (Notes 13 and 14)</b> |              |             |
| <b>Total Capitalization and Liabilities</b>            | \$1,078,478  | \$1,021,845 |

*The accompanying notes are an integral part of these financial statements.*

**GOLDEN STATE WATER COMPANY  
STATEMENTS OF CAPITALIZATION**

| (in thousands, except share data)                                                   | December 31,     |                  |
|-------------------------------------------------------------------------------------|------------------|------------------|
|                                                                                     | 2010             | 2009             |
| <b>Common Shareholder's Equity:</b>                                                 |                  |                  |
| Common shares, no par value, Outstanding: 142 shares in 2010 and 134 shares in 2009 | \$217,149        | \$195,821        |
| Earnings reinvested in the business                                                 | 141,146          | 135,709          |
|                                                                                     | <u>358,295</u>   | <u>331,530</u>   |
| <b>Long-Term Debt</b>                                                               |                  |                  |
| Notes/Debentures:                                                                   |                  |                  |
| 6.64% notes due 2013                                                                | 1,100            | 1,100            |
| 6.80% notes due 2013                                                                | 2,000            | 2,000            |
| 6.87% notes due 2023                                                                | 5,000            | 5,000            |
| 7.00% notes due 2023                                                                | 10,000           | 10,000           |
| 7.55% notes due 2025                                                                | 8,000            | 8,000            |
| 7.65% notes due 2025                                                                | 22,000           | 22,000           |
| 6.81% notes due 2028                                                                | 15,000           | 15,000           |
| 6.59% notes due 2029                                                                | 40,000           | 40,000           |
| 7.875% notes due 2030                                                               | 20,000           | 20,000           |
| 7.23% notes due 2031                                                                | 50,000           | 50,000           |
| Private Placement Notes:                                                            |                  |                  |
| 9.56% notes due 2031                                                                | 28,000           | 28,000           |
| 5.87% notes due 2028                                                                | 40,000           | 40,000           |
| 6.70% notes due 2019                                                                | 40,000           | 40,000           |
| Tax-Exempt Obligations:                                                             |                  |                  |
| 5.50% notes due 2026                                                                | 7,785            | 7,835            |
| Variable Rate Obligation due 2014                                                   | 6,000            | 6,000            |
| State Water Project due 2035                                                        | 4,617            | 4,685            |
| Other Debt Instruments:                                                             |                  |                  |
| 8.50% fixed rate obligation due 2012                                                | 346              | 541              |
| Variable rate obligation due 2018                                                   | 268              | 303              |
| Capital lease obligations                                                           | 99               | 122              |
|                                                                                     | <u>300,215</u>   | <u>300,586</u>   |
| Less: Current maturities                                                            | (376)            | (365)            |
|                                                                                     | <u>299,839</u>   | <u>300,221</u>   |
| <b>Total Capitalization</b>                                                         | <u>\$658,134</u> | <u>\$631,751</u> |

*The accompanying notes are an integral part of these financial statements.*

**GOLDEN STATE WATER COMPANY  
STATEMENTS OF INCOME**

| (in thousands)                                          | For the years ended December 31, |                 |                 |
|---------------------------------------------------------|----------------------------------|-----------------|-----------------|
|                                                         | 2010                             | 2009            | 2008            |
| <b>Operating Revenues</b>                               |                                  |                 |                 |
| Water                                                   | \$290,781                        | \$265,197       | \$240,464       |
| Electric                                                | 35,801                           | 28,922          | 28,424          |
| Total operating revenues                                | <u>326,582</u>                   | <u>294,119</u>  | <u>268,888</u>  |
| <b>Operating Expenses</b>                               |                                  |                 |                 |
| Water purchased                                         | 46,865                           | 44,972          | 45,815          |
| Power purchased for pumping                             | 9,113                            | 9,657           | 9,818           |
| Groundwater production assessment                       | 11,473                           | 11,563          | 10,623          |
| Power purchased for resale                              | 13,078                           | 12,853          | 13,616          |
| Unrealized gain on purchased power contracts            | —                                | —               | (1,554)         |
| Supply cost balancing accounts                          | 20,622                           | 12,434          | (387)           |
| Other operation expenses                                | 25,501                           | 25,296          | 24,781          |
| Administrative and general expenses                     | 71,671                           | 57,120          | 49,897          |
| Depreciation and amortization                           | 36,600                           | 30,867          | 28,997          |
| Maintenance                                             | 15,840                           | 14,318          | 13,431          |
| Property and other taxes                                | 12,658                           | 11,568          | 10,933          |
| Net gain on sale of property                            | (640)                            | (15)            | —               |
| Total operating expenses                                | <u>262,781</u>                   | <u>230,633</u>  | <u>205,970</u>  |
| <b>Operating Income</b>                                 | <u>63,801</u>                    | <u>63,486</u>   | <u>62,918</u>   |
| <b>Other Income and Expenses</b>                        |                                  |                 |                 |
| Interest expense                                        | (21,215)                         | (21,398)        | (19,651)        |
| Interest income                                         | 1,914                            | 898             | 1,774           |
| Other                                                   | (307)                            | 196             | 53              |
| Total other income and expenses                         | <u>(19,608)</u>                  | <u>(20,304)</u> | <u>(17,824)</u> |
| <b>Income from operations before income tax expense</b> | <u>44,193</u>                    | <u>43,182</u>   | <u>45,094</u>   |
| Income tax expense                                      | <u>19,083</u>                    | <u>17,809</u>   | <u>17,275</u>   |
| <b>Net Income</b>                                       | <u>\$25,110</u>                  | <u>\$25,373</u> | <u>\$27,819</u> |

*The accompanying notes are an integral part of these financial statements.*

**GOLDEN STATE WATER COMPANY  
STATEMENTS OF CHANGES IN  
COMMON SHAREHOLDER'S EQUITY**

| (in thousands, except number of shares)                             | Common Shares    |            | Earnings Reinvested in the Business | Total      |
|---------------------------------------------------------------------|------------------|------------|-------------------------------------|------------|
|                                                                     | Number of Shares | Amount     |                                     |            |
| <b>Balances at December 31, 2007</b>                                | 122              | \$ 163,180 | \$ 115,261                          | \$ 278,441 |
| Add:                                                                |                  |            |                                     |            |
| Net income                                                          |                  |            | 27,819                              | 27,819     |
| Issuance of Common Shares to Parent                                 | 12               | 30,000     |                                     | 30,000     |
| Tax benefit from employee stock options                             |                  | 149        |                                     | 149        |
| Compensation on stock based awards                                  |                  | 1,324      |                                     | 1,324      |
| Dividend equivalent rights on stock-based awards not paid in cash   |                  | 75         |                                     | 75         |
| Deduct:                                                             |                  |            |                                     |            |
| Dividends on Common Shares                                          |                  |            | 13,200                              | 13,200     |
| Dividend equivalent rights on stock-based awards, net of tax effect |                  |            | 75                                  | 75         |
| <b>Balances at December 31, 2008</b>                                | 134              | 194,728    | 129,805                             | 324,533    |
| Add:                                                                |                  |            |                                     |            |
| Net income                                                          |                  |            | 25,373                              | 25,373     |
| Tax benefit from employee stock options                             |                  | 79         |                                     | 79         |
| Compensation on stock based awards                                  |                  | 945        |                                     | 945        |
| Dividend equivalent rights on stock-based awards not paid in cash   |                  | 69         |                                     | 69         |
| Deduct:                                                             |                  |            |                                     |            |
| Dividends on Common Shares                                          |                  |            | 19,400                              | 19,400     |
| Dividend equivalent rights on stock-based awards, net of tax effect |                  |            | 69                                  | 69         |
| <b>Balances at December 31, 2009</b>                                | 134              | 195,821    | 135,709                             | 331,530    |
| Add:                                                                |                  |            |                                     |            |
| Net income                                                          |                  |            | 25,110                              | 25,110     |
| Issuance of Common Shares to Parent                                 | 8                | 20,000     |                                     | 20,000     |
| Tax benefit from employee stock options                             |                  | 107        |                                     | 107        |
| Compensation on stock based awards                                  |                  | 1,148      |                                     | 1,148      |
| Dividend equivalent rights on stock-based awards not paid in cash   |                  | 73         |                                     | 73         |
| Deduct:                                                             |                  |            |                                     |            |
| Dividends on Common Shares                                          |                  |            | 19,600                              | 19,600     |
| Dividend equivalent rights on stock-based awards, net of tax effect |                  |            | 73                                  | 73         |
| <b>Balances at December 31, 2010</b>                                | 142              | \$ 217,149 | \$ 141,146                          | \$ 358,295 |

*The accompanying notes are an integral part of these financial statements.*

**GOLDEN STATE WATER COMPANY**  
**STATEMENTS OF CASH FLOWS**

| (in thousands)                                                                    | For the years ended December 31, |                       |                       |
|-----------------------------------------------------------------------------------|----------------------------------|-----------------------|-----------------------|
|                                                                                   | 2010                             | 2009                  | 2008                  |
| <b>Cash Flows From Operating Activities:</b>                                      |                                  |                       |                       |
| Net income                                                                        | \$25,110                         | \$25,373              | \$ 27,819             |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                  |                       |                       |
| Depreciation and amortization                                                     | 36,600                           | 30,867                | 28,997                |
| Net gain on sale of property                                                      | (640)                            | (15)                  | —                     |
| Provision for doubtful accounts                                                   | 1,041                            | 977                   | 1,021                 |
| Deferred income taxes and investment tax credits                                  | 6,688                            | 7,994                 | 4,696                 |
| Unrealized gain on purchased power contracts                                      | —                                | —                     | (1,554)               |
| Impairment and other charges                                                      | 16,634                           | —                     | —                     |
| Equity loss (earnings) from investment                                            | 455                              | (87)                  | (53)                  |
| Stock-based compensation expense                                                  | 1,139                            | 946                   | 1,199                 |
| Other — net                                                                       | (200)                            | 741                   | 478                   |
| Changes in assets and liabilities:                                                |                                  |                       |                       |
| Accounts receivable — customers                                                   | (2,209)                          | (3,201)               | 899                   |
| Unbilled revenue                                                                  | (2,513)                          | (194)                 | (1,940)               |
| Other accounts receivable                                                         | 3,664                            | (1,246)               | 255                   |
| Materials and supplies                                                            | (100)                            | (136)                 | 19                    |
| Prepayments and other assets                                                      | (757)                            | (430)                 | (119)                 |
| Regulatory assets - supply cost balancing accounts                                | 20,622                           | 12,434                | (387)                 |
| Other assets (including other regulatory assets)                                  | (42,023)                         | (19,739)              | (538)                 |
| Accounts payable                                                                  | (683)                            | 2,722                 | 1,819                 |
| Inter-company receivable/payable                                                  | (75)                             | (304)                 | 304                   |
| Income taxes receivable/payable from/to Parent                                    | (2,001)                          | (5,290)               | 325                   |
| Accrued pension and other post-retirement benefits                                | (542)                            | 1,029                 | 687                   |
| Other liabilities                                                                 | (11,205)                         | 10,388                | (822)                 |
| Net cash provided                                                                 | <u>49,005</u>                    | <u>62,829</u>         | <u>63,105</u>         |
| <b>Cash Flows From Investing Activities:</b>                                      |                                  |                       |                       |
| Capital expenditures                                                              | (76,964)                         | (74,571)              | (73,092)              |
| Proceeds from sale of property                                                    | 817                              | 16                    | —                     |
| Net cash used                                                                     | <u>(76,147)</u>                  | <u>(74,555)</u>       | <u>(73,092)</u>       |
| <b>Cash Flows From Financing Activities:</b>                                      |                                  |                       |                       |
| Proceeds from issuance of long-term debt, net of issuance costs                   | —                                | 39,750                | —                     |
| Tax benefits from exercise of stock-based awards                                  | 107                              | 79                    | 149                   |
| Proceeds from issuance of Common Shares to Parent                                 | 20,000                           | —                     | 30,000                |
| Receipt of advances for and contributions in aid of construction                  | 5,944                            | 3,346                 | 4,550                 |
| Refunds on advances for construction                                              | (3,712)                          | (3,639)               | (3,220)               |
| Repayments of long-term debt                                                      | (371)                            | (301)                 | (363)                 |
| Net change in inter-company borrowings                                            | 25,400                           | (10,600)              | (5,390)               |
| Common dividends paid                                                             | (19,600)                         | (19,400)              | (13,200)              |
| Other                                                                             | (181)                            | (225)                 | (116)                 |
| Net cash provided                                                                 | <u>27,587</u>                    | <u>9,010</u>          | <u>12,410</u>         |
| <b>Net increase (decrease) in cash and cash equivalents</b>                       | <b>445</b>                       | <b>(2,716)</b>        | <b>2,423</b>          |
| Cash and cash equivalents, beginning of year                                      | <u>1,096</u>                     | <u>3,812</u>          | <u>1,389</u>          |
| <b>Cash and cash equivalents, end of year</b>                                     | <b><u>\$1,541</u></b>            | <b><u>\$1,096</u></b> | <b><u>\$3,812</u></b> |

*The accompanying notes are an integral part of these financial statements.*

## AMERICAN STATES WATER COMPANY AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

#### **Note 1 — Summary of Significant Accounting Policies**

**Nature of Operations:** American States Water Company (“AWR”) is the parent company of Golden State Water Company (“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 and its subsidiaries may be collectively referred to herein as “Registrant” or “the Company”. The subsidiaries of ASUS may be collectively referred to herein as the “Military Utility Privatization Subsidiaries.”

GSWC is a public utility engaged principally in the purchase, production, distribution and sale of water in California serving approximately 256,000 water customers. GSWC also distributes electricity in several San Bernardino Mountain communities serving approximately 23,000 electric customers. The California Public Utilities Commission (“CPUC”) regulates GSWC’s water and electric business, including properties, rates, services, facilities and other matters.

CCWC is a public utility regulated by the Arizona Corporation Commission (“ACC”) serving over 13,000 customers in the town of Fountain Hills, Arizona and a portion of the City of Scottsdale, Arizona. On June 7, 2010, AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. to sell all of the common shares of CCWC for a total purchase price of approximately \$35.0 million, including the assumption of approximately \$6.0 million of long-term debt as more fully described in Note 19. The purchase price is subject to certain adjustments for changes in retained earnings.

ASUS performs water and/or wastewater services and operations on a contract basis. Through its wholly-owned subsidiaries, ASUS has entered into agreements with the U.S. government to operate and maintain the water and/or wastewater systems at various military bases pursuant to 50-year fixed price contracts, which are subject to periodic price redeterminations and modifications for changes in circumstances, changes in laws and regulations and changes in wages and fringe benefits to the extent provided in each of the contracts. There is no direct regulatory oversight by either the CPUC or the ACC of the contracted services provided by ASUS or any of its wholly owned subsidiaries. AWR’s assets, revenues and operations are primarily those of GSWC.

**Basis of Presentation:** The consolidated financial statements and notes thereto are being presented in a combined report being filed by two separate Registrants: AWR and GSWC. References in this report to “Registrant” are to AWR and GSWC, collectively, unless otherwise specified. Certain prior period amounts have been reclassified to conform to the 2010 financial statement presentation related to discontinued operations described in Note 19.

The consolidated financial statements of AWR include the accounts of AWR and its wholly-owned subsidiaries and are prepared in conformity with accounting principles generally accepted in the United States of America. Inter-company transactions and balances have been eliminated in the AWR consolidated financial statements. Investments in partially-owned affiliates are accounted for by the equity method when Registrant’s ownership interest exceeds 20%. The preparation of these financial statements required the use of certain estimates by management in determining Registrant’s assets, liabilities, revenues and expenses. Actual results could differ from those estimates.

**Related Party Transactions:** AWR’s subsidiaries provide and receive various services to and from their parent, AWR, and among themselves. In addition, AWR has a \$100.0 million syndicated credit facility. AWR borrows under this facility and provides funds to its subsidiaries, including GSWC, in support of its operations. Amounts owed to AWR for borrowings under this facility represent the majority of GSWC’s inter-company payables on GSWC’s balance sheets as of December 31, 2010 and 2009. The interest rate charged to GSWC is sufficient to cover AWR’s interest cost under the credit facility. GSWC also allocates certain corporate office administrative and general costs to its affiliates using agreed allocation factors. AWR owns all of the outstanding common stock of GSWC, CCWC and ASUS. ASUS owns all of the outstanding common stock of the Military Utility Privatization Subsidiaries.

In May 2010, the Board of Directors approved the issuance of eight additional GSWC Common Shares to AWR for \$20.0 million. Proceeds from the issuance were used to pay down GSWC’s intercompany borrowings due to AWR.

**Utility Accounting:** Registrant’s accounting policies conform to accounting principles generally accepted in the United States of America, including the accounting principles for rate-regulated enterprises, which reflect the ratemaking policies of the CPUC, ACC and the Federal Energy Regulatory Commission (“FERC”). The utility subsidiaries, GSWC and CCWC, have incurred various costs and received various credits reflected as regulatory assets and liabilities. Accounting for such costs and credits as regulatory assets and liabilities is in accordance with the guidance for accounting for the effects of

certain types of regulation. This guidance sets forth the application of accounting principles generally accepted in the United States of America for those companies whose rates are established by or are subject to approval by an independent third-party regulator.

Under such accounting guidance, rate regulated entities defer costs and credits on the balance sheet as regulatory assets and liabilities when it is probable that those costs and credits will be recognized in the ratemaking process in a period different from the period in which they would have been reflected in income by an unregulated company. These deferred regulatory assets and liabilities are then reflected in the income statement in the period in which the same amounts are reflected in the rates charged for service. The amounts included as regulatory assets and liabilities that will be collected over a period exceeding one year are classified as long-term assets and liabilities as of December 31, 2010 and 2009.

**Property and Depreciation:** GSWC and CCWC capitalize, as utility plant, the cost of additions, betterments and replacements of retired units. Such cost includes labor, material and certain indirect charges. Water systems acquired are recorded at estimated original cost of utility plant when first devoted to utility service and the applicable accumulated depreciation is recorded to accumulated depreciation. The difference between the estimated original cost, less accumulated depreciation, and the purchase price, if recognized by the regulator, is recorded as an acquisition adjustment within utility plant. At December 31, 2010, utility plant includes a net credit acquisition adjustment of \$8.8 million for GSWC, which is generally being amortized over approximately 30 years as permitted by the CPUC. Amortization of the acquisition adjustments totaled \$374,000 for each of the three years ended December 31, 2010.

Depreciation is computed on the straight-line, remaining-life basis, based on depreciable plant as of the beginning of each year in accordance with the applicable ratemaking process. The aggregate provisions for depreciation for GSWC's water distribution unit approximated 3.8% for 2010 and 3.4% for 2009 and 2008, and approximately 3.7% for its electric unit for the years 2010, 2009 and 2008. The aggregate provision for depreciation for CCWC was approximately 3.9% for 2010 and 3.8% for 2009 and 2008. Expenditures for maintenance and repairs are expensed as incurred. Replaced or retired property costs, including cost of removal, are charged to the accumulated provision for depreciation. Property owned and depreciation recorded by ASUS and its subsidiaries are not material to Registrant's financial statements.

Estimated useful lives of GSWC's utility plant, as authorized by the CPUC, are as follows:

|                               |                      |
|-------------------------------|----------------------|
| Source of water supply        | 30 years to 50 years |
| Pumping                       | 25 years to 40 years |
| Water treatment               | 20 years to 35 years |
| Transmission and distribution | 25 years to 55 years |
| Generation                    | 40 years             |
| Other plant                   | 7 years to 40 years  |

**Impairment of Long-Lived Assets:** Long-lived assets are reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of an asset may not be fully recoverable in accordance with accounting guidance for impairment or disposal of long-lived assets. Registrant would recognize an impairment loss only if the carrying value amount of a long-lived asset is not recoverable from customer rates authorized by the CPUC and ACC. Impairment loss is measured as the excess of the carrying value over the amounts recovered in customer rates. During the year ended December 31, 2010, an impairment loss was recorded in operating expenses as a result of the disallowance of certain capital costs by the CPUC as more fully discussed in Note 2. For the years ended December 31, 2009 and 2008, no impairment losses were recorded.

**Goodwill:** At December 31, 2010, Registrant had approximately \$1.1 million of goodwill included in "Other Property and Investments." The \$1.1 million of the goodwill arose from ASUS's 2008 acquisition of a subcontractor's business.

In accordance with the accounting guidance for goodwill and other intangibles, goodwill is tested for impairment at least annually and more frequently if circumstances indicate that it may be impaired. Registrant performs its test for the impairment of goodwill as of December 31 each year. Goodwill impairment testing is performed at the operating segment (or "reporting unit") level. The goodwill impairment model is a two-step process. First, it requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. Registrant uses the terminal multiple valuation method in estimating fair value which assumes a business will be sold at the end of the projection period at a specific terminal multiple. Earnings and discounted cash flows were developed from Registrant's internal forecasts. Additionally, management must make an estimate of a weighted average cost of capital to be used as a discount rate, which takes into account certain risk and size premiums, long-term bond yields, and the capital structure of the industry. Changes in these projections or estimates could result in a reporting unit either passing or failing the first step in the impairment model, which could significantly change the amount of any impairment ultimately recorded.

Registrant also considers other qualitative and quantitative factors, including terminal multiples used in the water industry, the regulatory environment in which the reporting unit operates that can significantly impact future earnings and cash flows, and the effects of the volatile current economic environment. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. In this process, a fair value for goodwill is estimated, based in part on the fair value of the applicable reporting unit's assets and liabilities used in the first step, and are compared to its carrying value. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. The amount by which carrying value exceeds fair value represents the amount of goodwill impairment.

The current impairment analysis performed for 2010 did not indicate impairment had occurred for the current amount of \$1.1 million in goodwill for ASUS.

**Cash and Cash Equivalents:** Cash and cash equivalents include short-term cash investments with an original maturity of three months or less. At times, cash and cash equivalent balances may be in excess of federally insured limits. Cash and cash equivalents are held with financial institutions with high credit standings.

**Accounts Receivable:** Accounts receivable is reported on the balance sheet net of any allowance for doubtful accounts. The allowance for doubtful accounts is Registrant's best estimate of the amount of probable credit losses in Registrant's existing accounts receivable from its water and electric customers, and is determined based on historical write-off experience and the aging of account balances. Registrant reviews the allowance for doubtful accounts quarterly. Account balances are written off against the allowance when it is probable the receivable will not be recovered. When utility customers request extended payment terms, credit is extended based on regulatory guidelines, and collateral is not required. Other accounts receivable consist of amounts due from third parties (non-customers) for various reasons including amounts due from contractors, amounts due under settlement agreements, and amounts due from the U.S. government pursuant to contracts or modifications thereto to operate and maintain, and provide construction services for the water and/or wastewater systems at military bases. The allowance for these other accounts receivable is based on Registrant's evaluation of the receivable portfolio under current conditions and a review of specific problems and such other factors that, in Registrant's judgment, should be considered in estimating losses. Allowances for doubtful accounts are more fully disclosed in Note 17.

**Materials and Supplies:** Materials and supplies are stated at the lower of cost or market. Cost is computed using average cost.

**Interest:** Interest incurred during the construction of capital assets is generally not capitalized for financial reporting purposes as such policy is not followed in the ratemaking process. Interest expense is generally recovered through the regulatory process. However, in December 2010 as part of the final decision on the Region I general rate case, the CPUC authorized approximately \$18.5 million of capital projects to be filed for revenue recovery with advice letters when those projects are completed. During the time that such projects are under development and construction, GSWC may accrue an allowance for funds used during construction ("AFUDC") on the incurred expenditures to offset the cost of financing project construction. The advice letter projects are expected to be done over a two year period.

**Water and Electric Operating Revenues:** GSWC and CCWC record water and electric utility operating revenues when the service is provided to customers. Revenues include amounts billed to customers on a cycle basis based on meter reading for services provided and unbilled revenues representing estimated amounts to be billed for usage from the last meter reading date to the end of the accounting period. The unbilled revenues are based on customer billings subsequent to year end which are used to compile the actual unbilled consumption as of the year end reporting period. Flat-rate customers are billed in advance at the beginning of the service period and are reported as deferred revenues. Revenue from flat-rate customers is deferred and adjustments are calculated to determine the revenue related to the applicable period. In addition, with the adoption of the Water Revenue Adjustment Mechanism ("WRAM") and the Base Revenue Requirement Adjustment Mechanism ("BRRAM") by the CPUC, GSWC began recording the difference between what is billed to its regulated customers and that which is authorized by the CPUC.

**Other Operating Revenues:** Revenues from contract operations and maintenance agreements are recognized when services have been rendered to the customers under such agreements. Revenues from firm, fixed-price construction contracts are recognized based on the percentage-of-completion method of accounting. In accordance with GAAP, revenue recognition under the percentage-of-completion method requires us to estimate the progress toward completion on a contract in terms of efforts (such as costs incurred) or in terms of results achieved (such as units constructed). We have consistently applied these approaches of measuring progress on each of our firm, fixed-price construction projects. These approaches are used because management considers it to be the best available measure of progress on these contracts. Revenues from cost-plus-profit contracts are recognized on the basis of costs incurred during the period plus the profit earned, measured by the cost-to-cost method. Construction costs include all direct material and labor costs charged by subcontractors and those indirect costs related to contract performance, such as indirect labor, supplies, and tools. The factors considered in including

such costs in revenues and expenses are that ASUS and/or its subsidiaries: (i) are the primary obligor in these arrangements with the U.S. government; (ii) have latitude in establishing pricing; and (iii) bear credit risk in the collection of receivables from the U.S. government. Administrative and general costs are charged to expense as incurred. Precontract costs are generally expensed unless it is probable that we will be awarded the specific anticipated contract, in which case ASUS defers such costs. Capitalized precontract costs have been immaterial to date. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are determined. Changes in job performance, job conditions, change orders and estimated profitability, including those arising from contract penalty provisions, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

The asset, “Costs and estimated earnings in excess of billings on uncompleted contracts,” represents revenues recognized in excess of amounts billed. The liability, “Billings in excess of costs and estimated earnings on uncompleted contracts,” represents billings in excess of revenues recognized. Amounts expected to be earned/collected in the next 12-months have been classified as current.

**Debt Issuance Costs and Redemption Premiums:** Original debt issuance costs are capitalized and amortized over the lives of the respective issues. Premiums paid on the early redemption of debt, which is reacquired through refunding, are deferred and amortized over the life of the debt issued to finance the refunding as Registrant normally receives recovery of these costs in rates.

**Other Credits and Liabilities:** For GSWC, advances for construction represent amounts advanced by developers for the cost to construct water system facilities in order to extend water service to their properties. Advances are generally refundable at rates ranging from 10% to 22% of the revenue received from the installations for which funds were advanced or in equal annual installments, generally over 40 years. In certain instances, GSWC makes refunds on these advances over a specific period of time based on operating revenues related to the main or as new customers are connected to receive service from the main. Utility plant funded by advances and contributions is excluded from rate base. Generally, GSWC depreciates contributed property and amortizes contributions in aid of construction at the composite rate of the related property. Contributions-in-aid of construction are similar to advances, but require no refunding and are amortized over the useful lives of the related property.

**Fair Value of Financial Instruments:** For cash and cash equivalents, accounts receivable, accounts payable and short-term debt, the carrying amount is assumed to approximate fair value due to the short-term nature of the amounts. The table below estimates the fair value of long-term debt held by the utility subsidiaries. Rates available to the utility subsidiaries at December 31, 2010 and 2009 for debt with similar terms and remaining maturities were used to estimate fair value for long-term debt. Changes in the assumptions will produce differing results.

| (dollars in thousands) | 2010            |            | 2009            |            |
|------------------------|-----------------|------------|-----------------|------------|
|                        | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Financial liabilities: |                 |            |                 |            |
| Long-term debt—GSWC    | \$ 300,215      | \$ 356,005 | \$ 300,586      | \$ 335,217 |
|                        | \$ 300,215      | \$ 356,005 | \$ 300,586      | \$ 335,217 |

**Stock Options:** AWR has two stock incentive plans for employees, the 2000 Stock Incentive Plan, or 2000 Employee Plan, and the 2008 Stock Incentive Plan, or 2008 Employee Plan, and a stock incentive plan for directors, the 2003 Non-Employee Directors Stock Plan, or 2003 Directors Plan, which are described more fully in Note 12. Registrant applies the provisions in the accounting guidance for share-based payments in accounting for all of its stock-based awards. See Note 12 for further discussion.

**Sales and Use Taxes:** GSWC bills certain sales and use taxes levied by state or local governments to its customers. Included in these sales and use taxes are franchise fees, which GSWC pays to various municipalities (based on ordinances adopted by these municipalities) in order to use public right of way for utility purposes. GSWC bills these franchise fees to its customers based on a CPUC-authorized rate. These franchise fees, which are required to be paid regardless of GSWC's ability to collect from the customer, are accounted for on a gross basis. GSWC's franchise fees billed to customers and recorded as operating revenue were approximately \$3.3 million, \$2.9 million and \$2.6 million for the years ended December 31, 2010, 2009 and 2008, respectively. When GSWC acts as an agent, and the tax is not required to be remitted if it is not collected from the customer, the taxes are accounted for on a net basis.

Depending on the state in which the operations are conducted, ASUS and its subsidiaries are also subject to certain state non-income tax assessments generally computed on a “gross receipts” or “gross revenues” basis. These non-income tax assessments are required to be paid regardless of ASUS's ability to be reimbursed by the U.S. government under its 50-year contracts to operate and maintain the water and/or wastewater systems at military basis. The non-income tax assessments are accounted for on a gross basis and totaled \$890,000, \$726,000 and \$715,000 during the years ended December 31, 2010, 2009 and 2008, respectively.

Recently Issued Accounting Pronouncements: In June 2009, the Financial Accounting Standards Board (“FASB”) issued revised guidance which enhances information reported to users of financial statements by providing greater transparency about transfers of financial assets and a company’s continuing involvement in transferred assets. Generally accepted accounting principles no longer include the concept of a qualifying special purpose entity. The revised guidance also changes the requirements for derecognizing financial assets and requires additional disclosures about a transferor’s continuing involvement in transferred financial assets. This revised guidance was effective for Registrant beginning January 1, 2010 and did not have any impact on Registrant’s consolidated results of operations, financial position or cash flows.

In June 2009, the FASB amended the guidance on consolidation for variable interest entities. The new guidance requires a company to perform a qualitative analysis when determining whether it must consolidate a variable interest entity. This guidance also amends how to determine whether an entity is a variable interest entity. A company must now disclose how its involvement with a variable interest entity affects the company’s financial statements and disclose any significant judgments and assumptions made in determining whether it must consolidate a variable interest entity. This guidance was effective for the Registrant beginning January 1, 2010 and did not have any impact on the Registrant’s consolidated results of operations, financial position or cash flows.

In October 2009, the FASB issued an update to the accounting standards and provided amendments to the criteria of Accounting Standards Codification Topic 605, “*Revenue Recognition*”, for separately recognizing consideration in multiple-deliverable arrangements. The amendments establish a selling price hierarchy for determining the selling price of a deliverable. This guidance is effective for financial statements issued for fiscal years beginning on or after June 15, 2010. Registrant does not expect the adoption will have a material impact on its consolidated financial statements.

In January 2010, the FASB issued an update to the accounting standards and amended the disclosure guidance with respect to fair value measurements. Specifically, the new guidance requires disclosure of amounts transferred in and out of Levels 1 and 2 fair value measurements, a reconciliation presented on a gross basis rather than a net basis of activity in Level 3 fair value measurements, greater disaggregation of the assets and liabilities for which fair value measurements are presented and more robust disclosure of the valuation techniques and inputs used to measure Level 2 and 3 fair value measurements. This guidance is currently effective, with the exception of the new guidance for Level 3 activity reconciliations. The adoption of the effective portion of the guidance had no impact on Registrant’s consolidated financial statements. Certain Level 3 activities disclosure requirements of this guidance will be effective for fiscal years beginning after December 15, 2010. Registrant is currently evaluating the impact of Level 3 disclosure of this guidance, but does not expect the adoption will have a material impact on its consolidated financial statements.

Other accounting standards that have been issued or proposed by the FASB or other standards-setting bodies that do not require adoption until a future date are not expected to have a material impact on Registrant’s consolidated financial statements upon adoption.

## **Note 2 — Regulatory Matters**

In accordance with accounting principles for rate-regulated enterprises, Registrant records regulatory assets, which represent probable future revenue associated with certain costs that will be recovered from customers through the ratemaking process, and regulatory liabilities, which represent probable future reductions in revenue associated with amounts that are to be credited to customers through the ratemaking process. At December 31, 2010, Registrant had approximately \$36.2 million of regulatory assets not accruing carrying costs. Of this amount, \$30.4 million relates to the underfunded positions of the pension and other post-retirement obligations, \$4.3 million relates to deferred income taxes representing accelerated tax benefits flowed through to customers, which will be included in rates concurrently with recognition of the associated future tax expense, and \$6.9 million relates to a memorandum account authorized by the CPUC to track unrealized gains and losses on GSWC's purchase power contracts over the life of the contract. The remainder relates to other items that do not provide for or incur carrying costs. Regulatory assets, less regulatory liabilities, included in the consolidated balance sheets are as follows:

| (dollars in thousands)                                                              | December 31, |            |
|-------------------------------------------------------------------------------------|--------------|------------|
|                                                                                     | 2010         | 2009       |
| <b>GSWC</b>                                                                         |              |            |
| Electric supply cost balancing account.....                                         | \$ 10,305    | \$ 13,111  |
| Water supply cost balancing accounts.....                                           | 3,374        | 4,717      |
| Water Revenue Adjustment Mechanism, net of<br>Modified Cost Balancing Account ..... | 30,890       | 21,168     |
| Base Revenue Requirement Adjustment Mechanism.....                                  | 1,889        | 106        |
| Water Conservation Memorandum Account.....                                          | 1,435        | 1,985      |
| Costs deferred for future recovery on Aerojet case .....                            | 18,309       | 19,676     |
| Pensions and other post-retirement obligations.....                                 | 30,369       | 27,833     |
| Derivative unrealized loss (Note 4).....                                            | 6,850        | 7,338      |
| Flow-through taxes, net (Note 10).....                                              | 4,270        | 6,661      |
| Electric transmission line abandonment costs .....                                  | 2,638        | 2,828      |
| Asset retirement obligations .....                                                  | 2,711        | 3,826      |
| Low income rate assistance balancing accounts.....                                  | 4,657        | 4,764      |
| General rate case memorandum accounts .....                                         | 20,404       | 1,451      |
| Santa Maria adjudication memorandum accounts.....                                   | 3,737        | 3,895      |
| Other regulatory assets, net .....                                                  | 8,576        | 5,021      |
| Various refunds to customers .....                                                  | (14,461)     | (1,806)    |
| Total                                                                               | \$ 135,953   | \$ 122,574 |

### **Supply Cost Balancing Accounts:**

**Electric Supply Cost Balancing Account**—Electric power costs incurred by GSWC's Bear Valley Electric Service ("BVES") division continue to be charged to its electric supply cost balancing account. The under-collection in the electric supply cost balancing account is \$10.3 million at December 31, 2010. This balance is comprised of \$6.0 million for changes in purchased energy and power system delivery costs including interest, further discussed below. The remaining \$4.3 million in the electric supply cost balancing account relates to the tariff charged to GSWC by Southern California Edison ("Edison") for the abandonment of a transmission line upgrade, also discussed below.

Changes in purchased energy and power system delivery costs as compared to authorized rates have impacted the electric supply cost balancing account by \$6.0 million as of December 31, 2010. The purchased energy costs that are recorded in the supply cost balancing account are subject to a price cap by terms of a 2001 settlement which was subsequently approved in a CPUC decision. The BVES division of GSWC is allowed to include its actual recorded purchased energy costs up to a weighted annual average cost of \$77 per megawatt-hour ("MWh") in its electric supply cost balancing account. BVES began receiving power under a new purchased power contract on January 1, 2009. The main product under the new contract provides for 13 MWs of electric energy at a fixed price of \$67.85 per MWh during 2010 as compared to \$63.75 per MWh during 2009. The reduction in the actual price of purchased power helps decrease the under-collection balance in the electric supply cost balancing account. To the extent that the actual weighted average annual cost for power purchased exceeds the \$77 per MWh amount, GSWC will not be able to include these amounts in its balancing account and such amounts will be expensed. There were no amounts expensed over the \$77 per MWh cap during the years ended December 31, 2010, 2009 or 2008.

Charges to GSWC by Edison associated with the transportation of energy over Edison's power system and the abandonment of a transmission line upgrade have increased under Edison's tariff to levels that exceed the amounts authorized

by the CPUC in BVES retail power rates to its customers. The incremental cost increase to GSWC from the tariff for the abandonment of a transmission line upgrade, which is not currently included in rates, is approximately \$38,000 per month. The incremental costs of \$4.3 million at December 31, 2010 not included in rates have been included in the balancing account at December 31, 2010 for subsequent recovery from customers, subject to CPUC approval.

The power system delivery costs are not subject to the \$77 per MWh price cap referenced above. Other components, such as interest accrued on the cumulative under-collected balance and power lost during transmission, also affect the balance of the electric supply cost balancing account.

The CPUC has authorized GSWC to collect a surcharge from its customers of 2.2¢ per kilowatt hour through August 2011, to enable GSWC to recover an under-collection of approximately \$23.1 million at the end of 2001 which had been incurred during the energy crisis in late 2000 and 2001. As a result of the surcharge, the \$23.1 million under-collection incurred during the energy crisis in late 2000 and 2001 has now been fully recovered. This surcharge will continue to decrease the electric supply cost balancing account through August 2011. In December 2010, GSWC filed an advice letter with the CPUC seeking to extend the 2.2¢ surcharge through December 2012.

For the years ended December 31, 2010, 2009 and 2008, the under-collection decreased by approximately \$2.8 million, \$3.0 million and \$2.2 million, respectively.

**Water Supply Cost Balancing Accounts**— Prior to the implementation of the Modified Cost Balancing Account (“MCBA”) further discussed below, Registrant maintained water supply cost balancing accounts for GSWC to account for under-collections and over-collections of revenues designed to recover such costs. These supply cost balancing accounts tracked 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. Under-collections (recorded as regulatory assets) occurred when the current cost exceeded the amount in rates for these items and, conversely, over-collections (recorded as regulatory liabilities) occurred when the current cost of these items were less than the amount in rates. Typically, under-collections or over-collections, when they occur, were tracked in the supply cost balancing accounts for future recovery through a surcharge (in the event of an under-collection) or refund through a surcredit (in the event of an over-collection) on customers’ bills. Registrant accrues interest on its supply cost balancing accounts at the rate prevailing for 90-day commercial paper. Registrant does not maintain a supply cost balancing account for CCWC.

As of December 31, 2010, there is approximately \$3.4 million net under-collection in the water supply cost balancing accounts. Of this amount, approximately \$2.1 million relates to GSWC’s Region I customer service area. The remaining \$1.3 million net under-collection relates primarily to GSWC’s Region III. Currently, there is a surcharge in place to recover Region I’s under-collections. In March 2011, GSWC filed for recovery of its 2010 WRAM balances, net of MCBA and remaining supply cost balancing accounts in Regions II and III. Management believes that it is probable that the CPUC will permit GSWC to continue recovering in rates the net under-collections in supply costs.

On August 21, 2008, the CPUC issued a final decision approving a settlement agreement between GSWC and the CPUC’s Division of Ratepayer Advocates (“DRA”) regarding conservation rate design. As a result of this decision, GSWC established an MCBA that permits GSWC to recover supply costs related to changes in water supply mix in addition to rate changes by GSWC’s suppliers. GSWC implemented this MCBA in November 2008 for Regions II and III and in September 2009 for Region I. This account replaces the water supply cost balancing account procedure for costs incurred after the modified supply cost balancing account was implemented.

**Water Revenue Adjustment Mechanism (“WRAM”) and Modified Cost Balancing Account (“MCBA”):**

With the adoption of the WRAM and the MCBA effective November 25, 2008 for Regions II and III and September 1, 2009 for Region I’s ratemaking areas, GSWC began recording the difference between what is billed to its water customers and that which is authorized by the CPUC. Under the WRAM, GSWC records the adopted level of volumetric revenues as authorized by the CPUC for metered accounts (adopted volumetric revenues). While the WRAM tracks volumetric-based revenues, the revenue requirements approved by the CPUC include service charges, flat rate charges, and other items that are not subject to the WRAM. The adopted volumetric revenues consider the seasonality of consumption of water based upon historical averages. The variance between adopted volumetric revenues and actual billed volumetric revenues for metered accounts is recorded as a component of revenue with an offsetting entry to an asset or liability balancing account (tracked individually for each rate making area). The variance amount may be positive or negative and represents amounts that will be billed or refunded to customers in the future. The WRAM only applies to customer classes with conservation rates in place. Currently, the majority of GSWC’s water customers have conservation tiered rate billing structures.

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 an asset or liability balancing account (tracked individually for each rate-making area). Unlike the WRAM, the MCBA applies to all customer classes.

The balances in the WRAM and MCBA assets and liabilities accounts will fluctuate on a monthly basis depending upon the variance between adopted and actual results. The recovery or refund of the WRAM is netted against the MCBA over- or under-collection for the corresponding rate-making area and is interest bearing at the current 90-day commercial paper rate. Under the current CPUC decision, when the net amount at the end of the calendar year for Regions II, III or any of the Region I ratemaking areas achieves a pre-determined level (i.e., at least 2.5 percent over- or under-recovery of the approved revenue requirement), GSWC will seek approval from the CPUC to refund or collect the balance in the accounts. In March 2011, GSWC filed for recovery of its 2010 WRAM and MCBA balances. Based on CPUC guidelines, recovery periods relating to the 2010 balances will range between 12 and 36 months. In September 2010, GSWC, along with other California water utilities, filed an application with the CPUC to modify the recovery period of the WRAM and MCBA accounts to 24 months or less. A decision on this application is expected in 2011.

In March 2010, surcharges were put in place to recover \$18.3 million of amounts accumulated, as of December 31, 2009, in Regions II and III's WRAM, net of MCBA and supply cost balancing accounts. In April and May 2010, surcharges were implemented for recovery of \$2.1 million of the Region I WRAM accounts, net of the MCBA. For the year ended December 31, 2010, approximately \$6.2 million, respectively of surcharges were billed to customers to decrease previously incurred under-collections in the WRAM, net of MCBA balancing accounts. Going forward, GSWC will seek recovery of its WRAM, net of MCBA, on an annual basis. As of December 31, 2010, GSWC has a net aggregated regulatory asset of \$30.9 million which is comprised of a \$49.9 million under-collection in the WRAM accounts and \$19.0 million over-collection in the MCBA accounts.

#### **Base Revenue Requirement Adjustment Mechanism ("BRRAM"):**

Effective November 2, 2009, with the adoption of the Base Revenue Requirement Adjustment Mechanism ("BRRAM") account GSWC began recording the difference between what is billed to its electric customers and that which is authorized by the CPUC. The variance between adopted electric revenue and actual billed revenue is recorded as a component of electric revenue with an offsetting entry to a current asset or liability balancing account. The variance amount may be positive or negative and represents amounts that will be billed or refunded to electric customers in the future and is interest bearing at the current 90-day commercial paper rate. When the amount of the under or over collection is equal to or greater than 5 percent of the revenue requirement established for the previous twelve months, GSWC intends to seek approval from the CPUC to refund or collect the balance in the account. As of December 31, 2010, GSWC has a regulatory asset of \$1.9 million related to the BRRAM. GSWC intends to file an advice letter with the CPUC for recovery of the balance as of December 31, 2010 within 24 months or less.

#### **Costs Deferred for Future Recovery:**

In 1999, GSWC sued Aerojet-General Corporation ("Aerojet") for contaminating the Sacramento County Groundwater Basin, which affected certain GSWC wells. On a related matter, GSWC also filed a lawsuit against the State of California (the "State"). The CPUC authorized memorandum accounts to allow for recovery, from customers, of costs incurred by GSWC in prosecuting the cases against Aerojet and the State, less any recovery from the defendants or others. On July 21, 2005, the CPUC authorized GSWC to collect approximately \$21.3 million of the Aerojet litigation memorandum account, through a rate surcharge, which will continue for no longer than 20 years. Beginning in October 2005, new rates went into effect to begin amortizing the memorandum account over a 20-year period. Rate surcharges generating approximately \$911,000, \$990,000 and \$1.1 million were billed to customers during the years ended December 31, 2010, 2009 and 2008, respectively. GSWC will keep the Aerojet memorandum account open until the earlier of full amortization of the balance or 20 years. However, no costs will be added to the memorandum account, other than on-going interest charges approved by the CPUC decision. Pursuant to the decision, additional interest of approximately \$44,000, \$53,000 and \$445,000 was added to the Aerojet litigation memorandum account during the years ended December 31, 2010, 2009 and 2008, respectively.

Aerojet has also agreed to reimburse GSWC \$17.5 million, plus interest accruing from January 1, 2004, for GSWC's past legal and expert costs, which is included in the Aerojet litigation memorandum account. The reimbursement of the \$17.5 million is contingent upon the issuance of land use approvals for development in a defined area within Aerojet property in Eastern Sacramento County and the receipt of certain fees in connection with such development.

It is management's intention to offset certain proceeds from the housing development by Aerojet in the Westborough areas, pursuant to the settlement agreement, against the balance in this litigation memorandum account. At this time, management believes the full balance of the Aerojet litigation memorandum account will be collected either from customers or Aerojet.

**Pensions and Other Postretirement Obligations:**

A regulatory asset has been recorded at December 31, 2010 and 2009 for the costs that would otherwise be charged to "other comprehensive income" within shareholders' equity for the underfunded status of Registrant's pension and other postretirement benefit plans because the cost of these plans have historically been recovered through rates. As more fully discussed in Note 11, as of December 31, 2010, Registrant's underfunded position for these plans that have been recorded as a regulatory asset totaled \$30.4 million. Registrant expects this regulatory asset to be recovered through rates in future periods.

On November 19, 2010, the CPUC issued a final decision on the Region II, Region III and general office rate case. Among other things, the decision authorized GSWC to establish a two-way balancing account, effective January 1, 2010, for its three water regions and the general office to track differences between the forecasted annual pension expenses adopted in rates for 2010, 2011 and 2012 and the actual annual expense to be recorded by GSWC in accordance with the accounting guidance for pension costs. The two-way balancing account is interest bearing at the current 90-day commercial paper rate. Once this balancing account achieves a pre-determined level (i.e., at least 2.5 percent over- or under-recovery of the approved revenue requirement), GSWC will seek approval from the CPUC to refund or collect the balance in the account. As of December 31, 2010, GSWC has included a \$1.8 million under-collection in the two-way pension balancing account.

**Electric Transmission Line Abandonment Costs:**

The ability of GSWC to deliver purchased power to customers in its BVES customer service area is limited by the ability of the transmission facilities owned by Edison to transmit this power. GSWC filed a lawsuit against Edison in 2000 for breach of contract as a result of delays in upgrading these transmission facilities as well as for other reasons. In March 2004, GSWC and Edison agreed to settle this suit. Under the terms of the settlement agreement, GSWC agreed to pay a \$5.0 million project abandonment fee to Edison. Edison filed an application with the FERC for approval to treat the entire \$5.0 million settlement payment as an abandoned project cost to be included in Edison's wholesale tariff charged to GSWC. A liability to Edison with a corresponding regulatory asset of \$5.0 million was established at the time of settlement.

GSWC made an initial lump sum payment of \$1.4 million to Edison during the first quarter of 2004 and agreed to pay Edison the remaining \$3.6 million over a 15 year term through 180 equal monthly payments of approximately \$38,000 to be included in Edison's monthly tariff, discussed previously. Since the tariff was approved by the FERC, the \$1.4 million lump sum payment was recorded in the electric supply cost balancing account, which decreased this regulatory asset balance. In addition, monthly payments of approximately \$38,000 per month made to Edison during the years ended December 31, 2010, 2009 and 2008, as discussed previously, have also been included in the electric supply cost balancing account, the principal of which would also decrease the regulatory asset account. Management believes that it is probable that the CPUC will permit GSWC to recover the rates authorized by and on file with FERC in connection with the Edison settlement.

**Asset Retirement Obligations:**

As more fully discussed in Note 3, effective January 1, 2003, Registrant adopted authoritative guidance for accounting for asset retirement obligations. Because retirement costs have historically been recovered through rates at the time of retirement, upon implementing this guidance, the cumulative effect was reflected as a regulatory asset. Registrant will also reflect the gain or loss at settlement as a regulatory asset or liability on the balance sheet.

**Low Income Balancing Accounts:**

This regulatory asset reflects primarily the costs of implementing and administering the California Alternate Rates for Water program in GSWC's Regions and the California Alternate Rate for Energy program in GSWC's BVES division. These programs mandated by the CPUC provide a 15% discount for qualified low-income water customers and 20% for electric customers. GSWC accrues interest on its low income balancing accounts at the prevailing rate for 90-day commercial paper. In June 2010, the CPUC approved the recovery of \$2.7 million in Region II's low income balancing account and \$2.4 million in Region III's low income balancing account over a 12-month period. During 2008, GSWC also implemented a low income rate program in Region I. As of December 31, 2010, there is an aggregate \$4.7 million under-collection in the low income balancing accounts.

### **General Rate Case Memorandum Accounts:**

The balance in the general rate case memorandum accounts represents the revenue differences between interim rates and final rates authorized by the CPUC due to delays in receiving decisions on various general rate case applications. As of December 31, 2010, there is an aggregate \$20.4 million in the general rate case memorandum accounts. Of this amount, \$19.5 million relates to the final decision issued by the CPUC in November 2010 on the Region II, Region III and general office rate case for rates in year 2010, 2011 and 2012. Due to delays in issuing a decision on this rate case, interim rates for Region II and Region III were established and effective January 1, 2010. The final decision approved rate increases retroactive to January 1, 2010. Accordingly, in November 2010 GSWC recorded a \$19.5 million regulatory asset representing the difference between interim rates and the final rates authorized by the CPUC. Effective January 1, 2011, a twenty-four month surcharge is in effect to collect the \$19.5 million retroactive portion of the revenue increase.

The remaining balance of approximately \$900,000 in the general rate case memorandum accounts represents other retroactive revenues currently being recovered in rates related to various other rate case proceedings.

### **Santa Maria Adjudication Memorandum Accounts:**

GSWC has incurred costs of approximately \$7.2 million as of December 31, 2010, including legal and expert witness fees, in defending its rights to the groundwater supply in the Santa Maria Basin for use by its customers in Santa Barbara and San Luis Obispo Counties. Such costs had been recorded in utility plant for future rate recovery. Approximately \$5.5 million of these costs had been incurred as of December 31, 2005. In May 2007, the CPUC authorized GSWC to place \$2.7 million of these costs in rate base and to establish a memorandum account and amortize with interest the additional \$2.8 million of these costs. GSWC implemented a rate surcharge in the third quarter of 2007 to recover these costs. Rate surcharges generating approximately \$276,000, \$309,000 and \$325,000 were billed to customers during the years ended December 31, 2010, 2009 and 2008, respectively.

All litigation costs, including interest that has been incurred since December 31, 2005 totaling approximately \$1.7 million, have also been included in the memorandum account, subject to a reasonableness review by the CPUC in a subsequent proceeding. As part of its Region I general rate case filed with the CPUC in January 2010, GSWC requested an extension of the original memorandum account. As part of the CPUC's final decision on Region I's rate case, GSWC's request was granted. The decision also authorized the memorandum account to be interest bearing at the ten-year U.S. Treasury note rate. Management believes that these additional costs will be approved and that recovery of these costs is probable.

### **Other Regulatory Matters:**

#### **Environmental Clean-Up and Remediation:**

GSWC has included in other regulatory assets as of December 31, 2010 approximately \$1.2 million of additional estimated costs to remediate and clean-up a plant site for soil contamination. This site contained an underground storage tank which was used to store gasoline. Amounts paid by GSWC in the past for this site have been included in rate-base and approved by the CPUC for recovery. The ultimate cost may vary as there are many unknowns in remediation of underground gasoline leakage and this is an estimate based on currently available information.

At a separate plant site, hydrocarbon contaminated soil was found where an abandoned water tank was demolished. The clean-up was completed during the first quarter of 2010. All contaminated soil was removed and replaced with clean soil. The final Removal Action Completion Report ("RACR") was submitted to the Site Mitigation Unit ("SMU") on May 10, 2010. The SMU reviewed the RACR and issued a no further action letter. The letter states that the SMU concurs with the contents of the RACR, which states that the site contamination has been satisfactorily mitigated for the current use and no further action is required at the subject site. Clean-up costs incurred through December 31, 2010 totaled approximately \$337,000. Historically, the costs for this type of cleanup have been included in rate base for recovery.

#### **Catastrophic Event Memorandum Accounts:**

On November 19, 2010, GSWC issued a "Do Not Drink" water advisory to its customers in the Barstow service area notifying them that perchlorate had been detected in its water supply. On November 20, 2010, a state of emergency was issued by the Governor. One of GSWC's wells in service in the service area showed perchlorate levels above the maximum contaminant level. The contaminated well was shut down and the distribution system was flushed to remove contaminants in the distribution system. GSWC provided customers with bottled water during the "Do Not Drink" water advisory period. By November 24, 2010, the alert was lifted for all of GSWC's Barstow area customers. The incremental costs associated with handling the emergency (including the distribution of bottled water), remediation and clean-up efforts are being tracked in a Catastrophic Event Memorandum Account ("CEMA"). GSWC expects to receive authorization from the CPUC to recover

these costs, subject to a prudence review. As of December 31, 2010, GSWC has included in other regulatory assets \$553,000 related to the Barstow CEMA account.

In January 2010, the City of Big Bear Lake and surrounding areas of San Bernardino County experienced a series of snow storms, which damaged BVES power lines, poles, transformers, and other facilities and caused temporary interruption of service to BVES customers. Accordingly, a state of emergency was issued by the Governor. As a result of these storms, BVES has incurred additional operating costs to repair equipment and restore electric service to its customers. In February 2010, GSWC informed the CPUC that it will track these costs in a CEMA. The incremental costs include BVES labor, outside services assistance, equipment, materials, facilities damages and related snow removal services. GSWC intends to file with the CPUC in 2011 for recovery of these costs. Management believes these incremental costs will be approved by the CPUC for recovery through the CEMA. As of December 31, 2010, approximately \$327,000 has been incurred as a result of the storms and has been included in the CEMA account within other regulatory assets.

*Bear Valley Electric Service - Other Regulatory Matters:*

Included in other regulatory assets as of December 31, 2010, is a BVES memorandum account totaling \$726,000. In June 2009, the CPUC authorized BVES to track the difference between the 2007 adopted general office cost allocation to BVES and the 1996 adopted general office cost allocation to BVES, until the 2007 costs were incorporated into BVES' rates. From June 4, 2009 to October 31, 2009, when the 2007 costs were incorporated into BVES' rates, \$958,000 was recorded in the memorandum account. In March 2010, the CPUC approved this memorandum account for recovery through a surcharge over a 24-month period effective May 1, 2010. Accordingly, during the first quarter of 2010, GSWC recorded a regulatory asset and a corresponding increase to earnings for amounts included in this memorandum account. For the year ended December 31, 2010, surcharges totaling approximately \$235,000 were billed to BVES customers. The October 2009 decision in the rate case for BVES also allowed for an update to BVES' rates in 2010 for the corporate headquarters' costs based on the CPUC's adoption of new rates for GSWC's Regions II and III general rate case, including the recovery of expenses associated with its corporate headquarters. In December 2010 the CPUC approved an increase to BVES' revenue requirement, effective November 2010, for the increase in corporate headquarters cost allocation resulting from the Region II and Region III general rate case. The revenue requirement increase will be incorporated as part of the BRRAM account.

GSWC's BVES division has been regularly filing compliance reports with the CPUC regarding its purchases of energy from renewable energy resources. The filings have indicated that BVES has not achieved interim target purchase levels of renewable energy resources and thus, on its face, might be subject to a potential penalty. However, BVES expects that the CPUC will waive any potential fines in accordance with the CPUC's flexible compliance rules. Accordingly, no provision for loss has been recorded in the financial statements as of December 31, 2010, 2009 or 2008. BVES is continuing its efforts to procure renewable resources.

In November 2009, GSWC entered into a ten-year contract with the Los Angeles County Sanitation District ("LACSD") to purchase renewable energy created from landfill gas and a ten-year contract with a vendor to purchase biogas to power BVES's gas-fueled 8.4 MW generation facility. GSWC filed applications with the CPUC in June and July of 2010, respectively, for approval. In February 2011, GSWC was notified that the landfill gas-generated energy contract with the LACSD could potentially be terminated should LACSD determine to shut down the landfill gas generator. GSWC continues to work with LACSD to determine alternative resolutions. GSWC informed the CPUC of the potential termination of this contract.

In November 2010, the contracted bioenergy vendor for the purchase of biogas advised GSWC that the biogas production will be suspended due to financial constraints. As a result of the suspension, BVES has negotiated a Biogas Option Agreement with this vendor for the purchase of future production of biogas. On February 10, 2011, the Biogas Option Agreement was provided to the DRA and the CPUC for approval.

BVES believes that it will not be subject to fines under the CPUC's flexible compliance rules for not meeting interim targets due to its efforts to procure renewable energy resources.

### **Various Refunds to Customers:**

#### **Refund of Water Right Lease Revenues:**

In 1994, GSWC entered into a contract to lease to the City of Folsom, 5,000 acre-feet per year of water rights from the American River. GSWC included all associated revenues in a nonoperating income account. In a decision issued on March 16, 2004, the CPUC ordered GSWC to refund 70 percent of the total amount of lease revenues received since 1994, plus interest, to customers. A final amount of the refund was approved by the CPUC in June 2004 and GSWC adjusted its estimate to the approved refund amount of \$5.2 million. Refunds of approximately \$3.9 million have been provided to customers. As of December 31, 2010, the remaining amount to be refunded to the customers and included as a regulatory liability is \$1.3 million. The refunds will be made over a 9-year period which commenced in June 2004.

#### **Excess Usage Charges - Refund to Customers:**

In July 2009, GSWC began receiving reduced water allocations from member agencies of the Metropolitan Water District of Southern California ("MWD"). As a result, in July 2009, GSWC began implementing water rationing, restrictions, and excess usage charges to its customers in several of its service areas. The excess usage charges were being collected in the event that penalties were required to be paid to MWD for exceeding GSWC's water allocations. In 2010, approximately \$500,000 of excess usage charges were netted with the WRAM/MCBA balances in one of Region I's ratemaking areas. As of December 31, 2010, GSWC has excess usage charges totaling \$2.8 million, which are included in other regulatory assets/liabilities. In the event that GSWC is required to pay penalties to MWD for exceeding GSWC's water allocations in the current water year, GSWC will use the amounts previously billed to customers to pay the penalties.

#### **Other Refunds:**

As discussed in pending regulatory matters below, Registrant recorded a pretax charge for the impairment of assets and loss contingencies totaling \$16.6 million in 2010, a portion of which will be refunded to customers over a period ranging from 12-36 months.

### **Pending Regulatory Matters:**

Registrant records loss contingencies when an unfavorable outcome of a matter is deemed to be probable and the loss is reasonably estimable. Registrant will accrue the most likely amount when such an amount can be reasonably estimated or, at least the minimum of the range of probable loss when a range of probable loss can be estimated. Management determines the likelihood of an unfavorable outcome based on many factors such as the nature of the matter, available defenses, progress of the matter, views and opinions of legal counsel and other advisors, among others.

On February 15, 2007, the CPUC issued a subpoena to GSWC in connection with an investigation of certain work orders and charges paid to a specific contractor used previously by GSWC for numerous construction projects estimated to total \$24.0 million completed over a period of 14 years. The CPUC's investigation focuses on whether GSWC was overcharged for these construction projects and whether these overcharges, if any, were included in customer rates. The construction projects completed by this specific contractor related primarily to work on water treatment and pumping plants which have been placed in service and are used and useful. In June 2007, GSWC received notification from the CPUC that it was instituting an audit to examine for the period 1994 to the present, GSWC's policies, procedures, and practices throughout its three water regions regarding the granting or awarding of construction contracts or jobs.

Should the CPUC investigation result in a disallowance of certain previously capitalized costs, such costs, and potentially any return earned on such costs, may be required to be refunded to customers resulting in a charge to operating income. In addition to the disallowance of previously capitalized costs and the return earned on such costs, the CPUC also has the authority to assess fines and penalties. The staff of the CPUC has indicated to GSWC that it intends to seek such remedies, including possibly a fine and penalty. GSWC does not believe that a disallowance is required or that a penalty is justified. GSWC intends to vigorously defend the matter; however, proceedings such as this are difficult to predict and a final outcome is unknown. While reserving all rights, management believes it prudent to reserve for a probable loss related to this matter. The reserve estimates for this matter are subject to change as additional information becomes known. However, at this point, management does not expect increases in its recorded estimated reserve.

As a result of management's assessment of the CPUC subpoena matter and the CPUC's final decision on the Region II, Region III and general office rate case, GSWC recorded a pretax charge for the impairment of assets and loss contingencies totaling \$16.6 million in 2010. These reserve estimates may be adjusted as additional information becomes known.

### **Note 3 — Utility Plant and Intangible Assets**

The following table shows Registrant's utility plant utilized in continuing operations by major asset class:

| (dollars in thousands)          | GSWC<br>December 31, |                   | AWR<br>December 31, |                   |
|---------------------------------|----------------------|-------------------|---------------------|-------------------|
|                                 | 2010                 | 2009              | 2010                | 2009              |
| <b><u>Water</u></b>             |                      |                   |                     |                   |
| Land                            | \$ 15,192            | \$ 14,964         | \$ 15,192           | \$ 14,964         |
| Intangible assets               | 32,924               | 33,135            | 32,944              | 33,154            |
| Source of water supply          | 64,710               | 65,996            | 64,710              | 65,996            |
| Pumping                         | 137,178              | 142,422           | 137,178             | 142,422           |
| Water treatment                 | 66,775               | 64,970            | 66,775              | 64,970            |
| Transmission and distribution   | 716,221              | 669,405           | 716,221             | 669,405           |
| General                         | 75,205               | 70,453            | 80,980              | 74,944            |
|                                 | <u>1,108,205</u>     | <u>1,061,345</u>  | <u>1,114,000</u>    | <u>1,065,855</u>  |
| <b><u>Electric</u></b>          |                      |                   |                     |                   |
| Transmission and distribution   | 48,829               | 47,550            | 48,829              | 47,550            |
| Generation                      | 12,547               | 12,547            | 12,547              | 12,547            |
| General (1)                     | 7,438                | 7,151             | 7,438               | 7,151             |
|                                 | <u>68,814</u>        | <u>67,248</u>     | <u>68,814</u>       | <u>67,248</u>     |
| Less — accumulated depreciation | (375,740)            | (352,574)         | (378,055)           | (354,123)         |
| Construction work in progress   | 50,088               | 43,025            | 50,197              | 43,047            |
| Net utility plant               | <u>\$851,367</u>     | <u>\$ 819,044</u> | <u>\$ 854,956</u>   | <u>\$ 822,027</u> |

- (1) Includes intangible assets of \$1.2 million for planning studies performed in association with the electricity segment of the Registrant's continuing operations.

### **Intangible Assets:**

As of December 31, 2010 and 2009, intangible assets consist of the following:

| (dollars in thousands)                     | Weighted<br>Average<br>Amortization<br>Period | GSWC<br>December 31, |                  | AWR<br>December 31, |                  |
|--------------------------------------------|-----------------------------------------------|----------------------|------------------|---------------------|------------------|
|                                            |                                               | 2010                 | 2009             | 2010                | 2009             |
| <b><u>Amortized intangible assets:</u></b> |                                               |                      |                  |                     |                  |
| Conservation                               | 10 years                                      | \$ 9,637             | \$ 9,433         | \$ 9,637            | \$ 9,433         |
| Water and water service rights             | 22 years                                      | 8,124                | 8,124            | 8,695               | 8,695            |
| Water planning studies                     | 10 years                                      | 15,997               | 15,173           | 15,997              | 15,173           |
| Total amortized intangible assets          |                                               | <u>33,758</u>        | <u>32,730</u>    | <u>34,329</u>       | <u>33,301</u>    |
| Less — accumulated amortization            |                                               | (14,540)             | (12,093)         | (14,574)            | (12,117)         |
| Net amortized intangible assets            |                                               | <u>\$ 19,218</u>     | <u>\$ 20,637</u> | <u>\$ 19,755</u>    | <u>\$ 21,184</u> |

As of December 31, 2010 and 2009, unamortized intangible assets totaled \$409,000 and \$405,000, respectively, for GSWC, and \$427,000 and \$423,000, respectively, for AWR. These unamortized intangible assets primarily consist of organization and consent fees.

For the years ended December 31, 2010, 2009 and 2008, amortization of intangible assets was \$2.5 million, \$1.6 million and \$1.4 million, respectively. Estimated future consolidated amortization expense related to intangible assets for the succeeding five years is approximately \$2.5 million, \$2.5 million, \$2.4 million, \$2.3 million, \$2.3 million and \$7.1 million thereafter.

### **Asset Retirement Obligations:**

Effective January 1, 2003, Registrant adopted accounting guidance for asset retirement obligations, which requires businesses to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Registrant's legal obligations for retirement reflect principally the retirement of wells, which by law need to be properly capped at the time of removal. As such, the regulated subsidiaries of AWR incur asset retirement obligations. Retirement costs have historically been recovered through rates at the time of retirement. Accordingly, at implementation of the guidance for asset retirement obligations, the cumulative effect was reflected as a regulatory asset. Registrant also reflects the gain or loss at settlement as a regulatory asset or liability on the balance sheet. With regards to removal costs associated with certain other long-lived assets, such as water mains, distribution and transmission assets, asset retirement obligations have not been recognized as GSWC believes that it will not be obligated to retire these assets. In 2005, FASB issued accounting guidance for conditional asset retirement obligations, which had no impact on Registrant's asset retirement obligations.

Amounts recorded for asset retirement obligations are subject to various assumptions and determinations, such as determining whether a legal obligation exists to remove assets, and estimating the fair value of the costs of removal, when final removal will occur and the credit-adjusted risk-free interest rates to be utilized on discounting future liabilities. Changes that may arise over time with regard to these assumptions will change amounts recorded in the future. Estimating the fair value of the costs of removal were determined based on third party costs.

The following is a reconciliation of the beginning and ending aggregate carrying amount of the asset retirement obligations, which is included in "Other Credits" on the balance sheets as of December 31, 2010 and 2009:

| <b>(dollars in thousands)</b>   | <b>GSWC</b>    |
|---------------------------------|----------------|
| Obligation at December 31, 2008 | \$3,851        |
| Additional liabilities incurred | 17             |
| Liabilities settled             | (166)          |
| Accretion                       | 331            |
| Obligation at December 31, 2009 | 4,033          |
| Liabilities settled             | (1,444)        |
| Accretion                       | 321            |
| Obligation at December 31, 2010 | <u>\$2,910</u> |

### **Note 4 — Derivative Instruments**

In October 2008, GSWC executed a purchased power contract that permits GSWC to purchase power at a fixed cost over three and five year terms depending on the amount of power and the period during which the power is purchased under the contract. The contract is subject to the accounting guidance for derivatives and requires mark-to-market derivative accounting. GSWC began receiving power under this contract on January 1, 2009. In May 2009, the CPUC issued a final decision approving the contract and authorized GSWC to establish a regulatory asset and liability memorandum account to offset the entries required by the accounting guidance. Accordingly, all unrealized gains and losses generated from the new purchased power contract will be deferred on a monthly basis into a non-interest bearing regulatory memorandum account that will track the changes in fair value of the derivative throughout the term of the contract. As of December 31, 2010 there was a \$6.9 million cumulative unrealized loss which has been included in the memorandum account. The unrealized loss does not impact GSWC's earnings.

Registrant adopted accounting guidance for fair value measurements effective January 1, 2008 for financial assets and liabilities measured on a recurring basis. This guidance applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis. There was no impact to the consolidated financial statements for the adoption of this accounting guidance. However, the accounting guidance requires disclosure that establishes a framework for measuring fair value and expands disclosure about fair value measurements. The guidance requires fair value measurements to be classified and disclosed in one of the following three categories:

*Level 1:* Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

*Level 2:* Quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability, or

*Level 3:* Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

Registrant's valuation model utilizes various inputs that include quoted market prices for energy over the duration of the contract. The market prices used to determine the fair value for this derivative instrument were estimated based on independent sources such as broker quotes and publications that are not observable in or corroborated by the market. Registrant receives one broker quote to determine the fair value of its derivative instrument. When such inputs have a significant impact on the measurement of fair value, the instrument is categorized in Level 3. Accordingly, the valuation of the derivative on Registrant's new purchased power contract has been classified as Level 3 for all periods presented.

The following table presents changes in the fair value of GSWC's derivatives for the years ended December 31, 2010 and 2009.

| (dollars in thousands)                              | 2010              | 2009             | 2008        |
|-----------------------------------------------------|-------------------|------------------|-------------|
| Balance, at beginning of the period                 | \$ (7,338)        | \$ —             | \$(1,554)   |
| Unrealized gain (loss) on purchased power contracts | 488               | (7,338)          | 1,554       |
| Balance, at end of the period                       | <u>\$ (6,850)</u> | <u>\$(7,338)</u> | <u>\$ —</u> |

For the years ended December 31, 2010 and 2009, the unrealized gains and losses were included in regulatory assets due to regulatory mechanisms in place effective January 1, 2009. For the year ended December 31, 2008, the realized gains were included in GSWC's operating expenses.

#### **Note 5 — Military Privatization**

ASUS, through its wholly-owned subsidiaries, has entered into agreements with the U.S. government to operate and maintain the water and/or wastewater systems at various military bases pursuant to 50-year fixed price contracts, subject to periodic prospective price redeterminations and modifications for changes in circumstances.

Under the economics of the agreements with the U.S. government, each of the Military Utility Privatization Subsidiaries should recover 100% of its investment in the assets of the water and/or wastewater systems acquired at the time of execution of the applicable 50-year service contract for each of the military bases. A capital investment recovery charge in an amount equal to the payments due under the purchase obligation is paid to the Military Utility Privatization Subsidiaries by the U.S. government as a result of the purchase of the systems. Accordingly, Registrant recorded the purchase price obligation as a liability with an offsetting receivable of the same amount recorded against the liability, therefore, not impacting Registrant's financial position.

The amounts charged by the Military Utility Privatization Subsidiaries for water and wastewater services at the respective military bases are based upon the terms of the 50-year contracts between the Military Utility Privatization Subsidiaries and the U.S. government. Under the terms of these agreements, the Military Utility Privatization Subsidiaries agreed to operate and maintain the water and/or wastewater systems at the respective bases for (i) a monthly net fixed price for operation and maintenance, and (ii) an amount to cover renewals and replacements, both for the first two years of the contract. Under the terms of each of these contracts, prices are to be redetermined at the end of the initial two year period and every three years thereafter. In addition, prices may be equitably adjusted for changes in law and other circumstances. These adjustments can be retrospective and/or prospective. The Military Utility Privatization Subsidiaries have experienced and continue to experience delays in obtaining readjustment of prices and equitable adjustments as required by the terms of these contracts.

The fixed price for operation and maintenance is recorded in revenues on a monthly basis as the services are performed. The fixed price received monthly for renewals and replacements on the water and wastewater systems includes a profit that is recognized on the percentage-of-completion method of accounting as the individual capital projects are completed. From time to time, the U.S. government may modify the original contract(s) to include new construction projects including capital upgrades. However, earnings and cash flows from modifications to the original 50-year contracts with the U.S. government for new construction projects may or may not continue in future periods.

Each of the contracts may be subject to termination, 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 a Military Utility Privatization Subsidiary. In either event, each of the Military Utility Privatization Subsidiaries so impacted should be 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 asset, "Costs and estimated earnings in excess of billings on uncompleted contracts," represents revenues recognized in excess of amounts billed. The liability, "Billings in excess of costs and estimated earnings on uncompleted contracts," represents billings in excess of revenues recognized. Costs and estimated earnings on uncompleted contracts and amounts due from the U.S. government as of December 31, 2010 and 2009 are as follows:

| <u>(dollars in thousands, except amounts for allowance for doubtful accounts)</u> | <u>2010</u>      | <u>2009</u>     |
|-----------------------------------------------------------------------------------|------------------|-----------------|
| Revenues (costs and estimated earnings) recognized on uncompleted contracts       | \$57,126         | \$33,957        |
| Less: Billings to date                                                            | <u>(39,804)</u>  | <u>(24,153)</u> |
|                                                                                   | <u>\$17,322</u>  | <u>\$ 9,804</u> |
| <u>Included in the accompanying balance sheets under the following captions:</u>  |                  |                 |
| Costs and estimated earnings in excess of billings on uncompleted contracts       | \$ 42,748        | \$ 27,699       |
| Billings in excess of costs and estimated earnings on uncompleted contracts       | <u>(25,426)</u>  | <u>(17,895)</u> |
|                                                                                   | <u>\$ 17,322</u> | <u>\$ 9,804</u> |
| Receivable from the U.S. government, less allowance for doubtful accounts (1)     | <u>\$ 3,689</u>  | <u>\$ 4,245</u> |

(1) Allowance for doubtful accounts was \$43,000 and \$67,000 as of December 31, 2010 and 2009, respectively.

In March 2009, ONUS filed a request for equitable adjustment related to a joint inventory report which indicated the quantity of the Fort Bragg infrastructure to be greater than what was estimated by the U.S. government as part of its solicitation for this contract. On January 22, 2010, the U.S. government approved a \$6.5 million equitable adjustment regarding this inventory. As a result of this contract modification, ASUS recorded \$3.1 million of revenues and operating income during the first quarter of 2010 (approximately \$2.8 million of which is retroactive from the commencement of the contract in March 2008 to December 31, 2009). The remaining \$3.4 million, related to renewal and replacement funds, was recorded as billings in excess of costs and estimated earnings on uncompleted contracts in the first quarter of 2010. The deferred revenue will be recognized in construction revenues (along with the related construction costs) when the work is performed.

In March 2008, FBWS filed a request for equitable adjustment as a claim with the U.S. government seeking an adjustment in the contract after it was determined that the infrastructure at Fort Bliss was substantially more than originally estimated by the U.S. government as part of its solicitation for this contract. In January 2010, FBWS and the U.S. government entered into a settlement agreement pursuant to which the U.S. government agreed to pay FBWS retroactive operation and maintenance management fees and retroactive renewal and replacement fees from the contract commencement date, October 1, 2004. In March 2010, the U.S. government issued a \$6 million contract modification funding a majority of the settlement agreement. As a result, ASUS recorded \$2.5 million in revenues and pretax operating income and \$510,000 in interest income during the first quarter of 2010. The remaining \$3.0 million, related to renewal and replacement funds, was recorded as billings in excess of costs and estimated earnings on uncompleted contracts. The deferred revenue will be recognized in construction revenues (along with the related construction costs) as the work is performed. An additional modification funding the balance of the settlement amount was received in June 2010.

In August 2010, the U.S. government issued to TUS a contract modification approving interim increases in operation and maintenance management fees at Andrews Air Force Base retroactive from the second anniversary of the contract, February 1, 2008, pending resolution of the first price redetermination filing. As a result, ASUS recorded additional retroactive revenues and pretax operating income of approximately \$700,000 during the third quarter of 2010.

In May 2009, PSUS filed a request for equitable adjustment related to emergency construction work performed in 2008 related to a sanitary sewer overflow at Fort Jackson. In September 2010, the U.S. government approved the request for equitable adjustment. As a result, for the third quarter of 2010, ASUS recorded an additional \$689,000 in construction revenues and pretax operating income.

On July 22, 2010, ASUS was served with a subpoena issued in connection with a Grand Jury investigation related to ODUS' water and wastewater privatization contracts. On January 10, 2011, ASUS received official notification that the government had determined to close the matter.

#### **Note 6 — Earnings Per Share and Capital Stock**

In accordance with the accounting guidance for participating securities and earnings per share ("EPS"), Registrant uses the "two-class" method of computing EPS. 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 restricted stock units that earn dividend equivalents on an equal basis with AWR's Common Shares (the "Common Shares") that have been issued under AWR's 2000 and 2008 Employee Plans and the 2003 Directors Plan. In applying the "two-class" method, undistributed earnings are allocated to both common shares and participating securities. The following is a reconciliation of Registrant's net income and weighted average Common Shares outstanding for calculating basic net income per share:

|                                                              | <b>For The Years Ended December 31,</b> |                  |                  |
|--------------------------------------------------------------|-----------------------------------------|------------------|------------------|
|                                                              | <b>2010</b>                             | <b>2009</b>      | <b>2008</b>      |
| <b>Basic</b><br>(in thousands, except per share amounts)     |                                         |                  |                  |
| Net income from continuing operations                        | \$ 31,091                               | \$ 29,374        | \$ 25,996        |
| Net income (loss) from discontinued operations               | 2,106                                   | 157              | (3,991)          |
| Total net income                                             | 33,197                                  | 29,531           | 22,005           |
| Less: (a) Distributed earnings to common shareholders        | 19,329                                  | 18,233           | 17,262           |
| Distributed earnings to participating securities             | 102                                     | 82               | 91               |
| Undistributed earnings                                       | 13,766                                  | 11,216           | 4,652            |
| (b) Undistributed earnings allocated to common shareholders  | 13,694                                  | 11,166           | 4,628            |
| Undistributed earnings allocated to participating securities | 72                                      | 50               | 24               |
| Total income available to common shareholders, basic (a)+(b) | <u>\$ 33,023</u>                        | <u>\$ 29,399</u> | <u>\$ 21,890</u> |
| Weighted average Common Shares outstanding, basic            | 18,585                                  | 18,052           | 17,262           |
| <b>Basic earnings per Common Share:</b>                      |                                         |                  |                  |
| Income from continuing operations                            | \$ 1.67                                 | \$ 1.62          | \$ 1.50          |
| Income (loss) from discontinued operations                   | 0.11                                    | 0.01             | (0.23)           |
| Net income                                                   | <u>\$ 1.78</u>                          | <u>\$ 1.63</u>   | <u>\$ 1.27</u>   |

Diluted EPS is based upon the weighted average number of Common Shares, including both outstanding shares and shares potentially issuable in connection with stock options and restricted stock units granted under AWR's 2000 and 2008 Employee Plans, and the 2003 Directors Plan, and net income. At December 31, 2010, there were 726,405 stock options outstanding under these Plans. At December 31, 2010, there were also 105,727 restricted stock units outstanding. The following is a reconciliation of Registrant's net income and weighted average Common Shares outstanding for calculating diluted net income per share:

**Diluted****(in thousands, except per share amounts)**

|                                                       | For The Years Ended December 31, |                 |                  |
|-------------------------------------------------------|----------------------------------|-----------------|------------------|
|                                                       | 2010                             | 2009            | 2008             |
| Common shareholders earnings, basic                   | \$ 33,023                        | \$ 29,399       | \$ 21,890        |
| Undistributed earnings for dilutive stock options (1) | 72                               | 50              | 24               |
| Total common shareholders earnings, diluted           | <u>\$33,095</u>                  | <u>\$29,449</u> | <u>\$ 21,914</u> |
| Weighted average Common Shares outstanding, basic     | 18,585                           | 18,052          | 17,262           |
| Stock-based compensation (2)                          | 151                              | 136             | 132              |
| Weighted average Common Shares outstanding, diluted   | <u>18,736</u>                    | <u>18,188</u>   | <u>17,394</u>    |
| <b>Diluted earnings per Common Share</b>              |                                  |                 |                  |
| Income from continuing operations                     | \$ 1.66                          | \$ 1.61         | \$ 1.49          |
| Income (loss) from discontinued operations            | 0.11                             | 0.01            | (0.23)           |
| Net income                                            | <u>\$ 1.77</u>                   | <u>\$ 1.62</u>  | <u>\$ 1.26</u>   |

- (1) Undistributed earnings allocated to participating securities were not included due to their antidilutive effect on diluted earnings per share.
- (2) In applying the treasury stock method of reflecting the dilutive effect of outstanding stock-based compensation in the calculation of diluted EPS, 726,405 stock options and 105,727 restricted stock units at December 31, 2010 were deemed to be outstanding in accordance with accounting guidance on earnings per share.

During the year ended December 31, 2010, AWR issued 68,025 Common Shares under AWR's Common Share Purchase and Dividend Reinvestment Plan ("DRP") and the 2000 and 2008 Employee Plans for \$1,838,000. There are 549,831 and 220,235 Common Shares authorized for issuance directly by AWR but unissued under the DRP and the 401(k) Plan, respectively, at December 31, 2010. Shares reserved for the 401(k) Plan are in relation to AWR's matching contributions and investment by participants. During the year ended December 31, 2009, Registrant issued 68,352 Common Shares under AWR's Common Share Purchase and Dividend Reinvestment Plan ("DRP") and the 2000 and 2008 Employee Plans for \$1,823,000. During the year ended December 31, 2008, AWR issued 41,810 Common Shares under AWR's DRP and the 2000 and 2008 Employee Plans for \$1,173,000. In addition, during the years ended December 31, 2010, 2009 and 2008, AWR issued 30,500, 12,922 and 28,196 Common Shares for approximately \$857,000, \$309,000 and \$690,000, respectively, as a result of the exercise of stock options. During 2010, 2009 and 2008, no cash proceeds received by AWR as a result of the exercise of stock options were distributed to any subsidiaries of AWR.

In May 2009, AWR completed a public offering of 1,150,000 shares of its Common Shares, including 150,000 shares issued upon exercise of an option granted to the underwriters to cover over-allotments, at a price to the public of \$31 per share. The net proceeds from the offering were \$34.0 million, after deductions of underwriting commissions and discounts, and direct legal and accounting fees. AWR used the proceeds of the offering to repay short-term debt.

During the years ended December 31, 2010, 2009 and 2008, AWR repurchased in the open market 143,034, 14,018 and 36,509, respectively, Common Shares under AWR's DRP and 401(k) Plan, which were used to satisfy the requirements of these plans and programs.

AWR filed a Registration Statement on August 10, 2009 with the Securities and Exchange Commission ("SEC") for the sale from time to time of debt and equity securities. As of December 31, 2010, \$115.0 million was available for issuance of additional securities under this registration statement.

GSWC's outstanding common shares are owned entirely by its parent, AWR. To the extent GSWC does not reimburse AWR for stock-based compensation awarded under various stock compensation plans, such amounts increase the value of GSWC's common shareholder's equity. On May 26, 2010, the Board of Directors approved the issuance of eight additional GSWC Common Shares to AWR for \$20.0 million. Proceeds from the issuance were used to pay down GSWC's intercompany borrowings due to AWR. As of December 31, 2010, GSWC has \$100.0 million available for issuance of debt securities under a Registration Statement filed with the SEC.

## **Note 7 — Dividend Limitations**

GSWC is subject to contractual restrictions on its ability to pay dividends. GSWC's maximum ability to pay dividends is restricted by certain Note Agreements to the sum of \$21.0 million plus 100% of consolidated net income from various 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, \$298.8 million was available to pay dividends to AWR as of December 31, 2010. GSWC is also prohibited from paying dividends if, after giving effect to the dividend, its total indebtedness to capitalization ratio (as defined) would be more than 0.6667 to 1. Dividends in the amount of \$19.6 million, \$19.4 million, and \$13.2 million were paid to AWR by GSWC during the years ended December 31, 2010, 2009 and 2008, respectively.

The ability of AWR, ASUS and GSWC to pay dividends is also restricted by California law. Under restrictions of the California tests, approximately \$150.2 million of retained earnings for AWR was available to pay dividends to common shareholders at December 31, 2010. Approximately \$141.1 million was available from the retained earnings of GSWC to pay dividends to AWR. Approximately \$2.1 million was available from retained earnings of ASUS at December 31, 2010 to pay dividends to AWR under the California tests.

## **Note 8 — Bank Debt**

On May 27, 2010, AWR entered into the third amendment to the credit agreement in order to extend the expiration date of the syndicated credit facility to May 27, 2013 from June 3, 2010. The maximum amount that may be borrowed under this facility was reduced from \$115.0 million to \$100.0 million. AWR may, under the terms of the amended credit agreement, elect to increase the aggregate bank commitments by up to an additional \$40.0 million. The aggregate effective amount that may be outstanding under letters of credit has been increased to \$25.0 million from \$20.0 million. The rates (spreads to LIBOR) at which AWR may borrow under this facility have been increased due to market conditions and the lenders have consented to modifications to certain of the covenants in the amended credit agreement requested by AWR. AWR has obtained letters of credit, in the aggregate amount of \$11.0 million, including: (i) a letter of credit with a fee of 1.2%, in the amount of \$6.3 million, in favor of a trustee with respect to the variable rate obligation issued by the Three Valleys Municipal Water District; (ii) letters of credit with a fee of 1.2%, in an aggregate amount of \$540,000 as security for GSWC's business automobile insurance policy; (iii) a letter of credit with a fee of 1.2%, in an amount of \$585,000 as security for the purchase of power; and (iv) an irrevocable letter of credit in the amount of \$3.6 million, pursuant to a settlement agreement with Edison to cover GSWC's commitment to pay the settlement amount. There were no compensating balances required. GSWC has also agreed to issue up to \$7.2 million in letters of credit to the State of California, Department of Public Health in connection with obtaining up to \$9.0 million of funds under the California Safe Drinking Water State Revolving Fund and the American Recovery and Reinvestment Act of 2009 for the construction of water meters in Sacramento County. As of December 31, 2010, no letters of credit have been issued related to these projects.

Loans can be obtained at the option of AWR and bear interest at rates based on credit ratings and Euro rate margins. In July 2010, Standard & Poor's Ratings Services ("S&P") upgraded its corporate credit rating on AWR and GSWC from 'A' with a positive outlook to 'A+' with a stable outlook. Pursuant to the syndicated credit facility agreement, the upgrade to "A+ stable" resulted in a reduced interest rate spread on the facility from 125 basis points to 120 basis points.

At December 31, 2010, \$60.9 million was outstanding under this facility, \$33.0 million of which was loaned to GSWC to fund its operations, \$13.9 million was loaned to ASUS to fund its activities, and \$14.0 million was used in the purchase of eight shares of GSWC.

AWR's short-term borrowing activities (excluding letters of credit) for the last three years were as follows:

| (in thousands, except percent)        | December 31, |           |           |
|---------------------------------------|--------------|-----------|-----------|
|                                       | 2010         | 2009      | 2008      |
| Balance Outstanding at December 31,   | \$ 60,900    | \$ 17,400 | \$ 74,700 |
| Interest Rate at December 31,         | 1.47%        | 0.87%     | 1.82%     |
| Average Amount Outstanding            | \$ 37,623    | \$ 33,697 | \$ 57,429 |
| Weighted Average Annual Interest Rate | 1.40%        | 1.18%     | 3.32%     |
| Maximum Amount Outstanding            | \$ 63,900    | \$ 78,700 | \$ 88,500 |

All of the letters of credit are issued pursuant to the syndicated revolving credit facility. The syndicated revolving credit facility contains restrictions on prepayments, disposition of property, mergers, liens and negative pledges, indebtedness and guaranty obligations, transactions with affiliates, minimum interest coverage requirements, a maximum debt to capitalization ratio, and a minimum debt rating. Pursuant to the credit agreement, AWR must maintain a minimum interest coverage ratio of 3.25 times interest expense, a maximum total funded debt ratio of 0.65 to 1.00 and a minimum debt rating of Baa3 or BBB-. As of December 31, 2010, 2009 and 2008, AWR was in compliance with these requirements.

## **Note 9 — Long-Term Debt**

Registrant's long-term debt consists primarily of Notes and Debentures. Registrant summarizes its long-term debt in the Statements of Capitalization. GSWC does not currently have any outstanding mortgages or other encumbrances on its properties. GSWC's leases and other similar financial arrangements are not material.

Private placement notes issued by GSWC in the amount of \$28 million contain restrictions on the payment of dividends, minimum interest coverage requirements, a maximum debt to capitalization ratio and a negative pledge. Pursuant to the terms of these agreements, GSWC must maintain a minimum interest coverage ratio of two times interest expense.

On March 10, 2009 a senior note was issued by GSWC 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. This note bears interest at the rate of 6.7%. Under the terms of the note, GSWC shares in the profits of CoBank under a patronage arrangement. If CoBank continues to pay the current amount of patronage, the annual cost of the note will be reduced below 6.0%. In addition, on October 11, 2005, CoBank purchased a 5.87% Senior Note due December 20, 2028 in the aggregate principal amount of \$40.0 million from GSWC. Under the terms of the two senior notes issued to CoBank, GSWC may not incur any additional debt or pay any distributions to its shareholders if, after giving effect thereto, it would have a debt to capitalization ratio in excess of 0.6667 to 1 or a debt to earnings before interest, taxes, depreciation and amortization ("EBITDA") ratio of more than 8 to 1.

Redemption of certain long-term debt issues outstanding as of December 31, 2010 and 2009 can be made in whole or in part at the option of GSWC subject to redemption schedules embedded in the agreements particular to each issue. With the exception of the 9.56% Notes and the Senior Notes issued to Co-Bank, the redemption premiums in effect for 2010 range up to 1.5% of par value. The 9.56% Notes are subject to a make-whole premium based on 55 basis points above the applicable Treasury Yield if redeemed prior to 2021. After 2021, the maximum redemption premium is 3% of par value. The Senior Notes are subject to a make-whole premium based on the difference between Co-Bank's cost of funds on the date of purchase and Co-Bank's cost of funds on the date of redemption, plus 0.5%.

Annual maturities of all long-term debt, including capitalized leases, amount to approximately \$376,000, \$302,000, \$3,278,000, \$6,187,000, \$168,000 and \$289,904,000 for each fiscal year through December 31, 2015 and thereafter, respectively.

## **Note 10 — Taxes on Income**

Registrant provides deferred income taxes for temporary differences under the accounting guidance for income taxes for certain transactions which are recognized for income tax purposes in a period different from that in which they are reported in the financial statements. The most significant items are the tax effects of accelerated depreciation, the supply cost balancing accounts, and advances for, and contributions-in-aid-of-construction. The accounting guidance for income taxes also requires that rate-regulated enterprises record deferred income taxes for temporary differences given flow-through treatment at the direction of a regulatory commission. The resulting deferred tax assets and liabilities are recorded at the expected cash flow to be reflected in future rates. Given that the CPUC has consistently permitted the recovery of flowed-through tax effects, GSWC has established regulatory liabilities and assets offsetting such deferred tax assets and liabilities (Note 2). Deferred investment tax credits are amortized ratably to deferred tax expense over the lives of the property giving rise to the credits.

GSWC is included in AWR's consolidated federal income tax and combined California state franchise tax returns. Consistent with the method adopted for regulatory purposes, GSWC's tax expense is computed as if it were autonomous and filed separate returns.

As a rate-regulated utility, GSWC treats certain temporary differences as flow-through adjustments in computing its income tax expense consistent with the income tax approach approved by the CPUC for ratemaking purposes. Flow-through adjustments increase or decrease tax expense in one period, with an offsetting increase or decrease occurring in another period. Giving effect to these temporary differences as flow-through adjustments typically results in a greater variance between the effective tax rate and the statutory federal income tax rate in any given period than would otherwise exist if GSWC were not required to account for its income taxes as a regulated enterprise.

The significant components of the deferred tax assets and liabilities from continuing operations as reflected in the balance sheets at December 31, 2010 and 2009 were:

| (dollars in thousands)                                      | AWR                |                    | GSWC               |                    |
|-------------------------------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                                             | December 31,       |                    | December 31,       |                    |
|                                                             | 2010               | 2009               | 2010               | 2009               |
| Deferred tax assets:                                        |                    |                    |                    |                    |
| Regulatory-liability-related: ITC and excess deferred taxes | \$ 1,748           | \$ 1,797           | \$ 1,748           | \$ 1,797           |
| Regulatory-liability-related: California Corp Franchise Tax | 3,185              | 2,306              | 3,185              | 2,306              |
| California Corp Franchise Tax                               | 128                | 33                 | —                  | 353                |
| Other property-related                                      | 6,573              | 150                | 6,750              | 145                |
| Other nonproperty-related                                   | 142                | 1,103              | —                  | 556                |
| Accrued regulatory liabilities                              | 575                | 792                | 524                | 736                |
| Contributions and advances                                  | 12,155             | 11,593             | 12,008             | 11,353             |
|                                                             | <u>\$ 24,506</u>   | <u>\$ 17,774</u>   | <u>\$ 24,215</u>   | <u>\$ 17,246</u>   |
| Deferred tax liabilities:                                   |                    |                    |                    |                    |
| Fixed assets                                                | \$ (100,683)       | \$ (80,569)        | \$ (99,643)        | \$ (79,652)        |
| Regulatory-asset-related: depreciation and other            | (8,580)            | (10,242)           | (9,203)            | (10,764)           |
| California Corp Franchise Tax                               | —                  | —                  | (178)              | —                  |
| Other nonproperty-related                                   | —                  | —                  | (696)              | —                  |
| Balancing and memorandum accounts                           | (624)              | (7,917)            | (641)              | (8,072)            |
| Deferred charges                                            | (7,313)            | (7,860)            | (7,514)            | (8,030)            |
|                                                             | <u>(117,200)</u>   | <u>(106,588)</u>   | <u>(117,875)</u>   | <u>(106,518)</u>   |
| Accumulated deferred income taxes - net                     | <u>\$ (92,694)</u> | <u>\$ (88,814)</u> | <u>\$ (93,660)</u> | <u>\$ (89,272)</u> |

The current and deferred components of income tax expense from continuing operations were as follows:

| (dollars in thousands)                              | AWR                     |          |          |
|-----------------------------------------------------|-------------------------|----------|----------|
|                                                     | Year Ended December 31, |          |          |
|                                                     | 2010                    | 2009     | 2008     |
| Current                                             |                         |          |          |
| Federal                                             | \$10,785                | \$ 6,152 | \$ 6,971 |
| State                                               | 6,110                   | 4,936    | 4,194    |
| Total current tax expense                           | \$16,895                | \$11,088 | \$11,165 |
| Deferred                                            |                         |          |          |
| Federal                                             | \$ 7,465                | \$10,087 | \$ 5,607 |
| State                                               | (1,325)                 | (2,474)  | (805)    |
| Total deferred tax expense                          | 6,140                   | 7,613    | 4,802    |
| Total income tax expense from continuing operations | \$23,035                | \$18,701 | \$15,967 |
|                                                     |                         |          |          |
| (dollars in thousands)                              | GSWC                    |          |          |
|                                                     | Year Ended December 31, |          |          |
|                                                     | 2010                    | 2009     | 2008     |
| Current                                             |                         |          |          |
| Federal                                             | \$ 6,543                | \$4,314  | \$ 8,262 |
| State                                               | 5,852                   | 5,503    | 4,317    |
| Total current tax expense                           | \$12,395                | \$9,817  | \$12,579 |
| Deferred                                            |                         |          |          |
| Federal                                             | \$ 8,366                | \$ 9,766 | \$ 5,317 |
| State                                               | (1,678)                 | (1,774)  | (621)    |
| Total deferred tax expense                          | 6,688                   | 7,992    | 4,696    |
| Total income tax expense                            | \$19,083                | \$17,809 | \$17,275 |

The reconciliations of the effective tax rates to the federal statutory rate are as follows:

| (dollars in thousands, except percent)              | AWR                     |          |          |
|-----------------------------------------------------|-------------------------|----------|----------|
|                                                     | Year Ended December 31, |          |          |
|                                                     | 2010                    | 2009     | 2008     |
| Federal taxes on pretax income at statutory rate    | \$18,944                | \$16,826 | \$14,687 |
| Increase (decrease) in taxes resulting from:        |                         |          |          |
| State income tax, net of federal benefit            | 3,657                   | 1,720    | 2,034    |
| Flow-through on fixed assets                        | 525                     | 455      | 455      |
| Flow-through on pension costs                       | (567)                   | —        | (1,104)  |
| Investment tax credit                               | (91)                    | (91)     | (91)     |
| Other – net                                         | 567                     | (209)    | (14)     |
| Total income tax expense from continuing operations | \$23,035                | \$18,701 | \$15,967 |
| Pretax income from continuing operations            | \$54,126                | \$48,075 | \$41,963 |
| Effective income tax rate                           | 42.6%                   | 38.9%    | 38.1%    |
|                                                     |                         |          |          |
| (dollars in thousands, except percent)              | GSWC                    |          |          |
|                                                     | Year Ended December 31, |          |          |
|                                                     | 2010                    | 2009     | 2008     |
| Federal taxes on pretax income at statutory rate    | \$15,468                | \$15,114 | \$15,783 |
| Increase (decrease) in taxes resulting from:        |                         |          |          |
| State income tax, net of federal benefit            | 3,282                   | 2,563    | 2,250    |
| Flow-through on fixed assets                        | 525                     | 455      | 455      |
| Flow-through on pension costs                       | (567)                   | —        | (1,104)  |
| Investment tax credit                               | (91)                    | (91)     | (91)     |
| Other – net                                         | 466                     | (232)    | (18)     |
| Total income tax expense                            | \$19,083                | \$17,809 | \$17,275 |
| Pretax income                                       | \$44,193                | \$43,182 | \$45,094 |
| Effective income tax rate                           | 43.2%                   | 41.2%    | 38.3%    |

The following table provides a reconciliation of AWR's and GSWC's unrecognized tax benefits at December 31, 2010, 2009 and 2008:

| (dollars in thousands)                                            | 2010        |             | 2009            |                 | 2008            |                 |
|-------------------------------------------------------------------|-------------|-------------|-----------------|-----------------|-----------------|-----------------|
|                                                                   | AWR         | GSWC        | AWR             | GSWC            | AWR             | GSWC            |
| Unrecognized tax benefits at beginning of period                  | \$ 4,110    | \$ 4,110    | \$ 4,223        | \$ 4,223        | \$ 5,113        | \$ 5,113        |
| Increases as a result of tax positions taken prior to the period  | —           | —           | —               | —               | —               | —               |
| Decreases as a result of tax positions taken prior to the period  | (4,110)     | (4,110)     | —               | —               | (1,157)         | (1,157)         |
| Increases as a result of tax positions taken during the period    | —           | —           | —               | —               | 267             | 267             |
| Decreases as a result of tax positions taken during the period    | —           | —           | —               | —               | —               | —               |
| Decreases relating to settlements with taxing authorities         | —           | —           | (113)           | (113)           | —               | —               |
| Reductions as a result of lapses of statute-of-limitation periods | —           | —           | —               | —               | —               | —               |
| Unrecognized tax benefits at end of period                        | <u>\$ —</u> | <u>\$ —</u> | <u>\$ 4,110</u> | <u>\$ 4,110</u> | <u>\$ 4,223</u> | <u>\$ 4,223</u> |

For both AWR and GSWC, there was no portion of the unrecognized-tax-benefit balance at December 31, 2010 that would affect the effective tax rate if recognized.

Registrant's policy is to classify interest on income tax over/underpayments in interest income/expense and penalties in "other operating expenses."

At December 31, 2010, AWR and GSWC included \$2,285,000 and \$2,319,000, respectively, of net interest receivables from taxing authorities in other current and noncurrent assets. AWR and GSWC recognized \$1,367,000 and \$1,345,000, respectively, of interest income from taxing authorities during the year ended December 31, 2010. At December 31, 2009, AWR and GSWC included \$918,000 and \$974,000, respectively, of net interest receivables from taxing authorities in other assets (all as noncurrent). AWR and GSWC recognized \$65,000 and \$86,000, respectively, of interest income from taxing authorities during the year ended December 31, 2009. AWR and GSWC recognized \$539,000 and \$494,000, respectively, of interest income from taxing authorities during the year ended December 31, 2008.

At December 31, 2010, 2009 and 2008, Registrant had no significant accruals for income-tax-related penalties. Registrant did not recognize any significant income-tax-related penalties during the years ended December 31, 2010, 2009 and 2008.

Registrant files federal and various state income tax returns. The U.S. federal filings for the years 1997 through 1999 and 2002 came under Internal Revenue Service ("IRS") examination during the first quarter of 2007 as a result of AWR having filed an amended 2002 return during the third quarter of 2006. The 2002 return was amended primarily as a result of the IRS consenting to AWR's request for approval to change a tax accounting method ("Consent"). During the second quarter of 2008, the IRS issued a Revenue Agent's Report ("RAR") in connection with its examination of the 2002 tax year which resulted in Registrant recognizing certain tax benefits in accordance with the accounting guidance for tax uncertainties. Upon receiving the RAR, AWR filed a protest with the IRS's Office of Appeals ("Appeals") in which it requested a conference to address Registrant's disagreement with certain of the Agent's adjustments. In connection with the Consent, Registrant filed amended 2003 through 2006 returns during the third quarters of 2007 through 2010 prior to the expiration of each year's refund-claim period. The 2003 and 2004 returns came under IRS examination during the fourth quarter of 2008 and, at the initiation of the IRS in connection with the Consent, the 2007 return came under IRS examination during the second quarter of 2009.

Following AWR's conference with Appeals during the second quarter of 2010, Registrant and the IRS worked towards reaching a settlement of all years under examination during the second through fourth quarters of 2010. This culminated in AWR agreeing, in the fourth quarter of 2010, to revised RARs for all of the years under examination. The agreement resulted in Registrant decreasing its unrecognized-tax-benefit balance to zero as of December 31, 2010, with corresponding adjustments to its deferred taxes; however, as the refunds resulting from the agreement are subject to review by the Congressional Joint Committee of Taxation, the years under examination are not considered "effectively settled" under the accounting guidance for tax uncertainties. Nonetheless, Registrant reasonably anticipates that the IRS will issue refunds resulting from the agreement by December 31, 2011.

AWR's 2006 through 2009 tax years remain subject to examination by the IRS and state taxing authorities. AWR has filed protective refund claims with the applicable state taxing authority for the 2002 through 2005 tax years, also in connection with the Consent.

#### **Change in Federal Tax Law**

The Small Business Jobs Act of 2010 and the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 extended 50-percent bonus depreciation for qualifying property through 2012 and created a new 100-percent bonus depreciation for qualifying property placed in service between September 9, 2010 and December 31, 2011. As a result of these law changes, Registrant's current tax expense for 2010 reflects a benefit of approximately \$16.2 million. Although these law changes reduce AWR's current taxes payable, they do not reduce its total income tax expense or effective tax rate. In addition, the CPUC is currently evaluating the establishment of a memorandum account that would track the revenue effects associated with these law changes, which may reduce future revenue requirements in future rate case proceedings.

#### **Change in State Tax Law**

AWR receives a tax benefit for expenses incurred at the parent-company level. For the years ended December 31, 2010 and 2009, the taxes recorded at AWR also include the effect of changes in California law relating to state unitary tax principles during the first quarter of 2009. Management intends to elect, commencing with the 2011 tax year, an alternative apportionment method made available by tax law changes in 2009. As a result of management's intention to apply the alternative method, AWR adjusted its deferred tax balances in the first quarter of 2009 to reflect the expected amount at which it will realize its California deferred taxes consistent with the change in tax law, and refined certain related estimates. This resulted in the recording of a benefit of approximately \$918,000 during the first quarter of 2009. While the effect of the tax law changes will continue to affect AWR's state taxes, the future effects may be beneficial or detrimental depending on a combination of the profitability of AWR's non-California activities as well as the relative proportion of the factor(s) applied by its apportionment method. Periodically, management will assess its intention to apply the alternative method and will adjust its deferred tax balances accordingly.

GSWC continues to compute its state tax expense as if it were autonomous and not a member of AWR's unitary group. This approach is consistent with the methodology used for ratemaking purposes. Given that 100 percent of GSWC's activities are conducted within California, GSWC's state tax expense does not reflect apportionment of its income; consequently, the change in California law has had no effect upon GSWC's state taxes.

## **Note 11 — Employee Benefit Plans**

### **Pension and Post-Retirement Medical Plans:**

Registrant maintains a pension plan (the “Pension Plan”) that provides eligible employees (those aged 21 and older, with at least one year of service) monthly benefits upon retirement based on average salaries and length of service. The eligibility requirement to begin receiving these benefits is 5 years of vested service. The normal retirement benefit is equal to 2% of the five highest consecutive years’ average earnings multiplied by the number of years of credited service, up to a maximum of 40 years, reduced by a percentage of primary social security benefits. There is also an early retirement option; however, for terminations on or after January 1, 2004, the early retirement provisions were amended to increase benefits under the Pension Plan for employees who retire prior to age 65. The eligibility requirements for early retirement are age 55 and 5 years of vested service. The Pension Plan amendment increased Registrant’s annual pension cost by approximately 5%. Annual contributions are made to the Pension Plan, which comply with the funding requirements of the Employee Retirement Income Security Act (“ERISA”).

At December 31, 2010, Registrant had 1,001 participants in the Pension Plan of which 567 were active, 229 were retired, 189 were vested terminated, and 16 were disabled. Approximately 84 active employees are subject to collective bargaining arrangements. Average active participant age for the pension plan was 47 years.

In January 2011, the Board of Directors approved the closing of the Pension Plan to new hires as of December 31, 2010. Any employees hired or rehired on or after January 1, 2011 will not participate in the Pension Plan for future benefit accruals. Instead, they will participate in a new GSWC Defined Contribution Program once they have worked for GSWC for 30 days. Under this program, GSWC will provide a contribution of 5.25% of includable pay for each participating employee every pay period and the participants will direct the investment of these accounts. Full and complete vesting in the account balances of this new program will be achieved when the participant attains 3 years of service.

Registrant also provides post-retirement medical benefits for all active employees hired before February of 1995, through a medical insurance plan. Eligible employees, who retired prior to age 65, and/or their spouses, were able to retain the benefits under the plan for active employees until reaching age 65. Eligible employees upon reaching age 65, and those eligible employees retiring at or after age 65, and/or their spouses, receive coverage through a Medicare supplement insurance policy paid for by Registrant subject to an annual cap limit. Registrant’s post-retirement medical plan does not provide prescription drug benefits to Medicare-eligible employees and is not affected by the Medicare Prescription Drug Improvement and Modernization Act of 2003. At December 31, 2010, Registrant had 357 participants in the post-retirement medical plan of which 199 were active, 12 were disabled and 146 were retired.

In accordance with the guidance for accounting for the effects of certain types of regulation, Registrant has established a regulatory asset for underfunded positions of defined benefit post-retirement plans, including pension plans that are expected to be recovered through rates in future periods. The changes in actuarial gains and losses, prior service costs and transition assets or obligations pertaining to the regulatory asset are recognized as an adjustment to the regulatory asset account as these amounts are recognized as components of net periodic pension costs each year.

The following table sets forth the Pension Plan's funded status and amounts recognized in Registrant's balance sheets and the components of net pension cost and accrued post-retirement liability at December 31, 2010 and 2009:

| (dollars in thousands)                                                                               | Pension Benefits   |                    | Post-retirement Medical Benefits |                   |
|------------------------------------------------------------------------------------------------------|--------------------|--------------------|----------------------------------|-------------------|
|                                                                                                      | 2010               | 2009               | 2010                             | 2009              |
| <b>Change in Projected Benefit Obligation:</b>                                                       |                    |                    |                                  |                   |
| Projected benefit obligation at beginning of year                                                    | \$103,086          | \$ 95,446          | \$11,166                         | \$ 10,281         |
| Service cost                                                                                         | 4,795              | 4,327              | 390                              | 320               |
| Interest cost                                                                                        | 6,104              | 5,739              | 626                              | 637               |
| Actuarial loss                                                                                       | 7,909              | 593                | 255                              | 309               |
| Benefits/expenses paid                                                                               | (3,128)            | (3,019)            | (380)                            | (381)             |
| Projected benefit obligation at end of year                                                          | <u>\$118,766</u>   | <u>\$103,086</u>   | <u>\$12,057</u>                  | <u>\$11,166</u>   |
| <b>Changes in Plan Assets:</b>                                                                       |                    |                    |                                  |                   |
| Fair value of plan assets at beginning of year                                                       | \$74,001           | \$54,165           | \$6,060                          | \$ 4,944          |
| Actual return on plan assets                                                                         | 10,723             | 14,272             | 680                              | 927               |
| Employer contributions                                                                               | 8,583              | 8,583              | 600                              | 570               |
| Benefits/expenses paid                                                                               | (3,128)            | (3,019)            | (380)                            | (381)             |
| Fair value of plan assets at end of year                                                             | <u>\$90,179</u>    | <u>\$ 74,001</u>   | <u>\$6,960</u>                   | <u>\$ 6,060</u>   |
| <b>Funded Status:</b>                                                                                |                    |                    |                                  |                   |
| Net amount recognized as accrued pension cost                                                        | <u>\$(28,587)</u>  | <u>\$(29,085)</u>  | <u>\$ (5,097)</u>                | <u>\$ (5,106)</u> |
| <br>(dollars in thousands, except percent)                                                           |                    |                    |                                  |                   |
|                                                                                                      | Pension Benefits   |                    | Post-retirement Medical Benefits |                   |
|                                                                                                      | 2010               | 2009               | 2010                             | 2009              |
| <b>Amounts recognized on the balance sheets:</b>                                                     |                    |                    |                                  |                   |
| Current liabilities                                                                                  | \$ —               | \$ —               | \$ —                             | \$ —              |
| Non-current liabilities                                                                              | (28,587)           | (29,085)           | (5,097)                          | (5,106)           |
| Net amount recognized                                                                                | <u>\$ (28,587)</u> | <u>\$ (29,085)</u> | <u>\$ (5,097)</u>                | <u>\$ (5,106)</u> |
| <b>Amounts recognized in regulatory assets consist of:</b>                                           |                    |                    |                                  |                   |
| Initial net obligation                                                                               | \$ —               | \$ —               | \$ 1,675                         | \$ 2,095          |
| Prior service cost (credit)                                                                          | 640                | 758                | (1,032)                          | (1,232)           |
| Net loss                                                                                             | 25,831             | 24,562             | 402                              | 572               |
| <b>Regulatory assets</b>                                                                             | 26,471             | 25,320             | 1,045                            | 1,435             |
| Unfunded accrued pension cost                                                                        | 2,116              | 3,765              | 4,052                            | 3,671             |
| Net liability recognized                                                                             | <u>\$28,587</u>    | <u>\$29,085</u>    | <u>\$5,097</u>                   | <u>\$ 5,106</u>   |
| <br><b>Changes in plan assets and benefit obligations recognized in regulatory assets:</b>           |                    |                    |                                  |                   |
| Regulatory asset at beginning of year                                                                | \$ 25,320          | \$ 37,517          | \$ 1,435                         | \$ 2,064          |
| Net loss (gain)                                                                                      | 2,439              | (9,790)            | (171)                            | (410)             |
| Amortization of initial net obligation                                                               | —                  | —                  | (419)                            | (419)             |
| Amortization of prior service cost (credit)                                                          | (118)              | (118)              | 200                              | 200               |
| Amortization of net gain                                                                             | (1,170)            | (2,289)            | —                                | —                 |
| Total change in regulatory asset                                                                     | <u>1,151</u>       | <u>(12,197)</u>    | <u>(390)</u>                     | <u>(629)</u>      |
| Regulatory asset at end of year                                                                      | <u>\$ 26,471</u>   | <u>\$ 25,320</u>   | <u>\$ 1,045</u>                  | <u>\$ 1,435</u>   |
| Net periodic pension costs                                                                           | \$ 6,934           | \$ 8,583           | \$ 980                           | \$ 968            |
| Change in regulatory asset                                                                           | <u>1,151</u>       | <u>(12,197)</u>    | <u>(390)</u>                     | <u>( 629)</u>     |
| Total recognized in net periodic pension cost and regulatory asset                                   | <u>\$ 8,085</u>    | <u>\$ (3,614)</u>  | <u>\$ 590</u>                    | <u>\$ 339</u>     |
| <br><b>Estimated amounts that will be amortized from regulatory asset over the next fiscal year:</b> |                    |                    |                                  |                   |
| Initial net obligation                                                                               | \$ —               | \$ —               | \$ (419)                         | \$ (419)          |
| Prior service cost                                                                                   | (118)              | (118)              | 200                              | 200               |
| Net loss                                                                                             | (1,191)            | (1,231)            | —                                | —                 |

|                                                                                                                   | Pension Benefits |           | Post-retirement Medical Benefits |           |
|-------------------------------------------------------------------------------------------------------------------|------------------|-----------|----------------------------------|-----------|
|                                                                                                                   | 2010             | 2009      | 2010                             | 2009      |
| <b>Additional year-end information for plans with an accumulated benefit obligation in excess of plan assets:</b> |                  |           |                                  |           |
| Projected benefit obligation                                                                                      | \$118,766        | \$103,086 | \$12,057                         | \$ 11,166 |
| Accumulated benefit obligation                                                                                    | 99,254           | 86,017    | N/A                              | N/A       |
| Fair value of plan assets                                                                                         | 90,179           | 74,001    | 6,960                            | 6,060     |
| <b>Weighted-average assumptions used to determine benefit obligations at December 31:</b>                         |                  |           |                                  |           |
| Discount rate                                                                                                     | 5.55 %           | 6.05 %    | 5.20 %                           | 5.85 %    |
| Rate of compensation increase                                                                                     | 4.00 %           | 4.00 %    | N/A                              | N/A       |

In accordance with ratemaking, Registrant capitalizes a portion of its pension and other post-retirement costs in the overhead pool included in Utility Plant. The components of net periodic pension and post-retirement benefits cost, before allocation to the overhead pool, for 2010, 2009 and 2008 are as follows:

| (dollars in thousands, except percent)                       | Pension Benefits |                |                | Post-retirement Medical Benefits |              |              |
|--------------------------------------------------------------|------------------|----------------|----------------|----------------------------------|--------------|--------------|
|                                                              | 2010             | 2009           | 2008           | 2010                             | 2009         | 2008         |
| <b>Components of Net Periodic Benefits Cost:</b>             |                  |                |                |                                  |              |              |
| Service cost                                                 | \$4,795          | \$ 4,327       | \$3,585        | \$ 390                           | \$ 320       | \$ 328       |
| Interest cost                                                | 6,104            | 5,739          | 5,399          | 626                              | 637          | 616          |
| Expected return on plan assets                               | (5,253)          | (3,889)        | (4,937)        | (255)                            | (208)        | (252)        |
| Amortization of transition                                   | —                | —              | —              | 419                              | 419          | 419          |
| Amortization of prior service cost                           | 118              | 118            | 119            | (200)                            | (200)        | (199)        |
| Amortization of actuarial loss                               | 1,170            | 2,288          | —              | —                                | —            | —            |
| Net periodic pension cost under accounting standards         | \$6,934          | \$ 8,583       | \$4,166        | \$980                            | \$968        | \$912        |
| Regulatory adjustment - deferred                             | (1,823)          | —              | —              | —                                | —            | —            |
| Total expense recognized, before allocation to overhead pool | <u>\$5,111</u>   | <u>\$8,583</u> | <u>\$4,166</u> | <u>\$980</u>                     | <u>\$968</u> | <u>\$912</u> |

**Weighted-average assumptions used to determine net periodic cost:**

|                                          |       |       |       |       |       |       |
|------------------------------------------|-------|-------|-------|-------|-------|-------|
| Discount rate                            | 6.05% | 6.15% | 6.55% | 5.85% | 6.40% | 6.35% |
| Expected long-term return on plan assets | 7.00% | 7.00% | 7.00% | *     | *     | *     |
| Rate of compensation increase            | 4.00% | 4.00% | 4.00% | N/A   | N/A   | N/A   |

\*7.0% for union plan, 4.2% for non-union, net of income taxes in 2010, 2009, and 2008.

Regulatory Adjustment:

On November 19, 2010, the CPUC issued a final decision on the Region II, Region III and general office rate case. Among other things, the decision authorized GSWC to establish a two-way balancing account, effective January 1, 2010, for its three water regions and the general office to track differences between the forecasted annual pension expenses adopted in rates for 2010, 2011 and 2012 and the actual annual expense to be recorded by GSWC in accordance with the accounting guidance for pension costs. During the year ended December 31, 2010, GSWC's actual expense under the accounting standard was \$1.8 million greater than the amounts included in customer rates. This under-collection has been recorded in the two-way pension balancing account included in regulatory assets (Note 2).

Plan Funded Status:

Registrant's pension and post-retirement plans were underfunded at December 31, 2010 and 2009. Registrant's market related value of plan assets is equal to the fair value of plan assets. Past volatile market conditions have affected the value of AWR's trust established to fund its future long-term pension benefits. These benefit plan assets and related obligations are remeasured annually using a December 31 measurement date. Changes in the plan's funded status will affect the assets and liabilities recorded on the balance sheet in accordance with accounting guidance on employers' accounting for defined benefit pension and other post-retirement plans. Due to Registrant's regulatory recovery treatment, the recognition of the funded status is offset by a regulatory asset pursuant to guidance on accounting for the effects of certain types of regulation.

### Plan Assets:

The assets of the pension and post-retirement medical plans are managed by a third party trustee. The investment policy allocation of the assets in the trust was approved by Registrant's Administrative Committee (the "Committee") for the Pension and Retiree Medical Funds, which has oversight responsibility for all retirement plans. The primary objectives underlying the investment of the pension and post-retirement plan assets are: (i) attempt to maintain a fully funded status with a cushion for unexpected developments, possible future increases in expense levels, and/or a reduction in the expected return on investments; (ii) seek to earn long-term returns that compare favorably to appropriate market indexes, peer group universes and the policy asset allocation index; (iii) seek to provide sufficient liquidity to pay current benefits and expenses; (iv) attempt to limit risk exposure through prudent diversification; and (v) seek to limit costs of administering and managing the plans.

The Committee recognizes that risk and volatility are present to some degree with all types of investments. High levels of risk are avoided through diversification by asset class, style of each investment manager, and sector and industry limits. Investment managers are retained to manage a pool of assets and allocate funds in order to achieve an appropriate, diversified, and balanced asset mix. The Committee's strategy balances the requirement to maximize returns using potentially higher return generating assets, such as equity securities, with the need to control the risk versus the benefit obligations with less volatile assets, such as fixed income securities.

The Committee approves the target asset allocations. Registrant's pension and post-retirement plan weighted-average asset allocations at December 31, 2010 and 2009, by asset category are as follows:

| <u>Asset Category</u>                   | <u>Pension Benefits</u> |              | <u>Post-Retirement Medical Benefits</u> |              |
|-----------------------------------------|-------------------------|--------------|-----------------------------------------|--------------|
|                                         | <u>2010</u>             | <u>2009</u>  | <u>2010</u>                             | <u>2009</u>  |
| <b><u>Actual Asset Allocations:</u></b> |                         |              |                                         |              |
| Equity securities                       | 64 %                    | 63 %         | 60 %                                    | 56 %         |
| Debt securities                         | 33 %                    | 33 %         | 38 %                                    | 36 %         |
| Cash equivalents                        | 3 %                     | 4 %          | 2 %                                     | 8 %          |
| Total                                   | <u>100 %</u>            | <u>100 %</u> | <u>100 %</u>                            | <u>100 %</u> |

Equity securities did not include AWR's stock as of December 31, 2010 and 2009.

### **Target Asset Allocations for 2011:**

|                   | <u>Pension Benefits</u> | <u>Post-retirement Medical Benefits</u> |
|-------------------|-------------------------|-----------------------------------------|
| Equity securities | 60%                     | 60%                                     |
| Debt securities   | 40%                     | 40%                                     |
| Total             | <u>100%</u>             | <u>100%</u>                             |

As previously discussed in Note 4, accounting guidance for fair value measurements establishes a framework for measuring fair value and requires fair value measurements to be classified and disclosed in one of three levels. As required by the accounting guidance, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. All equity investments in the pension and post-retirement plans are Level 1 investments in mutual funds. The fixed income category includes corporate bonds and notes. The majority of fixed income investments range in maturities from less than one to twenty years. The fair values of these investments are based on quoted market prices in active markets.

The following tables set forth by level, within the fair value hierarchy, the pension and post-retirement plans' investment assets measured at fair value as of December 31, 2010 and 2009.

| (dollars in thousands)                            | Fair Value as of December 31, 2010 |         |         |           |
|---------------------------------------------------|------------------------------------|---------|---------|-----------|
|                                                   | Level 1                            | Level 2 | Level 3 | Total     |
| <b>Fair Value of Pension Plan Assets:</b>         |                                    |         |         |           |
| Cash equivalents                                  | \$ 2,091                           | -       | -       | \$ 2,091  |
| Fixed income securities                           | 30,202                             | -       | -       | 30,202    |
| <u>Equity securities:</u>                         |                                    |         |         |           |
| U.S. small cap stocks                             | 5,158                              | -       | -       | 5,158     |
| U.S. mid cap stocks                               | 9,942                              | -       | -       | 9,942     |
| U.S. large cap stocks                             | 28,813                             | -       | -       | 28,813    |
| International funds                               | 9,458                              | -       | -       | 9,458     |
| Real estate funds                                 | 4,515                              | -       | -       | 4,515     |
| Total equity securities                           | 57,886                             | -       | -       | 57,886    |
| Total investments measured at fair value          | \$ 90,179                          | -       | -       | \$ 90,179 |
| <b>Fair Value of Post-Retirement Plan Assets:</b> |                                    |         |         |           |
| Cash equivalents                                  | \$ 143                             | -       | -       | \$ 143    |
| Fixed income                                      | 2,640                              | -       | -       | 2,640     |
| U.S. equity securities (large cap stocks)         | 4,177                              | -       | -       | 4,177     |
| Total investments measured at fair value          | \$ 6,960                           | -       | -       | \$ 6,960  |

| (dollars in thousands)                            | Fair Value as of December 31, 2009 |         |         |           |
|---------------------------------------------------|------------------------------------|---------|---------|-----------|
|                                                   | Level 1                            | Level 2 | Level 3 | Total     |
| <b>Fair Value of Pension Plan Assets:</b>         |                                    |         |         |           |
| Cash equivalents                                  | \$ 2,647                           | -       | -       | \$ 2,647  |
| Fixed income securities                           | 24,657                             | -       | -       | 24,657    |
| <u>Equity securities:</u>                         |                                    |         |         |           |
| U.S. small cap stocks                             | 3,870                              | -       | -       | 3,870     |
| U.S. mid cap stocks                               | 7,920                              | -       | -       | 7,920     |
| U.S. large cap stocks                             | 23,178                             | -       | -       | 23,178    |
| International funds                               | 7,582                              | -       | -       | 7,582     |
| Real estate funds                                 | 3,268                              | -       | -       | 3,268     |
| Total equity securities                           | 45,818                             | -       | -       | 45,818    |
| Preferred stock                                   | 879                                | -       | -       | 879       |
| Total investments measured at fair value          | \$ 74,001                          | -       | -       | \$ 74,001 |
| <b>Fair Value of Post-Retirement Plan Assets:</b> |                                    |         |         |           |
| Cash equivalents                                  | \$ 462                             | -       | -       | \$ 462    |
| Fixed income                                      | 2,179                              | -       | -       | 2,179     |
| U.S. equity securities (large cap stocks)         | 3,419                              | -       | -       | 3,419     |
| Total investments measured at fair value          | \$ 6,060                           | -       | -       | \$ 6,060  |

Plan Contributions:

During 2010, Registrant contributed \$8.6 million and \$600,000 to its pension and post-retirement medical plans, respectively. Registrant currently expects to contribute \$6.6 million and \$500,000 to its pension and post-retirement medical plans in 2011, respectively. Registrant's policy is to fund the plans annually at a level which is deductible for income tax purposes and is consistent with amounts recovered in customer rates. In establishing the contribution amount, Registrant is considering the potential impact of funding rule changes under the Pension Protection Act of 2006 which establishes new minimum funding standards and prohibits plans underfunded by more than 20% from providing lump sum distributions and adopting amendments that increase plan liabilities.

### Benefit Payments:

Registrant's estimated future benefit payments at December 31, 2010 for the next ten years are as follows (in thousands):

|           | <u>Pension Benefits</u> | <u>Post-retirement Medical Benefits</u> |
|-----------|-------------------------|-----------------------------------------|
| 2011      | \$ 3,515                | \$ 576                                  |
| 2012      | 3,911                   | 625                                     |
| 2013      | 4,319                   | 653                                     |
| 2014      | 4,739                   | 716                                     |
| 2015      | 5,277                   | 777                                     |
| 2016-2020 | 35,351                  | 5,170                                   |
| Total     | <u>\$ 57,112</u>        | <u>\$ 8,517</u>                         |

### Assumptions:

Certain actuarial assumptions, such as the discount rate, long-term rate of return on plan assets and the healthcare cost trend rate have a significant effect on the amounts reported for net periodic benefit cost as well as the related benefit obligation amounts.

*Discount Rate* — The assumed discount rate for pension and post-retirement medical plans reflects the market rates for high-quality corporate bonds currently available. Registrant's discount rates were determined by considering the average of pension yield curves constructed of a large population of high quality corporate bonds. The resulting discount rate reflects the matching of plan liability cash flows to the yield curves.

*Expected Long-Term Rate of Return on Assets* — The long-term rate of return on plan assets represents an estimate of long-term returns on an investment portfolio consisting of a mixture of equities, fixed income, and other investments. To develop the expected long-term rate of return on assets assumption for the pension plan, Registrant considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocation of the pension portfolio. Registrant's policy is to fund the medical benefit trusts based on actuarially determined amounts as allowed in rates approved by the CPUC. Registrant has invested the funds in the post-retirement trusts that will achieve a desired return and minimize amounts necessary to recover through rates. The mix is expected to provide for a return on assets similar to the Pension Plan and to achieve Registrant's targeted allocation. This resulted in the selection of the 7.0% long-term rate of return on assets assumption for the union plan and 4.20% (net of income taxes) for the non-union plan.

*Healthcare Cost Trend Rate* — A sliding scale for assumed health care cost increases was used for the periods presented. In 2010, health care cost increases started at 8.0% grading down to 6.0% in 10 years for those under age 65, and at 7.0% grading down to 6.0% in 10 years for those 65 and over. In 2009, health care cost increases started at 8.0% grading down to 5.0% in 10 years for those under age 65, and at 9.0% grading down to 5.0% in 10 years for those 65 and over. In 2008, health care cost increases started at 8.5% grading down to 5.0% in 10 years for those under age 65, and at 9.5% grading down to 5.0% in 10 years for 65 and over.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

| <u>(dollars in thousands)</u>                           | <u>1-Percentage-Point Increase</u> | <u>1-Percentage-Point Decrease</u> |
|---------------------------------------------------------|------------------------------------|------------------------------------|
| Effect on total of service and interest cost components | \$ 78                              | \$ (116)                           |
| Effect on post-retirement benefit obligation            | \$ 1,406                           | \$ (1,215)                         |

### Supplemental Executive Retirement Plan:

Registrant has a supplemental executive retirement plan ("SERP") that provides additional retirement benefits to certain key employees and officers of Registrant by making up benefits, which are limited by Sections 415 and 401(a)(17) of the Internal Revenue Code of 1986, as amended, and certain additional benefits. In May 2009, the Board of Directors approved the establishment of a Rabbi Trust created for the SERP plan. An amount of \$948,000 was deposited in the Rabbi Trust during the year ended December 31, 2010, which has been included in Registrant's other property and investments. Assets in a Rabbi Trust can be subject to the claims of creditors; therefore, they are not considered as an asset for purposes of computing the SERP's funded status. As of December 31, 2010, the balance in the Rabbi Trust totals \$1.6 million.

The following provides a reconciliation of benefit obligations, funded status of the SERP, as well as a summary of significant estimates at December 31, 2010 and 2009:

| <b>(dollars in thousands)</b>                                                                                     | <b>2010</b>       | <b>2009</b>       |
|-------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| <b>Change in Benefit Obligation:</b>                                                                              |                   |                   |
| Benefit obligation at beginning of year                                                                           | \$5,967           | \$5,617           |
| Service cost                                                                                                      | 433               | 350               |
| Interest cost                                                                                                     | 354               | 331               |
| Actuarial (gain)/loss                                                                                             | 1,935             | (118)             |
| Benefits paid                                                                                                     | (221)             | (213)             |
| Benefit obligation at end of year                                                                                 | <u>\$ 8,468</u>   | <u>\$ 5,967</u>   |
| <b>Changes in Plan Assets:</b>                                                                                    |                   |                   |
| Fair value of plan assets at beginning of year                                                                    | —                 | —                 |
| Fair value of plan assets at end of year                                                                          | —                 | —                 |
| <b>Funded Status:</b>                                                                                             |                   |                   |
| Net amount recognized as accrued pension cost                                                                     | <u>\$(8,468)</u>  | <u>\$(5,967)</u>  |
| <b>Amounts recognized on the balance sheets:</b>                                                                  |                   |                   |
| Current liabilities                                                                                               | \$ (228)          | \$ (220)          |
| Non-current liabilities                                                                                           | (8,240)           | (5,747)           |
| Net amount recognized                                                                                             | <u>\$ (8,468)</u> | <u>\$ (5,967)</u> |
| <b>Amounts recognized in regulatory assets consist of:</b>                                                        |                   |                   |
| Prior service cost                                                                                                | \$ 797            | \$ 958            |
| Net loss                                                                                                          | 2,055             | 120               |
| <b>Regulatory assets</b>                                                                                          | <u>2,852</u>      | <u>1,078</u>      |
| Unfunded accrued pension cost                                                                                     | 5,616             | 4,889             |
| Net liability recognized                                                                                          | <u>\$ 8,468</u>   | <u>\$ 5,967</u>   |
|                                                                                                                   | <b>2010</b>       | <b>2009</b>       |
| <b>Changes in plan assets and benefit obligations recognized in regulatory assets consist of:</b>                 |                   |                   |
| Regulatory asset at beginning of year                                                                             | \$ 1,078          | \$ 1,357          |
| Net loss (gain)                                                                                                   | 1,935             | (118)             |
| Amortization of prior service credit                                                                              | (161)             | (161)             |
| Total change in regulatory asset                                                                                  | <u>1,774</u>      | <u>(279)</u>      |
| Regulatory asset at end of year                                                                                   | <u>\$2,852</u>    | <u>\$1,078</u>    |
| Net periodic pension cost                                                                                         | \$948             | \$842             |
| Change in regulatory asset                                                                                        | <u>1,774</u>      | <u>(279)</u>      |
| Total recognized in net periodic pension and net income                                                           | <u>\$2,722</u>    | <u>\$563</u>      |
| <b>Estimated amounts that will be amortized from regulatory asset over the next fiscal year:</b>                  |                   |                   |
| Initial net asset (obligation)                                                                                    | —                 | —                 |
| Prior service cost                                                                                                | \$ (161)          | \$ (161)          |
| Net gain (loss)                                                                                                   | —                 | —                 |
| <b>Additional year-end information for plans with an accumulated benefit obligation in excess of plan assets:</b> |                   |                   |
| Projected benefit obligation                                                                                      | \$8,468           | \$5,967           |
| Accumulated benefit obligation                                                                                    | 5,870             | 4,692             |
| Fair value of plan assets                                                                                         | —                 | —                 |
| <b>Weighted-average assumptions used to determine benefit obligations:</b>                                        |                   |                   |
| Discount rate                                                                                                     | 5.55%             | 6.05%             |
| Salary assumption                                                                                                 | 4.00%             | 4.00%             |

The components of SERP expense, before allocation to the overhead pool, for 2010, 2009, and 2008 are as follows:

| <u>(dollars in thousands, except percent)</u>    | <u>2010</u>   | <u>2009</u>   | <u>2008</u>     |
|--------------------------------------------------|---------------|---------------|-----------------|
| <b>Components of Net Periodic Benefits Cost:</b> |               |               |                 |
| Service cost                                     | \$ 433        | \$ 350        | \$ 240          |
| Interest cost                                    | 354           | 331           | 251             |
| Special termination benefits                     | —             | —             | 149             |
| Amortization of actuarial gain                   | —             | —             | (54)            |
| Amortization of prior service cost               | 161           | 161           | 918             |
| Net periodic pension cost                        | <u>\$ 948</u> | <u>\$ 842</u> | <u>\$ 1,504</u> |

**Weighted-average assumptions used to determine net periodic cost:**

|                   |       |       |       |
|-------------------|-------|-------|-------|
| Discount rate     | 6.05% | 6.30% | 6.45% |
| Salary assumption | 4.00% | 4.00% | 4.00% |

Benefit Payments: Registrant's estimated future benefit payments for the SERP at December 31, 2010 are as follows (in thousands):

|           |                 |
|-----------|-----------------|
| 2011      | \$ 230          |
| 2012      | 230             |
| 2013      | 302             |
| 2014      | 301             |
| 2015      | 311             |
| 2016-2020 | <u>2,412</u>    |
| Total     | <u>\$ 3,786</u> |

**401(k) Investment Incentive Program:**

Registrant has a 401(k) Investment Incentive Program under which employees may invest a percentage of their pay, up to a maximum investment prescribed by law, in an investment program managed by an outside investment manager. Registrant's cash contributions to the 401(k) are based upon a percentage of individual employee contributions and totaled \$1.8 million, \$1.8 million and \$1.5 million for 2010, 2009 and 2008, respectively.

**Note 12 – Stock Compensation Plans**

**Summary Description of Stock Incentive Plans**

AWR currently has three stock incentive plans: the 2000 Employee Plan and the 2008 Employee Plan for employees, and the 2003 Directors Plan for directors, each more fully described below.

2000 Employee Plan — AWR adopted the 2000 Employee Plan at the annual meeting of shareholders in 2000 to provide stock-based incentive awards in the form of stock options, and restricted stock to employees as a means of promoting the success of Registrant by attracting, retaining and more fully aligning the interests of employees with those of shareholders generally. The 2000 Employee Plan was amended in January 2006 to also permit the grant of restricted stock units. The 2000 Employee Plan is administered by the Compensation Committee of the Board of Directors (the "Board Committee").

For stock options, the Board Committee determined, among other things, the date of grant, the form, term, option exercise price, vesting and exercise terms of each option. Stock options granted by AWR have been in the form of nonqualified stock options, expire ten years from the date of grant, vest over a period of three years and are subject to earlier termination as provided in the form of option agreement approved by the Board Committee. The option price per share was determined by the Board Committee at the time of grant, but was not be less than 100% of the fair market value of Common Shares on the date of grant.

Each employee who received a grant of a restricted stock unit is entitled to dividend equivalent rights in the form of additional restricted stock units until vesting of the restricted stock units. The restricted stock units vested over a period of three years. Each restricted stock is non-voting and entitles the holder of the restricted stock unit to receive one Common Share.

There were 1,050,000 Common Shares reserved for issuance under the 2000 Employee Stock Plan, 136,673 of which remain available for payment of dividend equivalent rights as of December 31, 2010 on restricted stock units granted prior to March 31, 2008.

2008 Employee Plan — AWR adopted the 2008 Employee Plan at the annual meeting of shareholders in May 2008 in order to enable the Board Committee to continue to make stock awards to eligible employees in the same manner as under the 2000 Employee Plan. All new awards since April 1, 2008 have been and will be granted under the 2008 Employee Plan. There were 1,100,000 Common Shares reserved for issuance under the 2008 Employee Plan, of which 732,123 were available for awards as of December 31, 2010.

2003 Directors Plan — On May 20, 2003, the Board of Directors adopted the 2003 Directors Plan, subject to shareholder approval. The shareholders approved the 2003 Directors Plan at the May 2004 Annual Meeting. The 2003 Directors Plan provides the non-employee directors with supplemental stock-based compensation and encourages them to increase their stock ownership in AWR. There were 250,000 Common Shares reserved for issuance under the 2003 Directors Plan, of which 128,570 remain available for awards as of December 31, 2010. Pursuant to the 2003 Directors Plan, non-employee directors received grants of options to purchase 1,000 common shares at AWR's annual meetings in 2003 and 2004 and 3,000 shares common shares at AWR's annual meetings in 2005 and 2006.

Non-employee directors received restricted stock units equal to the annual retainer in lieu of stock options at the 2007 and 2008 annual meetings of shareholders. In addition, each non-employee director with no more than ten years of service with AWR received additional restricted stock units at the annual meetings in 2007 and 2008 in an amount equal to the then current annual retainer payable by AWR to each non-employee director divided by the fair market value of Common Shares on the last trading day prior to the annual meeting.

Commencing with AWR's 2009 annual meeting, all directors are entitled to receive restricted stock units equal to two times the annual retainer, regardless of their number of years of service on the board at each annual meeting. All stock options and restricted stock units have been granted with dividend equivalent rights payable in the form of additional restricted stock units.

The stock options granted under the 2003 Directors Plan are nonqualified stock options which must be exercised within ten years after the date of grant. The exercise price of the stock options is equal to the fair market value of Common Shares on the date of grant. Stock options granted under the 2003 Directors Plan are fully vested and exercisable upon the date of grant. Restricted stock units with respect to dividend equivalent rights on stock options credited to the non-employee director are payable in Common Shares on the earlier of the date on which the stock option is exercised and three years from the date of grant of the stock option.

Restricted stock units granted prior to 2009 and restricted stock units with respect to dividend equivalent rights with respect thereto are payable solely in Common Shares on the date that the participant terminates service as a director. One-third of the restricted stock units granted in 2009 and thereafter and restricted stock units with respect thereto are payable to each non-employee director at the earlier of the first, second and third anniversaries of the date of grant and the date of termination of service as a director. Restricted stock units credited to each non-employee director's restricted stock unit account are at all times fully vested and non-forfeitable.

### Effect of Stock-Based Compensation on Net Income

The Registrant recognizes compensation expense related to the fair value of stock-based compensation awards. Share-based compensation cost is measured by the Registrant at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant). The following table presents share-based compensation expenses for the years ended December 31, 2010, 2009 and 2008. These expenses resulting from stock options, restricted stock and restricted stock units are included in administrative and general expenses in AWR and GSWC's statements of income:

| (in thousands)                                                            | AWR                                 |                 |                 | GSWC                                |              |                 |
|---------------------------------------------------------------------------|-------------------------------------|-----------------|-----------------|-------------------------------------|--------------|-----------------|
|                                                                           | For The Years Ended<br>December 31, |                 |                 | For The Years Ended<br>December 31, |              |                 |
|                                                                           | 2010                                | 2009            | 2008            | 2010                                | 2009         | 2008            |
| Stock-based compensation related to:                                      |                                     |                 |                 |                                     |              |                 |
| Stock options granted to employees and directors                          | \$ 579                              | \$ 631          | \$ 789          | \$ 438                              | \$ 417       | \$ 617          |
| Restricted stock units granted to employees                               | 645                                 | 476             | 550             | 443                                 | 303          | 422             |
| Restricted stock units granted to directors                               | 258                                 | 226             | 160             | 258                                 | 226          | 160             |
| Stock-based compensation recognized in the income statement, before taxes | 1,482                               | 1,333           | 1,499           | 1,139                               | 946          | 1,199           |
| Income tax benefit (1)                                                    | —                                   | —               | —               | —                                   | —            | —               |
| Total stock-based compensation after income taxes                         | <u>\$1,482</u>                      | <u>\$ 1,333</u> | <u>\$ 1,499</u> | <u>\$1,139</u>                      | <u>\$946</u> | <u>\$ 1,199</u> |

- (1) A net income tax benefit is not reflected for GSWC, as its tax benefit recognition was fully offset by the recognition of a regulatory liability as a result of the flow-through treatment of its compensatory expenses for regulatory purposes.

Equity-based compensation cost, capitalized as part of utility plant for the year ended December 31, 2010 was \$190,000 for AWR and GSWC. For the year ended December 31, 2009, the equity-based compensation cost, capitalized as part of utility plant was \$226,000 and \$225,000, respectively, for both AWR and GSWC. For the year ended December 31, 2008, the equity-based compensation cost, capitalized as part of utility plant was \$242,000 and \$241,000, respectively, for both AWR and GSWC.

Registrant amortizes stock-based compensation over the requisite (vesting) period for the entire award. Options issued pursuant to the 2000 and 2008 Employee Plans vest and are exercisable in installments of 33% the first two years and 34% in the third year, starting one year from the date of the grant and expire 10 years from the date of the grant.

### **Valuation of Stock Options**

Registrant estimated the fair value of stock options granted during the years ended December 31, 2010, 2009 and 2008 using the Black-Scholes valuation model. Key input assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Registrant's stock over the option's expected term, the risk-free interest rate over the option's expected term, and the Registrant's expected annual dividend yield. Registrant believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating the fair values of Registrant's stock options granted during the years ended December 31, 2010, 2009 and 2008. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive equity awards. The fair value of stock units and restricted stock was determined based on the closing trading price of Common Shares on the grant date.

The fair value of each option grant during the years ended December 31, 2010, 2009 and 2008 was estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions:

|                                               | 2010   | 2009   | 2008   |
|-----------------------------------------------|--------|--------|--------|
| Weighted-average fair value of option granted | \$7.02 | \$6.33 | \$6.78 |
| Risk-free interest rate                       | 2.48%  | 1.52%  | 3.49%  |
| Expected annual dividend yield                | 3.04%  | 2.84%  | 2.60%  |
| Expected volatility factor                    | 28.98% | 26.67% | 23.34% |
| Expected option term (in years)               | 5      | 5      | 5      |

*Summary of key assumptions* — The risk-free interest rate for periods equal to the expected term of the share option was based on the U.S. Treasury yield curve in effect at the time of grant. Dividend yield reflects the current dividend rate at the date of grant. The stock volatility for each grant is measured using the weighted average of historical monthly and daily price changes of the Common Shares over the most recent period equal to the expected option life of the grant. Effective January 1, 2008, Registrant adopted additional Securities and Exchange Commission guidance on share-based payment which requires Registrant to develop expected option terms by reviewing detailed external information about employee exercise behavior. Accounting guidance also requires entities to estimate the number of forfeitures expected to occur and record expense based upon the number of awards expected to vest.

*Stock Options* — A summary of stock option activity as of December 31, 2010, and changes during the year ended December 31, 2010, are presented below:

|                                          | Number of<br>Options | Weighted<br>Average<br>Exercise Price | Weighted Average<br>Remaining<br>Contractual Term | Aggregate<br>Intrinsic Value |
|------------------------------------------|----------------------|---------------------------------------|---------------------------------------------------|------------------------------|
| Options outstanding at January 1, 2010   | 669,503              | \$ 31.62                              |                                                   |                              |
| Granted                                  | 96,669               | 33.38                                 |                                                   |                              |
| Exercised                                | (30,500)             | (28.09)                               |                                                   |                              |
| Forfeited or expired                     | (9,267)              | (31.90)                               |                                                   |                              |
| Options outstanding at December 31, 2010 | 726,405              | \$ 32.00                              | 5.92                                              | \$1,796,273                  |
| Options exercisable at December 31, 2010 | 399,961              | \$ 30.27                              | 4.19                                              | \$1,679,908                  |

The weighted-average grant-date fair value of options granted by Registrant during the year ended December 31, 2010 was \$7.02. The aggregate intrinsic value in the table above represents the total pretax intrinsic value (i.e., the difference between the closing price of the Common Shares on the last trading day of the 2010 calendar year and the exercise price, times the number of shares) that would have been received by the option holders had all option holders exercised their option on December 31, 2010. This amount changes if the fair market value of the Common Shares changes. The total intrinsic value of

options exercised during the years ended December 31, 2010, 2009 and 2008 was approximately \$281,000, \$138,000 and \$417,000, respectively.

During the years ended December 31, 2010, 2009 and 2008, Registrant received approximately \$857,000, \$309,000 and \$690,000, respectively, in cash proceeds from the exercise of its stock options and realized approximately \$111,000, \$80,000 and \$150,000, respectively, of tax benefit for the tax deduction from awards exercised. As of December 31, 2010, approximately \$670,000 of total unrecognized compensation cost related to outstanding stock options is expected to be recognized over a remaining period ranging from 0.07 to 2.81 years.

**Restricted Stock and Stock Units** — A summary of the status of Registrant's outstanding restricted stock units to employees and directors as of December 31, 2010, and changes during the year ended December 31, 2010, is presented below:

|                                             | <b>Number of<br/>Restricted Share<br/>Units</b> | <b>Weighted Average<br/>Grant-Date Value</b> |
|---------------------------------------------|-------------------------------------------------|----------------------------------------------|
| Restricted share units at January 1, 2010   | 87,233                                          | \$ 31.27                                     |
| Granted                                     | 40,211                                          | 33.57                                        |
| Vested                                      | (21,717)                                        | (34.78)                                      |
| Forfeited                                   | -                                               | -                                            |
| Restricted share units at December 31, 2010 | <u>105,727</u>                                  | <u>\$ 31.42</u>                              |

As of December 31, 2010, there was approximately \$745,000 of total unrecognized compensation cost related to restricted stock units granted under AWR's employee and director's stock plans. That cost is expected to be recognized over a remaining period ranging from 0.07 to 2.09 years.

AWR has no restricted stock outstanding as of December 31, 2010.

### **Note 13 - Business Risks and Commitments**

Registrant's rate-regulated utility operations are engaged in supplying water and electric service to the public. Registrant is required to provide service and grant credit to customers within its defined service areas. Although Registrant has a diversified base of residential, industrial and other customers, revenues derived from commercial and residential water customers accounted for approximately 90% of total water revenues in 2010, which is about the same percentage as in 2009 and 2008. Registrant faces additional risks associated with weather conditions, adequacy and quality of water supplies, regulatory decisions, pronouncements and laws, water-related litigation, and general business conditions.

#### **GSWC's Water Supply:**

GSWC obtains its water supply from its operating wells and purchases from others, principally member agencies of the Metropolitan Water District of Southern California ("MWD"). The MWD is a public agency and quasi-municipal corporation created in 1928 by a vote of the electorates of several Southern California cities. MWD's primary purpose was and is to provide a supplemental supply of water for domestic and municipal uses and purposes at wholesale rates to its member public agencies. There are 26 member public agencies of MWD, consisting of 14 cities, 11 municipal water districts, and one county water authority. GSWC has 58 connections to MWD's water distribution facilities and those of other member water agencies. Its combined MWD water purchases through 6 separate MWD member agencies total more than 75,000 acre feet annually. MWD's principal sources of water are the State Water Project and the Colorado River.

GSWC has contracts with MWD member agencies, various governmental entities and other parties to purchase water or water rights for an aggregate amount of \$54.0 million as of December 31, 2010. Contracts for \$48.4 million expire on an agreement by agreement basis commencing in 2011 through 2013. Each of these contracts contain minimum take or pay provisions with the terms and conditions varying under each contract. GSWC plans to continue to purchase and use at least the minimum water requirement under the respective contracts in the future. The amount of the remaining obligations was estimated based on current rates per acre-foot. These rates may be changed annually. Also included in the \$54.0 million is a remaining commitment of \$2.2 million under an agreement with the City of Claremont ("the City") to lease water rights that were ascribed to the City as part of the Six Basins adjudication. The initial term of the agreement expires in 2028. GSWC can exercise an option to renew this agreement for 10 additional years. The remaining amounts of \$3.4 million are commitments for purchased water with various third parties which expire commencing in 2013 through 2038.

GSWC's estimated future minimum payments under these purchased water supply commitments at December 31, 2010 are as follows, in thousands:

|            |                 |
|------------|-----------------|
| 2011       | \$17,367        |
| 2012       | 16,434          |
| 2013       | 16,222          |
| 2014       | 209             |
| 2015       | 209             |
| Thereafter | 3,523           |
| Total      | <u>\$53,964</u> |

**Bear Valley Electric:**

In October 2008, GSWC executed a purchased power contract with Shell Energy North America (US), LP ("Shell") that began providing power to BVES effective January 1, 2009 at a fixed cost over three to five year terms for different amounts of power over different time periods under the contract. The main product under the new contract with Shell provides for 13 MWs of electric energy at an average fixed price of \$67.15 per MWh beginning January 1, 2009 through November 30, 2013. During the winter peak, another product under the Shell contract provides for 7 MWs of electric energy at an average fixed price of \$66.40 per MWh beginning January 1, 2009 through December 31, 2011. GSWC's total commitment under this agreement amounts to \$40.9 million, of which \$23.9 million remains outstanding as of December 31, 2010.

The average minimum load at GSWC's BVES customer service area has been approximately 11 MWs. The average winter load has been 21 MWs with a winter peak of 44 MWs when the snowmaking machines at the ski resorts are operating. In addition to the purchased power contracts, GSWC buys additional energy to meet peak demand and sells surplus power as needed. GSWC owns a natural gas-fueled 8.4 MW generation facility that became commercially operational in 2005, and assists GSWC in meeting demand.

On July 17, 2002, the CPUC approved a settlement agreement reached among GSWC, all intervening parties and the then Office of Ratepayer Advocates of the CPUC, which permits GSWC to recover \$77 per MWh of purchased power costs through rates. GSWC is only allowed to include up to a weighted annual energy purchase cost of \$77 per MWh each year, in its balancing account. To the extent GSWC's actual average annual weighted cost for purchased power is less than \$77 per MWh, the differential helps to recover amounts included in the electric supply balancing account. Conversely, to the extent that actual average annual weighted costs for power purchased exceed the \$77 per MWh amount, GSWC will not be able to include these amounts in its balancing account and such amounts will be expensed. There was no expense in 2010, 2009 or 2008 over the \$77 per MWh cap. As a result of the settlement, GSWC is also permitted to collect a surcharge of 2.2¢ per kilowatt hour from its customers for up to ten years commencing August 2001 to allow GSWC an opportunity to collect amounts remaining in its electric cost balancing account, with interest, incurred by GSWC. In December 2010, GSWC filed an advice letter with the CPUC seeking to extend the 2.2¢ surcharge through December 2012.

The ability of GSWC to deliver purchased power to customers in its BVES service area is limited by the ability of the transmission facilities owned by Edison to transmit this power. GSWC filed a lawsuit against Edison in 2000 for breach of contract as a result of delays in upgrading these transmission facilities as well as for other reasons. As described in Note 2, GSWC and Edison agreed to settle this suit. Under the terms of the agreement, GSWC agreed to pay a \$5 million project abandonment fee to Edison and made an initial lump sum payment of \$1.4 million to Edison during the first quarter of 2004. GSWC agreed to pay Edison an additional \$3.6 million over a 15-year term through 180 equal monthly payments of approximately \$38,000. All payments made to Edison under this agreement are included in the electric supply cost balancing account.

### **Operating Leases:**

Registrant leases equipment and facilities primarily for its Regional and District offices under non-cancelable operating leases with varying terms, provisions, and expiration dates. Rent expense for leases that contain scheduled rent increases are recorded on a straight-line basis. During 2010, 2009 and 2008, Registrant's consolidated rent expense was approximately \$3,437,000, \$3,268,000 and \$3,371,000 respectively. Registrant's future minimum payments under long-term non-cancelable operating leases at December 31, 2010 are as follows (in thousands):

|            |                 |
|------------|-----------------|
| 2011       | \$ 3,270        |
| 2012       | 2,197           |
| 2013       | 1,345           |
| 2014       | 916             |
| 2015       | 9               |
| Thereafter | —               |
| Total      | <u>\$ 7,737</u> |

There is no material difference between the consolidated operations of AWR and the operations of GSWC in regards to the future minimum payments under long-term non-cancelable operating leases.

### **Note 14 - Contingencies**

#### **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 and the San Gabriel Basin Water Quality Authority ("WQA"), against some of those allegedly responsible for the contamination of two of these wells. 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 the two impacted GSWC 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 have been reached between WQA and some PRPs. Settlements with a number of other PRPs are being finalized; however, Registrant is presently unable to predict the ultimate outcome of these settlement discussions.

#### **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, 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.

The Town of Apple Valley (the "Town") abandoned its activities related to a potential condemnation of GSWC's water systems serving the Town in 2007. However, in January 2011, the Town Council directed staff to update the previously prepared financial feasibility study for the acquisition of GSWC's water systems. GSWC's Apple Valley water systems serve approximately 2,800 customers.

Except for the Town of Apple Valley, Registrant is currently not 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.

#### **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 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.

#### **Aerojet Note Receivable:**

Pursuant to the settlement agreement with Aerojet discussed in Note 2, GSWC has a note receivable which is scheduled to be paid by Aerojet in installments over five years beginning in December 2009. GenCorp Inc. is the parent of Aerojet. In January 2010, Standard & Poor's ("S&P") upgraded GenCorp Inc's credit rating to B- from CCC+ with a stable outlook. This is a non-investment grade rating assigned by S&P to companies whose financial situation varies. On March 26, 2010, Moody's Investor Services ("Moody's") upgraded its corporate family rating from B3 to B2. This is a non-investment grade rating assigned by Moody's to obligations that are speculative and subject to high credit risk and of generally poor credit quality.

As of December 31, 2010, GSWC has received from Aerojet a total of \$5.0 million including interest as payment of the first and second annual installment under the terms of the 2004 settlement agreement. As of December 31, 2010, the unpaid portion of the note receivable is \$6.1 million, comprised of \$4.8 million in principal and \$1.3 million in accrued interest. At this time, management believes the note receivable from Aerojet is fully collectible and has not provided a reserve for uncollectible amounts as of December 31, 2010. GSWC will continue to assess recoverability of this note receivable.

#### **Environmental Clean-Up and Remediation:**

Chadron Plant: GSWC has been involved in environmental remediation and clean-up at a plant site ("Chadron Plant") that contained an underground storage tank which was used to store gasoline for its vehicles. This tank was removed from the ground in July 1990 along with the dispenser and ancillary piping. Since then, GSWC has been involved in various remediation activities at this site. Recent site assessments have been conducted which showed that there was more gasoline at higher concentrations spread over a larger area than previously measured. Remediation is estimated to take two more years, followed by at least one year of monitoring and reporting. As of December 31, 2010, the total spent to clean-up and remediate GSWC's plant facility is approximately \$3.5 million, of which \$1.5 million has been paid by the State of California Underground Storage Tank Fund. Amounts paid by GSWC have been included in rate-base and approved by the CPUC for recovery.

As of December 31, 2010, GSWC has an accrued liability for the estimated additional cost of \$1.2 million to complete the clean-up at the site. The ultimate cost may vary as there are many unknowns in remediation of underground gasoline spills and this is an estimate based on currently available information. Management also believes it is probable that the estimated additional costs will be approved in rate base by the CPUC.

**Ballona Plant:** During the first quarter of 2008, hydrocarbon contaminated soil was found at a plant site (“Ballona Plant”) located in GSWC’s Southwest customer service area where an abandoned water tank was demolished. All contaminated soil was removed and replaced with clean soil. The clean-up was completed during the first quarter of 2010. The final Removal Action Completion Report (“RACR”) was submitted to the Site Mitigation Unit (“SMU”) on May 10, 2010. The SMU reviewed the RACR and issued a no further action letter. The letter states that the SMU concurs with the contents of the RACR, which states that the site contamination has been satisfactorily mitigated for the current use and no further action is required at the subject site. Clean-up costs incurred through December 31, 2010 totaled approximately \$337,000. Historically, the costs for this type of cleanup have been included in rate base for recovery.

**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. GSWC filed a cross-complaint against the former officers. The lawsuits were filed on November 15, 2007 in the Los Angeles Superior Court. On February 15, 2010, the parties agreed to mutually settle the matter and a Settlement Agreement was executed. Among other things, the Settlement Agreement releases GSWC from claims of the former officers. The Settlement Agreement further provides that there was no admission of liability by any of the parties and that each party denies any liability to the other. As a result of this matter, Registrant recorded a pre-tax charge of \$3.8 million during the fourth quarter of 2009 for legal and settlement costs. This charge has been reflected in administrative and general expenses in the Consolidated Statements of Income.

Registrant is also subject to other 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. Registrant is unable to predict an estimate of the loss, if any, resulting from any pending suits or administrative proceedings.

**Note 15 - Construction Program**

GSWC maintains an ongoing water distribution main replacement program throughout its customer service areas based on the age of and type of distribution system materials, priority of leaks detected, remaining productive life of the distribution system and an underlying replacement schedule. In addition, GSWC upgrades its electric and water supply facilities in accordance with industry standards, local requirements and CPUC requirements. As of December 31, 2010, GSWC has unconditional purchase obligations for capital projects of approximately \$26.1 million.

ASUS actively seeks opportunities to own, operate and maintain water and/or wastewater systems at U.S. government military installations, which may involve significant capital commitments. The Military Utility Privatization Subsidiaries have capital commitments that are being funded by the U.S. government. In certain circumstances, the government may request that ASUS finance the cost of selected construction projects. ASUS will consider financing such projects. The terms of any such financing, including interest rates, will be determined on a case-by-case basis.

## Note 16 — Business Segments

AWR has three reportable segments, water, electric and contracted services, whereas GSWC has two segments, water and electric. Within the segments, AWR has two continuing principal business units: water and electric service utility operations conducted through GSWC, and a contracted services unit conducted through ASUS and its subsidiaries. All activities of GSWC are geographically located within California. The operating activities of CCWC have been included in discontinued operations as described in Note 19. All activities of CCWC are located in the state of Arizona. Both GSWC and CCWC are rate-regulated utilities.

Activities of ASUS and its subsidiaries are conducted in California, Maryland, New Mexico, North Carolina, South Carolina, Texas and Virginia. ASUS's wholly owned subsidiaries are regulated (but not as to rates) by the state in which the subsidiary primarily conducts water and/or wastewater operations. Fees charged for operation and maintenance and renewal and replacement services are based upon the terms of the contracts with the U.S. government which have been filed with the commissions in the states in which ASUS's subsidiaries are incorporated.

On a stand-alone basis, AWR has no material assets other than its investments in its subsidiaries.

The tables below set forth information relating to GSWC's operating segments, ASUS and its subsidiaries, and other matters. Certain assets, revenues and expenses have been allocated in the amounts set forth. The identifiable assets are net of respective accumulated provisions for depreciation. Capital additions reflect capital expenditures paid in cash, and exclude property installed by developers and conveyed to GSWC and CCWC and installations paid for by the U.S. government or others at ASUS and its subsidiaries.

| As Of And For The Year Ended December 31, 2010 |           |           |            |           |          |              |
|------------------------------------------------|-----------|-----------|------------|-----------|----------|--------------|
| (dollars in thousands)                         | GSWC      |           | CCWC       | ASUS      | AWR      | Consolidated |
|                                                | Water     | Electric  | Water      | Contracts | Parent   | AWR          |
| Operating revenues                             | \$290,781 | \$ 35,801 | \$ —       | \$ 72,360 | \$ —     | \$ 398,942   |
| Operating income (loss)                        | 58,121    | 5,680     | (1,103)(1) | 11,487    | (366)    | 73,819       |
| Interest expense, net                          | 17,803    | 1,498     | —          | (224)     | 153      | 19,230       |
| Identifiable assets                            | 813,942   | 37,425    | —          | 3,589     | —        | 854,956      |
| Depreciation and amortization expense          | 34,360    | 2,240     | —          | 805       | —        | 37,405       |
| Net income from discontinued operations        | —         | —         | 2,532(2)   | —         | (426)(4) | 2,106        |
| Capital additions                              | 74,264    | 2,700     | 688        | 1,398     | —        | 79,050       |

| As Of And For The Year Ended December 31, 2009 |            |           |          |           |        |              |
|------------------------------------------------|------------|-----------|----------|-----------|--------|--------------|
| (dollars in thousands)                         | GSWC       |           | CCWC     | ASUS      | AWR    | Consolidated |
|                                                | Water      | Electric  | Water    | Contracts | Parent | AWR          |
| Operating revenues                             | \$ 265,197 | \$ 28,922 | \$ —     | \$ 59,132 | \$ —   | \$ 353,251   |
| Operating income (loss)                        | 64,039     | (553)     | (915)(1) | 6,358     | (87)   | 68,842       |
| Interest expense, net                          | 18,327     | 2,173     | —        | 351       | 137    | 20,988       |
| Identifiable assets                            | 781,874    | 37,170    | —        | 2,983     | —      | 822,027      |
| Depreciation and amortization expense          | 28,609     | 2,258     | —        | 664       | —      | 31,531       |
| Net income from discontinued operations        | —          | —         | 157      | —         | —      | 157          |
| Capital additions                              | 72,702     | 1,869     | 1,488    | 1,400     | —      | 77,459       |

| As Of And For The Year Ended December 31, 2008 |            |           |          |           |        |              |
|------------------------------------------------|------------|-----------|----------|-----------|--------|--------------|
| (dollars in thousands)                         | GSWC       |           | CCWC     | ASUS      | AWR    | Consolidated |
|                                                | Water      | Electric  | Water    | Contracts | Parent | AWR          |
| Operating revenues                             | \$ 240,464 | \$ 28,424 | \$ —     | \$ 42,358 | \$ —   | \$ 311,246   |
| Operating income (loss)                        | 61,584     | 1,334(3)  | (843)(1) | (988)     | (149)  | 60,938       |
| Interest expense, net                          | 16,059     | 1,818     | —        | 888       | 280    | 19,045       |
| Identifiable assets                            | 740,073    | 37,770    | —        | 2,305     | —      | 780,148      |
| Depreciation and amortization expense          | 26,788     | 2,209     | —        | 513       | —      | 29,510       |
| Net loss from discontinued operations          | —          | —         | (3,991)  | —         | —      | (3,991)      |
| Capital additions                              | 71,563     | 1,529     | 2,597    | 1,329     | —      | 77,018       |

- (1) Operating income (loss) include CCWC's allocated corporate overhead costs that are expected to continue primarily at GSWC.
- (2) In accordance with the accounting guidance relating to assets held for sale, Registrant ceased recording depreciation expense for CCWC as of June 2010. Identifiable assets for CCWC were \$44.0 million, \$44.4 million and \$45.1 million as of December 31, 2010, 2009 and 2008, respectively.
- (3) Includes \$1,554,000 unrealized gain on purchased power contracts.
- (4) Included in discontinued operations for the year ended December 31, 2010 are direct transaction costs of \$708,000 (\$426,000 after tax) for legal and consulting services in connection with the sale of CCWC.

**Note 17 — Allowance for Doubtful Accounts**

The table below presents Registrant's provision for doubtful accounts charged to expense and accounts written off, net of recoveries. Provisions included in 2010, 2009 and 2008 for AWR and GSWC are as follows:

| (dollars in thousands)                                                     | AWR            |                |                |
|----------------------------------------------------------------------------|----------------|----------------|----------------|
|                                                                            | December 31,   |                |                |
|                                                                            | 2010           | 2009           | 2008           |
| Balance at beginning of year                                               | \$1,158        | \$1,220        | \$1,640        |
| Provision charged to expense                                               | 1,083          | 1,046          | 891            |
| Accounts written off, net of recoveries                                    | (1,190)        | (1,108)        | (1,311)        |
| Balance at end of year                                                     | <u>\$1,051</u> | <u>\$1,158</u> | <u>\$1,220</u> |
| Allowance for doubtful accounts related to accounts receivable-customer    | \$670          | \$657          | \$632          |
| Allowance for doubtful accounts related to receivable from U.S. government | 43             | 67             | 121            |
| Allowance for doubtful accounts related to other accounts receivable       | 338            | 434            | 467            |
| Total allowance for doubtful accounts                                      | <u>\$1,051</u> | <u>\$1,158</u> | <u>\$1,220</u> |

| (dollars in thousands)                                                  | GSWC           |                |                |
|-------------------------------------------------------------------------|----------------|----------------|----------------|
|                                                                         | December 31,   |                |                |
|                                                                         | 2010           | 2009           | 2008           |
| Balance at beginning of year                                            | \$1,088        | \$1,039        | \$961          |
| Provision charged to expense                                            | 1,083          | 1,046          | 1,075          |
| Accounts written off, net of recoveries                                 | (1,166)        | (997)          | (997)          |
| Balance at end of year                                                  | <u>\$1,005</u> | <u>\$1,088</u> | <u>\$1,039</u> |
| Allowance for doubtful accounts related to accounts receivable-customer | \$670          | \$657          | \$632          |
| Allowance for doubtful accounts related to other accounts receivable    | 335            | 431            | 407            |
| Total allowance for doubtful accounts                                   | <u>\$1,005</u> | <u>\$1,088</u> | <u>\$1,039</u> |

**Note 18 — Supplemental Cash Flow Information**

The following table sets forth non-cash financing and investing activities and other cash flow information (in thousands).

|                                               | AWR          |          |          | GSWC         |          |          |
|-----------------------------------------------|--------------|----------|----------|--------------|----------|----------|
|                                               | December 31, |          |          | December 31, |          |          |
|                                               | 2010         | 2009     | 2008     | 2010         | 2009     | 2008     |
| <b>Taxes and Interest Paid:</b>               |              |          |          |              |          |          |
| Income taxes paid                             | \$22,287     | \$14,858 | \$13,353 | \$16,310     | \$15,172 | \$13,185 |
| Interest paid                                 | 21,632       | 20,217   | 20,640   | 21,016       | 19,534   | 19,104   |
| <b>Non-Cash Transactions:</b>                 |              |          |          |              |          |          |
| Property installed by developers and conveyed | \$3,471      | \$ 3,838 | \$ 7,284 | \$ 3,471     | \$ 2,998 | \$ 5,567 |

**Note 19 — Discontinued Operations:**

On June 7, 2010, AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. to sell all of the common shares of CCWC for a total purchase price of \$35.0 million, including the assumption of approximately \$6.0 million of long-term debt. Approximately \$29.0 million in cash will be paid to AWR at closing. The purchase price is subject to certain adjustments for changes in retained earnings. The consummation of the transaction contemplated by the agreement is subject to customary conditions, including among other things, regulatory approval by the Arizona Corporation Commission, which is anticipated to be received in 2011. Therefore, no gain on disposal of CCWC has been recorded for the year ended December 31, 2010, pending regulatory approval. Had the transaction closed as of December 31, 2010, AWR would have recognized a pretax gain on disposal of approximately \$5.8 million, net of transaction costs of \$708,000. The assets and liabilities of CCWC have been classified as current assets and liabilities held for sale as of December 31, 2010.

The carrying amounts of the major classes of assets and liabilities of CCWC included in discontinued operations are as follows:

| <u>(dollars in thousands)</u>                          | <u>December 31,</u><br><u>2010</u> | <u>December 31,</u><br><u>2009</u> |
|--------------------------------------------------------|------------------------------------|------------------------------------|
| Assets:                                                |                                    |                                    |
| Utility Plant, net                                     | \$ 44,085                          | \$ 44,391                          |
| Goodwill, net                                          | 3,321                              | 3,321                              |
| Other assets                                           | 3,477                              | 2,465                              |
| Total assets of discontinued operations                | <u>\$ 50,883</u>                   | <u>\$ 50,177</u>                   |
| Liabilities:                                           |                                    |                                    |
| Advances and contributions in aid of construction, net | \$ 17,867                          | \$ 18,035                          |
| Long term debt                                         | 5,645                              | 5,975                              |
| Other liabilities                                      | 3,519                              | 2,996                              |
| Total liabilities of discontinued operations           | <u>\$ 27,031</u>                   | <u>\$ 27,006</u>                   |

### **Regulatory Matters:**

On October 8, 2009, despite previous rulings in prior proceedings on similar matters, the ACC ordered CCWC to treat the entire gain of \$1,520,000 from a settlement agreement with the Fountain Hills Sanitary District ("FHSD") as a reduction to rate base. As a result, CCWC recognized a loss of \$760,000 during the third quarter of 2009, which effectively reversed the original gain recorded in 2005. In November 2009, CCWC filed an application for rehearing on several issues including the sharing of this gain from the settlement proceeds. The ACC granted CCWC's request to hold a rehearing on this issue and one other issue. On January 27, 2010, a procedural conference was held with the judge and the staff of the ACC involved in the rate case to address a schedule for the rehearing. The rehearing was held in April 2010 and a final decision by the ACC is expected in 2011. At this time, management is unable to predict the outcome of this matter.

### **Goodwill:**

At December 31, 2010, CCWC had approximately \$3.3 million of goodwill that arose during AWR's acquisition of CCWC in October 2000 and represents the remaining difference between the aggregate purchase price and the fair value of CCWC's net assets acquired. CCWC's goodwill is reduced on an ongoing basis to reflect the total tax benefit realized from amortizing, for tax purposes, the excess of tax over book goodwill basis in accordance with guidance on accounting for income taxes.

In accordance with the accounting guidance for goodwill and other intangibles, CCWC's goodwill is tested for impairment at least annually on December 31 and more frequently if circumstances indicate that it may be impaired. Goodwill impairment testing is performed at the operating segment (or "reporting unit") level. The goodwill impairment model is a two-step process. First, it requires a comparison of the book value of net assets to the fair value of the related operations that have goodwill assigned to them. Registrant uses the terminal multiple valuation method in estimating fair value which assumes a business will be sold at the end of the projection period at a specific terminal multiple. Earnings and discounted cash flows were developed from Registrant's internal forecasts. Additionally, management must make an estimate of a weighted average cost of capital to be used as a discount rate, which takes into account certain risk and size premiums, long-term bond yields, and the capital structure of the industry. Changes in these projections or estimates could result in a reporting unit either passing or failing the first step in the impairment model, which could significantly change the amount of any impairment ultimately recorded.

Registrant also considers other qualitative and quantitative factors, including terminal multiples used in the water industry, the regulatory environment in which the reporting unit operates that can significantly impact future earnings and cash flows, and the effects of the volatile current economic environment. If the fair value is determined to be less than book value, a second step is performed to compute the amount of the impairment. In this process, a fair value for goodwill is estimated, based in part on the fair value of the applicable reporting unit's assets and liabilities used in the first step, and are compared to its carrying value. The fair values for the majority of such assets and liabilities are equal to their carrying values; however, the fair values of the applicable debt are highly dependent upon market conditions surrounding the measurement date. The amount by which carrying value exceeds fair value represents the amount of goodwill impairment.

During the fourth quarter ended December 31, 2008, based on a combination of factors, including the recent economic downturn, as well as the current regulatory environment in Arizona resulting in regulatory lags and lower than anticipated rate increases, Registrant determined that its goodwill for CCWC was impaired and recorded a charge of \$7.7 million included below in CCWC's 2008 consolidated statement of income statement. The current impairment analysis

performed for 2010 did not indicate impairment had occurred for the current goodwill amount of \$3.3 million since the purchase price from the pending sale with EPCOR is above book value. The changes in the carrying amount of CCWC's goodwill for the years ended December 31, 2010 and 2009 are summarized as follows (in thousands):

|                               |                 |
|-------------------------------|-----------------|
| Goodwill at December 31, 2008 | \$ 3,494        |
| Income tax amortization       | (173)           |
| Goodwill at December 31, 2009 | 3,321           |
| Income tax amortization       | —               |
| Goodwill at December 31, 2010 | <u>\$ 3,321</u> |

#### **Long-Term Debt:**

CCWC has outstanding obligations under Industrial Development Authority Bonds ("IDA Bonds"). Substantially all of the utility plant of CCWC is pledged as collateral for its IDA Bonds. The Bond Agreement, among other things: (i) requires CCWC to maintain certain financial ratios; (ii) restricts CCWC's ability to incur additional debt, make liens, sell, lease or dispose of assets, merge with another corporation, and pay dividends, and (iii) requires CCWC to establish a debt service reserve fund held in trust for future payments, which totaled approximately \$656,000 as of December 31, 2010 and 2009. As previously mentioned, AWR entered into a stock purchase agreement with EPCOR Water (USA) Inc. to sell all of the common shares of CCWC for a total purchase price of \$35.0 million, including the assumption of approximately \$6.0 million of long-term debt.

Annual maturities of CCWC's long-term debt amount to approximately \$345,000, \$365,000, \$390,000, \$405,000, \$430,000 and \$3,710,000 for each fiscal year through December 31, 2015 and thereafter, respectively.

#### **Advances and Contributions in Aid of Construction, net:**

For CCWC, advances for construction represent amounts advanced by developers which are refundable over 10 to 20 years. Refund amounts under the CCWC contracts are based on annual revenues from the extensions, as authorized by the ACC. After all refunds are made, any remaining balance is transferred to contributions-in-aid of construction. Utility plant funded by advances and contributions is excluded from rate base. Generally, CCWC depreciates contributed property and amortizes contributions in aid of construction at the composite rate of the related property. During 2010, 2009 and 2008, approximately \$482,000, \$1.1 million and \$993,000, respectively, of CCWC's advances that expired were transferred to contributions-in-aid of construction. Contributions-in-aid of construction are similar to advances, but require no refunding and are amortized over the useful lives of the related property.

A summary of discontinued operations presented in the consolidated statements of income for the years ended December 31, 2010, 2009 and 2008 are as follows (in thousands):

| (dollars in thousands)                         | For The Years Ended December 31, |          |            |
|------------------------------------------------|----------------------------------|----------|------------|
|                                                | 2010                             | 2009     | 2008       |
| Operating revenues                             | \$ 8,745                         | \$ 7,722 | \$ 7,472   |
| Supply costs                                   | 1,467                            | 1,761    | 1,412      |
| Other operating expenses (1)                   | 2,770                            | 5,309    | 12,193     |
| Total operating expenses                       | 4,237                            | 7,070    | 13,605     |
| Operating income (loss)                        | 4,508                            | 652      | (6,133)    |
| Interest expense, net                          | (356)                            | (371)    | (447)      |
| Income (loss) before income taxes              | 4,152                            | 281      | (6,580)    |
| Income tax expense/(benefit) (2)               | 1,620                            | 124      | (2,589)    |
| Net income (loss)                              | 2,532                            | 157      | (3,991)    |
| Transaction costs, net of taxes (3)            | 426                              | —        | —          |
| Income (loss) from discontinued operations (4) | \$ 2,106                         | \$ 157   | \$ (3,991) |

- (1) In accordance with the accounting guidance relating to assets held for sale, Registrant ceased recording depreciation expense for CCWC as of June 2010.
- (2) Income tax expense (benefit) does not include the effects of CCWC's inclusion in the AWR combined California unitary return, which are included in, and do not materially affect, the income tax expense of continuing operations.
- (3) Included in discontinued operations for the twelve months ended December 31, 2010 are direct transaction costs of \$708,000 for legal and consulting services in connection with the pending sale of CCWC.
- (4) Corporate overhead costs allocated to CCWC have been excluded from discontinued operations. The majority of these costs are expected to continue primarily at GSWC. Accordingly, these corporate overhead costs have been included in other operating expenses and administrative and general expenses as part of continuing operations in the consolidated statements of income. Such costs allocated to CCWC that have been reflected as part of continuing operations amounted \$1,103,000, \$915,000, and \$843,000 for the years ended December 31, 2010, 2009, and 2008, respectively.

**Note 20 — Selected Quarterly Financial Data (Unaudited)**

The quarterly financial information presented below is unaudited. The business of Registrant is of a seasonal nature and it is management's opinion that comparisons of basic earnings for the quarterly periods do not reflect overall trends and changes in Registrant's operations.

| (in thousands, except per share amounts)        | AWR                                  |                |                   |                    |           |
|-------------------------------------------------|--------------------------------------|----------------|-------------------|--------------------|-----------|
|                                                 | For The Year Ended December 31, 2010 |                |                   |                    |           |
|                                                 | First Quarter                        | Second Quarter | Third Quarter (1) | Fourth Quarter (2) | Year      |
| Operating revenues from continuing operations   | \$88,466                             | \$95,476       | \$111,300         | \$103,700          | \$398,942 |
| Operating income from continuing operations     | 19,151                               | 21,150         | 16,897            | 16,621             | 73,819    |
| Income from continuing operations, net of tax   | 8,290                                | 8,870          | 5,669             | 8,262              | 31,091    |
| Income from discontinued operations, net of tax | 200                                  | 105            | 983               | 818                | 2,106     |
| Basic earnings per share:                       |                                      |                |                   |                    |           |
| Income from continuing operations               | 0.45                                 | 0.47           | 0.31              | 0.44               | 1.67      |
| Income from discontinued operations             | 0.01                                 | 0.01           | 0.05              | 0.04               | 0.11      |
| Diluted earnings per share:                     |                                      |                |                   |                    |           |
| Income from continuing operations*              | 0.44                                 | 0.47           | 0.30              | 0.44               | 1.66      |
| Income from discontinued operations             | 0.01                                 | 0.01           | 0.05              | 0.04               | 0.11      |

| (in thousands)     | GSWC                                 |                |                   |                    |           |
|--------------------|--------------------------------------|----------------|-------------------|--------------------|-----------|
|                    | For The Year Ended December 31, 2010 |                |                   |                    |           |
|                    | First Quarter                        | Second Quarter | Third Quarter (1) | Fourth Quarter (2) | Year      |
| Operating revenues | \$67,036                             | \$80,661       | \$90,551          | \$88,334           | \$326,582 |
| Operating income   | 11,659                               | 19,779         | 13,985            | 18,378             | 63,801    |
| Net Income         | 3,564                                | 8,094          | 4,153             | 9,299              | 25,110    |

| (in thousands, except per share amounts)        | AWR                                  |                |               |                    |           |
|-------------------------------------------------|--------------------------------------|----------------|---------------|--------------------|-----------|
|                                                 | For The Year Ended December 31, 2009 |                |               |                    |           |
|                                                 | First Quarter                        | Second Quarter | Third Quarter | Fourth Quarter (3) | Year      |
| Operating revenues from continuing operations   | \$77,993                             | \$91,691       | \$99,325      | \$84,242           | \$353,251 |
| Operating income from continuing operations     | 11,468                               | 24,266         | 22,668        | 10,440             | 68,842    |
| Income from continuing operations, net of tax   | 5,028                                | 11,415         | 9,891         | 3,040              | 29,374    |
| Income from discontinued operations, net of tax | (96)                                 | 84             | (193)         | 362                | 157       |
| Basic earnings per share:                       |                                      |                |               |                    |           |
| Income from continuing operations *             | 0.28                                 | 0.64           | 0.53          | 0.16               | 1.62      |
| Income from discontinued operations             | —                                    | —              | (0.01)        | 0.02               | 0.01      |
| Diluted earnings per share:                     |                                      |                |               |                    |           |
| Income from continuing operations               | 0.28                                 | 0.64           | 0.53          | 0.16               | 1.61      |
| Income from discontinued operations             | —                                    | —              | (0.01)        | 0.02               | 0.01      |

| (in thousands)     | GSWC                                 |                |               |                    |           |
|--------------------|--------------------------------------|----------------|---------------|--------------------|-----------|
|                    | For The Year Ended December 31, 2009 |                |               |                    |           |
|                    | First Quarter                        | Second Quarter | Third Quarter | Fourth Quarter (3) | Year      |
| Operating revenues | \$63,810                             | \$78,183       | \$82,684      | \$69,442           | \$294,119 |
| Operating income   | 10,623                               | 23,523         | 20,453        | 8,887              | 63,486    |
| Net Income         | 3,693                                | 10,914         | 8,542         | 2,224              | 25,373    |

\* The sum of the quarterly 2009 basic and 2010 diluted earnings per share amounts do not agree to the yearly totals due to rounding.

- (1) The third quarter of 2010 reflects a \$9.0 million pretax charge related to the impairment of assets and loss contingencies in connection with regulatory matters as a result of proposed decisions issued in October 2010.
- (2) The fourth quarter of 2010 reflects an additional \$7.6 million pretax charge related to the impairment of assets and loss contingencies in connection with developments in regulatory matters including the issuance of a final decision by the CPUC on Regions II and III rate case received in November 2010. In addition, the fourth quarter of 2010 reflects retroactive rates related to the first nine months of 2010 totaling \$9.4 million.
- (3) The fourth quarter of 2009 reflects a \$3.8 million pretax charge related to legal and settlement costs in connection with a settlement reached between GSWC and two former officers of GSWC.

## Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of  
American State Water Company:

In our opinion, the accompanying consolidated balance sheets, statements of capitalization, and the related consolidated statements of income, common shareholders' equity, and cash flows present fairly, in all material respects, the financial position of American States Water Company and its subsidiaries ("the Company") at December 31, 2010 and December 31, 2009, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in Item 15(a)(2), presented fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control over Financial Reporting appearing in Item 9A. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

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

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California  
March 11, 2011

## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and  
Shareholder of Golden State Water Company:

In our opinion, the accompanying balance sheets, statements of capitalization, and the related statements of income, common shareholder's equity, and cash flows present fairly, in all material respects, the financial position of Golden State Water Company ("GSWC") at December 31, 2010 and 2009, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2010 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of GSWC's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

Los Angeles, California  
March 11, 2011

## **Report from Management on the Responsibility for Financial Statements**

The consolidated financial statements contained in the annual report were prepared by the management of American States Water Company, which is responsible for their integrity and objectivity. The consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America and include, where necessary, amounts based upon management's best estimates and judgments. All other financial information in the annual report is consistent with the consolidated financial statements and is also the responsibility of management.

The Audit Committee, composed of three outside directors, exercises oversight of management's discharge of its responsibilities regarding the systems of internal control and financial reporting. The committee periodically meets with management, the internal auditor and the independent accountants to review the work and findings of each. The committee also reviews the qualifications of, and recommends to the board of directors, a firm of independent registered public accountants.

Registrant's independent registered public accounting firm, PricewaterhouseCoopers LLP, is engaged to audit the consolidated financial statements included in this report in accordance with the standards of the Public Company Accounting Oversight Board (United States) and to express an opinion on whether those consolidated financial statements fairly present, in all material respects, Registrant's results of operations, financial position and cash flows. In addition, the effectiveness of AWR's internal control over financial reporting as of December 31, 2010 has been audited by PricewaterhouseCoopers LLP. The result of their work is expressed in their Report of Independent Registered Public Accounting Firm.

/s/ ROBERT J. SPROWLS  
Robert J. Sprowls  
President, Chief Executive Officer

/s/ EVA G. TANG  
Eva G. Tang  
Chief Financial Officer,  
Senior Vice President - Finance,  
Treasurer and Corporate Secretary

March 11, 2011

## **Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None

### **Item 9A. Controls and Procedures**

#### **(a) Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of our disclosure controls and procedures, as such term is defined under Rule 13a-15(e) or 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Based on this evaluation, our principal executive officer and our principal financial officer concluded that the disclosure controls and procedures of AWR and GSWC were effective as of the end of the period covered by this annual report.

#### **(b) Management’s Report on Internal Control over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in *Internal Control - Integrated Framework*, our management concluded that the internal control over financial reporting of AWR and GSWC was effective as of December 31, 2010.

#### **(c) Attestation Report of the Independent Registered Public Accounting Firm**

The effectiveness of our internal control over financial reporting of AWR as of December 31, 2010 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

#### **(d) Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) or 15d(f) under the Exchange Act) of AWR and GSWC that occurred during the fourth quarter of 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Item 9B. Other Information**

None

### **PART III**

#### **Item 10. Directors, Executive Officers and Corporate Governance**

Information responsive to Part III, Item 10 is included in the Proxy Statement, to be filed by AWR with the SEC pursuant to Regulation 14A, under the captions therein entitled: (i) “Proposal 1: Election of Directors”; (ii) “Executive Officers”; (iii) “Governance of the Company”; (iv) “Stock Ownership”; (v) “Nominating and Governance Committee”; (vi) “Audit and Finance Committee;”, and (vii) “Obtaining Additional Information From Us” and is incorporated herein by reference pursuant to General Instruction G(3).

#### **Item 11. Executive Compensation**

Information responsive to Part III, Item 11 is included in the Proxy Statement, to be filed by AWR with the SEC pursuant to Regulation 14A, under the captions therein entitled: (i) “Proposal 1: Election of Directors”; (ii) “Executive Officers;” and (iii) “Compensation Committee” and is incorporated herein by reference pursuant to General Instruction G(3).

#### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information responsive to Part III, Item 12 is included in the Proxy Statement, to be filed by AWR with the SEC pursuant to Regulation 14A, under the caption entitled “Stock Ownership”, and is incorporated herein by reference pursuant to General Instruction G(3).

#### **Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information responsive to Part III, Item 13 is included in the Proxy Statement, to be filed by AWR with the SEC pursuant to Regulation 14A, under the caption therein entitled “Governance of the Company” and is incorporated herein by reference pursuant to General Instruction G(3).

#### **Item 14. Principal Accounting Fees and Services**

Information responsive to Part III, Item 14 is included in the Proxy Statement, to be filed by AWR with the SEC pursuant to Regulation 14A, under the caption therein entitled “Proposal 3: Ratification of Auditors” and is incorporated herein by reference pursuant to General Instruction G(3).

## PART IV

### **Item 15. Exhibits, Financial Statement Schedules**

#### **(a) The following documents are filed as a part of this Annual Report on Form 10-K:**

1. Reference is made to the Financial Statements incorporated herein by reference to Part II, Item 8 hereof.
2. Schedule I — Condensed Financial Information of AWR may be found in the Financial Statements and Notes to Financial Statements incorporated herein by reference to Part II, Item 8 hereof or at the conclusion of this Item. Schedules II, III, IV, and V are omitted as they are not applicable.
3. Reference is made to Item 15(b) of this Annual Report on Form 10-K.

#### **(b) Exhibits:**

- 3.1 By-Laws of American States Water Company incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K, filed January 4, 2008
- 3.2 By-laws of Golden State Water Company incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K filed January 2, 2009
- 3.3 Amended and Restated Articles of Incorporation of American States Water Company incorporated by reference to Exhibit 3.3 of Registrant's Form 10-K/A for the year ended December 31, 2003
- 3.4 Restated Articles of Incorporation of Golden State Water Company, as amended, incorporated herein by reference to Exhibit 3.1 of Registrant's Form 10-Q for the quarter ended September 30, 2005
- 4.1 Indenture, dated September 1, 1993 between Golden State Water Company and The Bank of New York Mellon Trust Company, N.A., as successor trustee, as supplemented, incorporated herein by reference to Exhibit 4.01 of Golden State Water Company Form S-3 filed December 12, 2008
- 4.2 Note Purchase Agreement dated as of October 11, 2005 between Golden State Water Company and Co-Bank, ACB incorporated by reference to Exhibit 4.1 of Registrant's Form 8-K filed October 13, 2005
- 4.3 Note Purchase Agreement dated as of March 10, 2009 between Golden State Water Company and Co-Bank, ACB, incorporated herein by reference to Exhibit 10.16 to Registrant's Form 10-K filed on March 13, 2009
- 4.4 Indenture dated as of December 1, 1998 between American States Water Company and The Bank of New York Mellon Trust Company, N.A., as supplemented by the First Supplemental Indenture dated as of July 31, 2009 incorporated herein by reference to Exhibit 4.1 of American States Water Company's Form 10-Q for the quarter ended June 30, 2009
- 10.1 Deferred Compensation Plan for Directors and Executives incorporated herein by reference to Registrant's Registration Statement on Form S-2, Registration No. 33-5151 (2)
- 10.2 Second Sublease dated October 5, 1984 between Golden State Water Company and Three Valleys Municipal Water District incorporated herein by reference to Registrant's Registration Statement on Form S-2, Registration No. 33-5151
- 10.3 Note Agreement dated as of May 15, 1991 between Golden State Water Company and Transamerica Occidental Life Insurance Company incorporated herein by reference to Registrant's Form 10-Q with respect to the quarter ended June 30, 1991
- 10.4 Schedule of omitted Note Agreements, dated May 15, 1991, between Golden State Water Company and Transamerica Annuity Life Insurance Company, and Golden State Water Company and First Colony Life Insurance Company incorporated herein by reference to Registrant's Form 10-Q with respect to the quarter ended June 30, 1991

- 10.5 Loan Agreement between California Pollution Control Financing Authority and Golden State Water Company, dated as of December 1, 1996 incorporated by reference to Exhibit 10.7 of Registrant's Form 10-K for the year ended December 31, 1998
- 10.6 Agreement for Financing Capital Improvement dated as of June 2, 1992 between Golden State Water Company and Three Valleys Municipal Water District incorporated herein by reference to Registrant's Form 10-K with respect to the year ended December 31, 1992
- 10.7 Water Supply Agreement dated as of June 1, 1994 between Golden State Water Company and Central Coast Water Authority incorporated herein by reference to Exhibit 10.15 of Registrant's Form 10-K with respect to the year ended December 31, 1994
- 10.8 2003 Non-Employee Directors Stock Purchase Plan, as amended, incorporated herein by reference to Exhibit 10.1 to Registrant's Form 8-K filed on January 30, 2009 (2)
- 10.9 Dividend Reinvestment and Common Share Purchase Plan incorporated herein by reference to American States Water Company Registrant's Form S-3 filed November 12, 2008
- 10.10 Form of Amended and Restated Change in Control Agreement between American States Water Company or a subsidiary and certain executives incorporated herein by reference to Exhibit 10.5 to Registrant's Form 8-K filed on November 5, 2008(2)
- 10.11 Golden State Water Company Pension Restoration Plan, as amended, incorporated herein by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on May 20, 2009(2)
- 10.12 American States Water Company 2000 Stock Incentive Plan, as amended, incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed May 23, 2008 (2)
- 10.13 Loan and Trust Agreement between The Industrial Development Authority of The County of Maricopa, Chaparral City Water Company and Bank One, Arizona, NA, dated as of December 1, 1997 incorporated by reference to Exhibit 10.19 of Registrant's Form 10-K with respect to the year ended December 31, 2000
- 10.14 Subcontract among the United States, Central Arizona Water Conservation District and Chaparral City Water Company providing for water service, dated as of December 6, 1984 incorporated by reference to Exhibit 10.20 to Registrant's Form 10-K with respect to the year ended December 31, 2000
- 10.15 Contract between the United States and Chaparral City Water Company service, dated as of December 6, 1984 for construction of a water distribution system incorporated by reference to Exhibit 10.21 Registrant's Form 10-K with respect to the year ended December 31, 2000
- 10.16 Amended and Restated Credit Agreement between American States Water Company dated June 3, 2005 with Wells Fargo Bank, N.A., as Administrative Agent, as amended, incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed May 27, 2010
- 10.17 Form of Indemnification Agreement for executive officers and directors incorporated by reference to Exhibit 10.21 to Registrant's Form 10-K for the year ended December 31, 2006 (2)
- 10.18 Form of Non-Qualified Stock Option Plan Agreement for officers and key employees for the 2000 Stock Incentive Plan incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K on January 1, 2005 (2)
- 10.19 Form of Non-Qualified Stock Option Plan Agreement for officers and key employees for the 2000 Stock Incentive Plan incorporated by reference to Exhibit 10.1 of Registrant's Form 10-Q for the period ended March 31, 2006 (2)
- 10.20 Form of Director's Non-Qualified Stock Option Agreement incorporated by reference to Exhibit 10.1 to Registrant's Form 10-Q for the period ended September 30, 2006 (2)
- 10.21 Water Sale Agreement dated as of January 31, 2006 between Natomas Mutual Water Company and American States Utility Services, Inc. incorporated by reference to Exhibit 9.01 to Registrant's Form 8-K filed February 3, 2006
- 10.22 Form of Restricted Stock Unit Award Agreement for officers and key employees under the 2000 Stock Incentive Plan incorporated by reference to Exhibit 10.3 of Registrant's Form 8-K filed November 5, 2008 (2)

- 10.23 Form of Restricted Stock Unit Award Agreement for officers and key employees under the 2008 Stock Incentive Plan for restricted stock unit awards prior to January 1, 2011 incorporated by reference to Exhibit 10.4 of Registrant's Form 8-K filed on November 5, 2008 (2)
- 10.23 Form of Amendment to Change in Control Agreement between American States Water Company or a subsidiary and certain executives incorporated herein by reference to Exhibit 10.6 to Registrant's Form 8-K filed November 5, 2008 (2)
- 10.25 2008 Stock Incentive Plan incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed May 23, 2008 (2)
- 10.26 Form of Nonqualified Stock Option Agreement for officers and key employees for the 2008 Stock Incentive Plan incorporated for stock options granted prior to January 1, 2011 herein by reference to Exhibit 10.3 to Registrant's Form 8-K filed May 23, 2008 (2)
- 10.27 2010 Short-Term Incentive Program incorporated herein by reference to Exhibit 10.1 to the Registrant's Form 8-K filed on April 6, 2010(2)
- 10.28 Form of Award Agreement for Awards under the 2010 Short-Term Incentive Program incorporated herein by reference to Exhibit 10.2 to the Registrant's Form 8-K filed on April 6, 2010(2)
- 10.29 Policy Regarding the Recoupment of Certain Performance-Based Compensation Payments incorporated herein by reference to Exhibit 10.3 to the Registrant's Form 8-K filed on July 31, 2009(2)
- 10.30 Performance Incentive Plan incorporated herein by reference to Exhibit 10.4 to the Registrant's Form 8-K filed on July 31, 2009(2)
- 10.31 Officer Relocation Policy incorporated herein by reference to Exhibit 10.5 to the Registrant's Form 8-K filed on July 31, 2009(2)
- 10.32 Form of Non-Qualified Stock Option Award Agreement for officers and key employees under the 2008 Stock Incentive Plan for stock options granted after December 31, 2010 incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K filed on February 4, 2011
- 10.33 Form of Restricted Stock Unit Award Agreement for officers and key employees under the 2008 Stock Incentive Plan for restricted stock unit awards after December 31, 2010 incorporated by reference to Exhibit 10.1 to Registrant's Form 8-K filed on February 4, 2011
- 21. Subsidiaries of Registrant (1)
- 23.1 Consent of Independent Registered Public Accounting Firm for AWR (1)
- 23.1.1 Consent of Independent Registered Public Accounting Firm for GSWC (1)
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for AWR (1)
- 31.1.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for GSWC (1)
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for AWR (1)
- 31.2.1 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for GSWC (1)
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (3)
- 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (3)

**(c) See Item 15(a)(2)**

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- (1) Filed concurrently herewith
- (2) Management contract or compensatory arrangement
- (3) Furnished concurrently herewith

## **SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, Registrants have duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

### **AMERICAN STATES WATER COMPANY (“AWR”):**

By: /s/ EVA G. TANG

Senior Vice President-Finance, Chief Financial  
Officer, Treasurer and Corporate Secretary

### **GOLDEN STATE WATER COMPANY (“GSWC”):**

By: /s/ EVA G. TANG

Senior Vice President-Finance, Chief Financial  
Officer and Secretary

Date: March 11, 2011

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of Registrants and in the capacities and on the dates indicated.

|                                                                                                                                                                                                                                                                                     | Date:                 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------|
| <u>/s/ LLOYD E. ROSS</u><br>Lloyd E. Ross<br>Chairman of the Board and Director of AWR and GSWC                                                                                                                                                                                     | <u>March 11, 2011</u> |
| <u>/s/ ROBERT J. SPROWLS</u><br>Robert J. Sprowls<br>Principal Executive Officer, President and Chief Executive Officer of AWR and GSWC and Director of GSWC                                                                                                                        | <u>March 11, 2011</u> |
| <u>/s/ EVA G. TANG</u><br>Eva G. Tang<br>Principal Financial and Accounting Officer,<br>Senior Vice President-Finance, Chief Financial Officer, Treasurer<br>and Corporate Secretary of AWR; and<br>Senior Vice President-Finance, Chief Financial Officer and<br>Secretary of GSWC | <u>March 11, 2011</u> |
| <u>/s/ JAMES L. ANDERSON</u><br>James L. Anderson<br>Director of AWR and GSWC                                                                                                                                                                                                       | <u>March 11, 2011</u> |
| <u>/s/ DIANA M. BONTÁ</u><br>Diana M. Bontá<br>Director of AWR and GSWC                                                                                                                                                                                                             | <u>March 11, 2011</u> |
| <u>/s/ N.P. DODGE, JR.</u><br>N.P. Dodge, Jr.<br>Director of AWR and GSWC                                                                                                                                                                                                           | <u>March 11, 2011</u> |
| <u>/s/ ANNE M. HOLLOWAY</u><br>Anne M. Holloway<br>Director of AWR and GSWC                                                                                                                                                                                                         | <u>March 11, 2011</u> |
| <u>/s/ ROBERT F. KATHOL</u><br>Robert F. Kathol<br>Director of AWR and GSWC                                                                                                                                                                                                         | <u>March 11, 2011</u> |
| <u>/s/ GARY F. KING</u><br>Gary F. King<br>Director of AWR and GSWC                                                                                                                                                                                                                 | <u>March 11, 2011</u> |
| <u>/s/ JAMES F. MCNULTY</u><br>James F. McNulty<br>Director of AWR and GSWC                                                                                                                                                                                                         | <u>March 11, 2011</u> |

**AMERICAN STATES WATER COMPANY**  
**SCHEDULE I — CONDENSED FINANCIAL INFORMATION OF PARENT**  
**CONDENSED BALANCE SHEET**

| (in thousands)                             | December 31,     |                  |
|--------------------------------------------|------------------|------------------|
|                                            | 2010             | 2009             |
| <b>Assets</b>                              |                  |                  |
| Cash and equivalents                       | \$ 2,091         | \$ 70            |
| Inter-company loan receivables             | 48,475           | 26,000           |
| Income taxes receivable                    | 1,291            | —                |
| Deferred income taxes – current            | 641              | —                |
| Total current assets                       | <u>52,498</u>    | <u>26,070</u>    |
| Investments in subsidiaries                | 385,407          | 349,296          |
| Other assets                               | 2,347            | 2,335            |
| Total assets                               | <u>\$440,252</u> | <u>\$377,701</u> |
| <b>Liabilities and Capitalization</b>      |                  |                  |
| Note payable to bank                       | \$ 60,900        | \$ 17,400        |
| Income taxes payable                       | 992              | 738              |
| Deferred taxes and other liabilities       | 240              | 133              |
| Total current liabilities                  | <u>62,132</u>    | <u>18,271</u>    |
| Deferred taxes                             | 126              | —                |
| Income taxes payable and other liabilities | 453              | —                |
| Total other liabilities                    | <u>579</u>       | <u>—</u>         |
| Common shareholders' equity                | 377,541          | 359,430          |
| Total capitalization                       | <u>377,541</u>   | <u>359,430</u>   |
| Total liabilities and capitalization       | <u>\$440,252</u> | <u>\$377,701</u> |

*The accompanying condensed note is an integral part of these condensed financial statements.*

**AMERICAN STATES WATER COMPANY**  
**SCHEDULE I - CONDENSED FINANCIAL INFORMATION OF PARENT**

**CONDENSED STATEMENTS OF INCOME**

| (In thousands, except per share amounts)                     | For the Years Ended December 31, |                 |                 |
|--------------------------------------------------------------|----------------------------------|-----------------|-----------------|
|                                                              | 2010                             | 2009            | 2008            |
| Operating revenues and other income                          | \$ —                             | \$ 24           | \$ 18           |
| Operating expenses                                           | 1,385                            | 223             | 428             |
| Operating loss                                               | (1,385)                          | (199)           | (410)           |
| Equity in earnings of subsidiaries                           | 34,165                           | 28,768          | 22,177          |
| Income before income taxes                                   | 32,780                           | 28,569          | 21,767          |
| Income tax benefit                                           | (417)                            | (962)           | (238)           |
| Net income                                                   | <u>\$33,197</u>                  | <u>\$29,531</u> | <u>\$22,005</u> |
| Weighted Average Number of Common Shares Outstanding         | <u>18,585</u>                    | <u>18,052</u>   | <u>17,262</u>   |
| Basic Earnings Per Common Share                              | <u>\$ 1.78</u>                   | <u>\$ 1.63</u>  | <u>\$ 1.27</u>  |
| Weighted Average Number of Diluted Common Shares Outstanding | <u>18,736</u>                    | <u>18,188</u>   | <u>17,394</u>   |
| Fully Diluted Earnings per Common Share                      | <u>\$ 1.77</u>                   | <u>\$ 1.62</u>  | <u>\$ 1.26</u>  |

*The accompanying condensed note is an integral part of these condensed financial statements.*

**AMERICAN STATES WATER COMPANY**  
**SCHEDULE I — CONDENSED FINANCIAL INFORMATION OF PARENT**

**CONDENSED STATEMENTS OF CASH FLOWS**

| (in thousands)                                          | For the Years Ended December 31, |           |           |
|---------------------------------------------------------|----------------------------------|-----------|-----------|
|                                                         | 2010                             | 2009      | 2008      |
| Cash Flows From Operating Activities                    | \$ 17,627                        | \$ 18,995 | \$ 12,368 |
| Cash Flows From Investing Activities:                   |                                  |           |           |
| Loans (made to)/repaid from, wholly-owned subsidiaries  | (22,475)                         | 20,351    | (4,611)   |
| Increase in investment of subsidiary                    | (20,000)                         | —         | (30,000)  |
| Net cash provided (used) in investing activities        | (42,475)                         | 20,351    | (34,611)  |
| Cash Flows From Financing Activities:                   |                                  |           |           |
| Proceeds from the issuance of common stock              | 1,838                            | 35,796    | 1,173     |
| Proceeds from stock option exercises                    | 857                              | 309       | 690       |
| Net change in notes payable to banks                    | 43,500                           | (57,300)  | 37,500    |
| Dividends paid                                          | (19,326)                         | (18,098)  | (17,257)  |
| Net cash provided (used) in financing activities        | 26,869                           | (39,293)  | 22,106    |
| Increase (decrease) in cash and equivalents             | 2,021                            | 53        | (137)     |
| Cash and equivalents at beginning of period             | 70                               | 17        | 154       |
| Cash and equivalents at the end of period               | \$ 2,091                         | \$ 70     | \$ 17     |
| Cash dividends received from Golden State Water Company | \$ 19,600                        | \$ 19,400 | \$ 13,200 |

*The accompanying condensed note is an integral part of these condensed financial statements.*

**AMERICAN STATES WATER COMPANY**  
**NOTES TO CONDENSED FINANCIAL INFORMATION OF PARENT**

**Note 1 — Basis of Presentation**

The accompanying condensed financial statements of AWR (parent) should be read in conjunction with the consolidated financial statements and notes thereto of American States Water Company and subsidiaries (“Registrant”) included in Part II, Item 8 of this Form 10-K. AWR’s (parent) significant accounting policies are consistent with those of Registrant and its wholly-owned subsidiary, Golden State Water Company (“GSWC”), except that all subsidiaries are accounted for as equity method investments. Certain prior-period amounts were reclassified on the condensed statements of income to conform to 2010 financial statement presentation.

**Note 2 — Note Payable to Banks**

AWR (parent) established a syndicated credit facility, as amended, that expires in May 2013, which provides for borrowings up to \$100.0 million. AWR may, under the terms of the amended credit agreement, elect to increase the aggregate bank commitments by up to \$40.0 million. Under the terms of this facility, either AWR (parent) or GSWC may obtain letters of credit for up to an aggregate of \$25.0 million. GSWC has obtained letters of credit, in the aggregate amount of \$11.0 million, including: (i) a letter of credit with a fee of 1.2%, in the amount of \$6.3 million, in favor of a trustee with respect to the variable rate obligation issued by the Three Valleys Municipal Water District; (ii) letters of credit with a fee of 1.2%, in an aggregate amount of \$540,000 as security for the Company’s business automobile insurance policy; (iii) a letter of credit with a fee of 1.2%, in an amount of \$585,000 as security for the purchase of power; and (iv) an irrevocable letter of credit in the amount of \$3.6 million, pursuant to a settlement agreement with Edison to cover Registrant’s commitment to pay the settlement amount. There were no compensating balances required. Loans can be obtained at the option of AWR (parent) and bear interest at rates based on credit ratings and Euro rate margins.

At December 31, 2010, \$60.9 million was outstanding under this facility. AWR (parent) borrows under this facility and provides loans to its subsidiaries, including GSWC, in support of its operations, under terms that are similar to that of the credit facility. AWR’s (parent) short-term borrowing activities (excluding letters of credit) for the last three years were as follows:

| (in thousands, except percent)        | December 31, |          |          |
|---------------------------------------|--------------|----------|----------|
|                                       | 2010         | 2009     | 2008     |
| Balance Outstanding at December 31,   | \$60,900     | \$17,400 | \$74,700 |
| Interest Rate at December 31,         | 1.47%        | 0.87%    | 1.82%    |
| Average Amount Outstanding            | \$37,623     | \$33,697 | \$57,429 |
| Weighted Average Annual Interest Rate | 1.40%        | 1.18%    | 3.32%    |
| Maximum Amount Outstanding            | \$63,900     | \$78,700 | \$88,500 |

All of the letters of credit are issued pursuant to the syndicated revolving credit facility. The syndicated revolving credit facility contains restrictions on prepayments, disposition of property, mergers, liens and negative pledges, indebtedness and guaranty obligations, transactions with affiliates, minimum interest coverage requirements, a maximum debt to capitalization ratio, and a minimum debt rating. Pursuant to the credit agreement, AWR (parent) must maintain a minimum interest coverage ratio of 3.25 times interest expense, a maximum total funded debt ratio of 0.65 to 1.00 and a minimum debt rating of Baa3 or BBB-. As of December 31, 2010, 2009 and 2008, AWR (parent) was in compliance with these requirements.

**Note 3 — Income Taxes**

AWR (parent) receives a tax benefit for expenses incurred at the parent-company level. On February 20, 2009, California’s governor signed two bills into law that amended and added several new provisions to California’s Revenue and Taxation Code. This resulted in the recording of a benefit of approximately \$918,000 during the first quarter of 2009, without a material change through the end of 2009 and 2010. While the effect of the tax law change will continue to affect AWR’s state taxes, the future effects may be beneficial or detrimental depending on a combination of the profitability of AWR’s non-California activities as well as the relative proportion of the factor(s) applied by its apportionment method. Periodically, management will assess its intention to apply the alternative method and will adjust its deferred tax balances accordingly.

**Note 4 — Transaction Costs**

On June 7, 2010, Registrant entered into a stock purchase agreement with EPCOR Water (USA) Inc. to sell all of the common shares of its wholly-owned subsidiary, Chaparral City Water Company (“CCWC”), for a total purchase price of \$35.0 million, including the assumption of approximately \$6.0 million of long-term debt. Approximately \$29.0 million in cash will be paid to AWR at closing. The consummation of the transaction contemplated by the agreement is subject to customary conditions, including among other things, regulatory approval by the Arizona Corporation Commission, which is anticipated to be received in 2011. In connection with the sale of CCWC, direct transaction costs of \$708,000 for legal and consulting services are included in the operations of AWR (parent).

# SHAREHOLDER INFORMATION

## ANNUAL MEETING OF SHAREHOLDERS

All shareholders are invited to attend the Annual Meeting of Shareholders, which will be held on Tuesday, May 10, 2011, beginning at 10:00 a.m. at The Langham Hotel, 1401 South Oak Knoll Ave, Pasadena, CA 91106. Notice of meeting and proxy materials will be mailed.

## STOCK LISTING

Common shares of American States Water Company are traded on the New York Stock Exchange (NYSE) under the symbol AWR. The high and low NYSE prices and the dividends paid on the common shares for the past two years were:

| 2010           | High     | Low      | Dividends Paid |
|----------------|----------|----------|----------------|
| First Quarter  | \$ 36.42 | \$ 31.20 | \$ 0.26        |
| Second Quarter | 39.61    | 31.41    | 0.26           |
| Third Quarter  | 37.00    | 31.24    | 0.26           |
| Fourth Quarter | 38.59    | 33.01    | 0.26           |
|                |          |          | \$1.04         |
| 2009           | High     | Low      | Dividends Paid |
| First Quarter  | \$ 38.79 | \$ 29.76 | \$ 0.25        |
| Second Quarter | 36.40    | 30.82    | 0.25           |
| Third Quarter  | 37.42    | 32.10    | 0.25           |
| Fourth Quarter | 36.92    | 31.58    | 0.26           |
|                |          |          | \$ 1.01        |

## INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

PricewaterhouseCoopers, LLP  
350 South Grand Avenue, 44th Floor  
Los Angeles, California 90071

## CORPORATE REPORTS

Shareholders with questions, or who wish to obtain a copy of the Company's reports to the Securities and Exchange Commission without charge, should contact:

### American States Water Company

Attn: Corporate Secretary  
630 East Foothill Boulevard  
San Dimas, California 91773-1212  
Phone: (909) 394-3600  
Fax: (909) 394-1382

## SHAREHOLDER ASSISTANCE

Shareholders with questions about replacement of dividend checks, transferring stock, replacing lost or stolen certificates or other matters related to their ownership of stock, should contact:

### BNY Mellon Shareowner Services

Attn: Shareholder Relations Dept.  
PO Box 358015  
Pittsburgh, PA 15252  
888-816-6998  
<http://www.melloninvestor.com/isd>

## COMMON SHARE PURCHASE AND DIVIDEND REINVESTMENT PLAN

The Company has a Common Shares Purchase and Dividend Reinvestment Plan ("Plan") that is sponsored and administered by BNY Mellon Shareowner Services. The Plan provides a simple and cost-effective method for current and potential shareholders to build ownership in the Company through the direct purchase of common shares from the Company and the reinvestment of their cash dividends. A Prospectus and enrollment form may be obtained from BNY Mellon Shareowner Services at (888) 816-6998 or from the Company at (877) 463-6297 (INFOAWR).

## 2011 DIVIDEND SCHEDULE

The following schedule shows the anticipated common share record and payment dates for 2011:

| Record Dates | Payment Dates |
|--------------|---------------|
| February 14  | March 1       |
| May 12       | June 1        |
| August 11    | September 1   |
| November 10  | December 1    |

## INTERNET ADDRESS

<http://www.aswater.com>

The front and back covers are photographs taken at the Rancho Santa Ana Botanic Garden in Claremont, California and is a customer of Golden State Water Company.

RSABG.ORG



**American States**  
Water Company

630 East Foothill Blvd, San Dimas, CA 91773 | 909 394 3600 | [www.aswater.com](http://www.aswater.com)