

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2004 or
 Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____

Commission file number 333-47647

American States Water Company

(Exact Name of Registrant as Specified in Its Charter)

California

95-4676679

(State or Other Jurisdiction of Incorporation or Organization)

(IRS Employer Identification No.)

630 East Foothill Boulevard, San Dimas

91773

(Address of Principal Executive Offices)

(Zip Code)

(909) 394-3600

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Commission file number 000-01121

Southern California Water Company

(Exact Name of Registrant as Specified in Its Charter)

California

95-1243678

(State or Other Jurisdiction of
Incorporation or Organization)

(IRS Employer Identification No.)

630 East Foothill Boulevard, San Dimas

91773

(Address of Principal Executive Offices)

(Zip Code)

(909) 394-3600

(Registrant's Telephone Number, Including Area Code)

Not Applicable

(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether 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

Southern California Water Company

Yes No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act.).

As of May 10, 2004, the number of Common Shares outstanding, of American States Water Company was 15,244,928 shares.

As of May 10, 2004, all of the 110 outstanding Common Shares of Southern California Water Company were owned by American States Water Company.

AMERICAN STATES WATER COMPANY
and
SOUTHERN CALIFORNIA WATER COMPANY
FORM 10-Q
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PART I

Item 1. Financial Statements

General

The basic financial statements included herein have been prepared by Registrant, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission.

Certain information and footnote disclosures normally included in financial statements, prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to such rules and regulations, although Registrant believes that the disclosures are adequate to make the information presented not misleading. In the opinion of management, all adjustments necessary for a fair statement of results for the interim period have been made.

It is suggested that these financial statements be read in conjunction with the financial statements and notes thereto in the latest Annual Report on Form 10-K of American States Water Company and its wholly owned subsidiary, Southern California Water Company.

Filing Format

This quarterly report on Form 10-Q is a combined report being filed by two separate Registrants: American States Water Company (hereinafter "AWR") and Southern California Water Company (hereinafter "SCW"). For more information, please see Note 1 to the *Notes to Financial Statements* and the heading entitled *General* in *Item 2 — Management's Discussion and Analysis of Financial Condition and Results of Operation*. References in this report to "Registrant" are to AWR and SCW collectively, unless otherwise specified. SCW makes no representations as to the information contained in this report relating to AWR and its subsidiaries, other than SCW.

AMERICAN STATES WATER COMPANY
CONSOLIDATED BALANCE SHEETS
ASSETS
(Unaudited)

(in thousands)	March 31, 2004	December 31, 2003
Utility Plant, at cost		
Water	\$ 730,973	\$ 726,811
Electric	43,445	42,711
	774,418	769,522
Less — Accumulated depreciation	(228,114)	(222,567)
	546,304	546,955
Construction work in progress	63,902	55,343
Net utility plant	610,206	602,298
Other Property and Investments	22,071	22,120
Current Assets		
Cash and cash equivalents	9,011	12,775
Accounts receivable-customers (less allowance for doubtful accounts of \$750 in 2004 and \$831 in 2003)	8,665	11,758
Unbilled revenue	11,088	12,714
Other accounts receivable	1,404	10,649
Materials and supplies, at average cost	1,438	1,346
Regulatory assets — current	5,262	5,331
Prepayments	2,677	3,786
	39,545	58,359
Regulatory and Other Assets		
Regulatory assets	58,239	57,704
Other accounts receivable	8,000	8,000
Other	8,904	8,994
Total regulatory and other assets	75,143	74,698
Total Assets	\$ 746,965	\$ 757,475

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

AMERICAN STATES WATER COMPANY
CONSOLIDATED BALANCE SHEETS
CAPITALIZATION AND LIABILITIES
(Unaudited)

(in thousands)	March 31, 2004	December 31, 2003
Capitalization		
Common shares, no par value, no stated value	\$128,308	\$127,699
Earnings reinvested in the business	82,572	84,788
Total common shareholders' equity	210,880	212,487
Long-term debt	229,590	229,799
Total capitalization	440,470	442,286
Current Liabilities		
Notes payable to banks	47,000	56,000
Long-term debt — current	820	820
Accounts payable	13,382	18,774
Taxes payable	1,950	2,784
Accrued employee expenses	4,791	3,925
Accrued interest	5,006	1,681
Deferred income taxes — current	1,486	1,217
Other	7,979	10,697
Total current liabilities	82,414	95,898
Other Credits		
Advances for construction	79,313	77,154
Contributions in aid of construction — net	64,555	64,297
Deferred income taxes	54,007	53,243
Unamortized investment tax credits	2,678	2,700
Accrued pension and other postretirement benefits	5,849	4,584
Regulatory liabilities	9,911	9,642
Other	7,768	7,671
Total other credits	224,081	219,291
Commitments and Contingencies (Note 8)		
	—	—
Total Capitalization and Liabilities	\$746,965	\$757,475

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

AMERICAN STATES WATER COMPANY
CONSOLIDATED STATEMENTS OF INCOME
FOR THE THREE MONTHS
ENDED MARCH 31, 2004 AND 2003
(Unaudited)

(in thousands, except per share amounts)	Three Months Ended March 31,	
	2004	2003
Operating Revenues		
Water	\$38,742	\$39,425
Electric	7,627	7,004
Other	282	247
	<u>46,651</u>	<u>46,676</u>
Operating Expenses		
Water purchased	8,881	7,888
Power purchased for pumping	1,717	1,956
Power purchased for resale	4,829	3,856
Unrealized (gain) loss on purchased power contracts	(557)	283
Groundwater production assessment	1,822	1,667
Supply cost balancing accounts	221	958
Other operating expenses	4,437	4,040
Administrative and general expenses	9,079	7,524
Depreciation and amortization	5,177	4,947
Maintenance	2,327	1,950
Taxes on income	942	1,995
Other taxes	2,226	2,057
Total operating expenses	<u>41,101</u>	<u>39,121</u>
Operating Income	5,550	7,555
Other Income (Loss)		
Other income (loss) — net of taxes	(83)	—
Total other income (loss)	(83)	—
Interest Charges		
Interest on long-term debt	4,050	4,255
Other interest and amortization of debt expense	271	310
Total interest charges	4,321	4,565
Net Income	<u>\$ 1,146</u>	<u>\$ 2,990</u>
Weighted Average Number of Shares Outstanding	15,224	15,188
Basic Earnings Per Common Share	\$ 0.08	\$ 0.20
Weighted Average Number of Diluted Shares	15,255	15,194
Fully Diluted Earnings Per Share	\$ 0.08	\$ 0.20
Dividends Declared Per Common Share	\$ 0.221	\$ 0.221

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

AMERICAN STATES WATER COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOW
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003

(Unaudited)

(in thousands)	Three Months Ended March 31,	
	2004	2003
Cash Flows From Operating Activities:		
Net income	\$ 1,146	\$ 2,990
Adjustments for non-cash items:		
Depreciation and amortization	5,177	4,947
Deferred income taxes and investment tax credits	1,018	2,330
Unrealized (gain) loss on purchased power contracts	(557)	283
Other — net	184	(15)
Changes in assets and liabilities:		
Accounts receivable — customers	3,093	446
Unbilled revenue	1,626	1,211
Other accounts receivable	9,245	405
Materials and supplies	(92)	(71)
Prepayments	1,109	543
Regulatory assets — supply cost balancing accounts	221	958
Other assets	(487)	(1,327)
Accounts payable	(5,392)	(3,215)
Taxes payable	(834)	1,519
Other liabilities	3,661	2,232
Net cash provided	19,118	13,236
Cash Flows From Investing Activities:		
Construction expenditures	(13,399)	(8,409)
Net cash used	(13,399)	(8,409)
Cash Flows From Financing Activities:		
Proceeds from issuance of common shares	609	402
Receipt of advances for and contributions in aid of construction	2,904	1,780
Refunds on advances for construction	(425)	(433)
Repayment of long-term debt	(209)	(202)
Net change in notes payable to banks	(9,000)	(5,000)
Dividends paid	(3,362)	(3,356)
Net cash used	(9,483)	(6,809)
Net decrease in cash and cash equivalents	(3,764)	(1,982)
Cash and cash equivalents, beginning of period	12,775	18,397
Cash and cash equivalents, end of period	\$ 9,011	\$16,415
Non-cash activities — supplemental disclosures:		
Adoption of new accounting standard for asset retirement obligations:		
Cumulative effect of adoption — Regulatory asset	—	\$ 2,495
Net utility plant	—	223
Asset retirement obligations	—	(2,718)

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

SOUTHERN CALIFORNIA WATER COMPANY
BALANCE SHEETS
ASSETS
(Unaudited)

(in thousands)	March 31, 2004	December 31, 2003
Utility Plant, at cost		
Water	\$ 690,474	\$ 688,079
Electric	43,445	42,711
	733,919	730,790
Less — Accumulated depreciation	(216,742)	(211,424)
	517,177	519,366
Construction work in progress	61,146	51,354
Net utility plant	578,323	570,720
Other Property and Investments	7,421	7,471
Current Assets		
Cash and cash equivalents	3,199	8,306
Accounts receivable-customers (less allowance for doubtful accounts of \$714 in 2004 and \$797 in 2003)	8,587	11,487
Unbilled revenue	10,895	12,484
Intercompany receivable	1,072	445
Other accounts receivable	1,231	10,516
Materials and supplies, at average cost	1,414	1,322
Regulatory assets — current	5,262	5,331
Prepayments	2,549	3,638
Total current assets	34,209	53,529
Regulatory and Other Assets		
Regulatory assets	58,156	57,624
Other accounts receivable	8,000	8,000
Other	8,150	8,219
Total regulatory and other assets	74,306	73,843
Total Assets	\$ 694,259	\$ 705,563

The accompanying notes are an integral part of these financial statements

SOUTHERN CALIFORNIA WATER COMPANY
BALANCE SHEETS
CAPITALIZATION AND LIABILITIES
(Unaudited)

(in thousands)	March 31, 2004	December 31, 2003
Capitalization		
Common shares, no par value	\$123,391	\$123,391
Earnings reinvested in the business	80,523	82,656
Total common shareholder's equity	203,914	206,047
Long-term debt	221,944	221,996
Total capitalization	425,858	428,043
Current Liabilities		
Long-term debt — current	260	260
Accounts payable	12,664	17,312
Intercompany payable	23,721	34,111
Taxes payable	3,967	4,382
Accrued employee expenses	4,687	3,828
Accrued interest	4,841	1,581
Deferred income taxes — current	1,330	1,057
Other	7,667	10,376
Total current liabilities	59,137	72,907
Other Credits		
Advances for construction	69,000	66,827
Contributions in aid of construction-net	64,272	64,023
Deferred income taxes-net	50,934	50,277
Unamortized investment tax credits	2,678	2,700
Accrued pension and other postretirement benefits	5,849	4,584
Regulatory liabilities	9,911	9,642
Other	6,620	6,560
	209,264	204,613
Commitments and Contingencies (Note 8)		
	—	—
Total Capitalization and Liabilities	\$694,259	\$705,563

The accompanying notes are an integral part of these financial statements

SOUTHERN CALIFORNIA WATER COMPANY
STATEMENTS OF INCOME
FOR THE THREE MONTHS
ENDED MARCH 31, 2004 AND 2003
(Unaudited)

(in thousands)	Three Months Ended March 31,	
	2004	2003
Operating Revenues		
Water	\$37,461	\$38,169
Electric	7,627	7,004
	45,088	45,173
Operating Expenses		
Water purchased	8,720	7,710
Power purchased for pumping	1,641	1,890
Power purchased for resale	4,829	3,856
Unrealized (gain) loss on power purchased contracts	(557)	283
Groundwater production assessment	1,822	1,667
Supply cost balancing accounts	221	958
Other operating expenses	4,093	3,753
Administrative and general expenses	7,736	7,010
Depreciation and amortization	4,937	4,718
Maintenance	2,253	1,872
Taxes on income	1,336	2,090
Other taxes	2,125	1,949
Total operating expenses	39,156	37,756
Operating Income	5,932	7,417
Other Income (Loss)		
Other income (loss) — net of taxes	(86)	(3)
Total other income (loss)	(86)	(3)
Interest Charges		
Interest on long-term debt	3,935	4,140
Other interest and amortization of debt expense	192	150
Total interest charges	4,127	4,290
Net Income	\$ 1,719	\$ 3,124

The accompanying notes are an integral part of these financial statements

SOUTHERN CALIFORNIA WATER COMPANY
CASH FLOW STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2004 AND 2003
(Unaudited)

(in thousands)	Three Months Ended March 31,	
	2004	2003
Cash Flows From Operating Activities:		
Net income	\$ 1,719	\$ 3,124
Adjustments for non-cash items:		
Depreciation and amortization	4,937	4,718
Deferred income taxes and investment tax credits	915	2,255
Unrealized (gain) loss on purchased power contracts	(557)	283
Other — net	152	(84)
Changes in assets and liabilities:		
Accounts receivable — customers	2,900	402
Unbilled revenue	1,589	1,181
Other accounts receivable	9,285	403
Materials and supplies	(92)	(72)
Prepayments	1,089	468
Regulatory assets — supply cost balancing accounts	221	958
Other assets	(478)	(1,322)
Accounts payable	(4,648)	(2,603)
Taxes payable	(415)	1,504
Other liabilities	3,561	2,130
Net Cash Provided	20,178	13,345
Cash Flows From Investing Activities:		
Construction expenditures	(12,848)	(8,029)
Net Cash Used	(12,848)	(8,029)
Cash Flows From Financing Activities:		
Receipt of advances for and contributions in aid of construction	2,895	1,684
Refunds on advances for construction	(411)	(433)
Repayments of long-term debt	(54)	(57)
Net change in intercompany borrowings	(11,017)	(7,098)
Dividends paid	(3,850)	(3,850)
Net Cash Used	(12,437)	(9,754)
Net decrease in cash and cash equivalents	(5,107)	(4,438)
Cash and cash equivalents, beginning of period	8,306	11,677
Cash and cash equivalents, end of period	\$ 3,199	\$ 7,239
Non-cash activities — supplemental disclosures:		
Adoption of new accounting standard for asset retirement obligations:		
Cumulative effect of adoption — Regulatory asset	—	\$ 2,479
Utility plant, net	—	221
Asset retirement obligations	—	(2,700)

The accompanying notes are an integral part of these financial statements

**AMERICAN STATES WATER COMPANY
AND
SOUTHERN CALIFORNIA WATER COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

American States Water Company (AWR), incorporated in 1998, is the parent company of Southern California Water Company (SCW), American States Utility Services, Inc. (ASUS) and Chaparral City Water Company (CCWC). More than 90% of AWR's assets consist of the common stock of SCW. SCW is a public utility company engaged principally in the purchase, production, distribution and sale of water in California. In addition, SCW distributes and sells electric energy in several mountain communities in California. Unless otherwise stated in this report, the term Registrant applies to both AWR and SCW, collectively.

Note 1 — Basis of Presentation: The consolidated financial statements included herein have been prepared by Registrant, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America for annual financial statements have been condensed or omitted pursuant to such rules and regulations. The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. In the opinion of management, all adjustments, consisting of normal recurring items and estimates necessary for a fair statement of the results for the interim periods, have been made. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Form 10-K for the year ended December 31, 2003 filed with the SEC.

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 rate-making process, and regulatory liabilities, which represent probable future reductions in revenue associated with amounts that are to be credited to customers through the rate-making process. Regulatory assets, less regulatory liabilities, included in the consolidated balance sheets are as follows:

(In thousands)	March 31, 2004	December 31, 2003
SCW		
Supply cost balancing accounts	\$24,211	\$24,432
Costs deferred for future recovery on Aerojet case	16,272	16,177
Flow-through taxes, net	10,683	10,690
Transmission line abandonment costs	5,000	5,000
Asset retirement obligations	2,791	2,729
Low income balancing accounts	1,659	1,462
Refund of water right lease revenues	(6,446)	(6,177)
Revenues subject to refund	(3,465)	(3,465)
Other regulatory assets	2,802	2,465
Total SCW	<u>\$53,507</u>	<u>\$53,313</u>
CCWC		
Asset retirement obligations	\$ 45	\$ 40
Other regulatory assets	38	40
Total AWR	<u>\$53,590</u>	<u>\$53,393</u>

Note 2 — Regulatory Matters (Continued):

Supply Cost Balancing Accounts:

As permitted by the California Public Utilities Commission (“CPUC”), SCW has historically maintained water supply balancing accounts prior to November 29, 2001 and electric supply balancing accounts to account for under-collections and over-collections of revenues designed to recover such costs. Costs are recorded in income 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. SCW accrues interest on its supply cost balancing accounts at the rate prevailing for 90-day commercial paper. CCWC does not maintain a supply cost balancing account.

Water Balancing Account – On November 29, 2001, the CPUC ordered water utilities with existing water supply balancing accounts to cease booking amounts to such accounts. In its place, water utilities are now required to establish a memorandum supply cost account. The over- or under-collection of water supply costs is recorded in this memorandum account in a manner similar to the balancing account. The income statements of SCW no longer include entries reflecting differences between authorized water supply unit costs included in rates and actual water supply costs. As a result, any changes in water supply costs as well as any future authorized revenue increases for supply expenses may directly impact earnings.

In a decision issued on June 19, 2003 related to the memorandum supply cost account, the CPUC concluded that (i) if a utility is within its 3-year rate case cycle and does not earn in excess of its authorized rate of return, the utility is entitled to recover its costs in the memorandum supply cost account, subject to a reasonableness review by the CPUC; (ii) if a utility is either within or outside of its rate case cycle and earns in excess of its authorized rate-of-return, the utility’s recovery of expenses from the memorandum supply cost account will be reduced by the amount exceeding the authorized rate-of-return, and (iii) a utility is required to seek review of under and over collections by filing an advice letter annually. SCW recently filed advice letters for Regions I and II and will file Region III shortly, seeking recovery of an under-collected balance of \$2.3 million for the period November 29, 2001 through December 31, 2002 and \$1.7 million for the year 2003. Upon receiving approval from the CPUC, SCW will recognize on its books the authorized under-collected amount as supply cost balancing accounts. As of March 31, 2004, SCW has an under-collection of approximately \$4.5 million in its memorandum supply cost account, including the \$4.0 million filed with the CPUC. SCW intends to file advice letters annually by March 31. Amounts included in the memorandum supply cost account are not capitalized until a rate order is received from the CPUC.

With respect to pre-November 29, 2001 water supply balancing accounts, SCW has a net under-collection amount of \$1.5 million recorded at March 31, 2004, the majority of which has been included in rates authorized on June 19, 2003.

Note 2 — Regulatory Matters (Continued):

Electric Balancing Account – Electric power costs incurred by SCW’s Bear Valley Electric division continue to be charged to its electric supply cost balancing account. The under-collection in the electric balancing account is \$22.7 million at March 31, 2004. The CPUC has authorized SCW to collect a surcharge from its customers of 2.2¢ per kilowatt hour through August 2011, to enable SCW to recover the under-collection. SCW sold 40,751,889 and 39,685,128 kilowatt hours of electricity to its Bear Valley Electric division customers for the three months ended March 31, 2004 and 2003, respectively. SCW anticipates electricity sales to be sufficient during this period for it to recover the amount of the under-collection. SCW is allowed to include only up to a weighted annual energy purchase cost of \$77 per MWh each year through August 2011 in its electric supply cost balancing account. To the extent that actual weighted average annual cost for power purchased exceeds the \$77 per MWh amount, SCW will not be able to include these amounts in its balancing account and such amounts will be expensed. During April 2001, SCW recorded a one-time sale of energy on the spot market that generated a \$644,000 gain which was recorded in the supply cost balancing account at that time. The gain was the subject of a complaint filed at the Federal Energy Regulatory Commission (“FERC”) by Mirant Marketing where Mirant Marketing, the purchaser of the energy, was seeking to be refunded all or a portion of the gain. In March 2004, the FERC ordered SCW to refund the \$644,000, plus interest, to Mirant. This refund increased the cost of power purchased for resale during the three months ended March 31, 2004, with a corresponding amount to the provision for supply cost balancing account. The sale of excess energy on the spot market in 2001 resulted from a one-month overlap of energy purchase agreements.

Costs Deferred for Future Recovery on Aerojet Case:

SCW sued Aerojet-General Corporation (“Aerojet”) for causing the contamination of the Sacramento County Groundwater Basin, which affected certain SCW wells. On a related matter, SCW also filed a lawsuit against the State of California. The CPUC authorized memorandum accounts to allow for recovery, from customers, of costs incurred by SCW in prosecuting the cases against Aerojet and the State, less any recovery from the defendants or others. As of March 31, 2004 and December 31, 2003, approximately \$16 million has been recorded as a non-yielding regulatory asset representing primarily legal costs incurred to date in connection with prosecuting the cases. Management believes these costs are recoverable through rates; however, it is management’s intention to offset any settlement proceeds from Aerojet that may occur from these actions, against the balance in the memorandum accounts at the time of settlement. Management cannot give assurance that the CPUC will ultimately allow recovery of all or any of these costs.

Refund of Water Right Lease Revenues:

In 1994, SCW entered into a contract to lease to the City of Folsom, 5,000 acre-feet per year of water rights to the American River, and had included all associated revenues in a non-operating income account. This issue was raised by the Office of Ratepayer Advocates (“ORA”) in SCW’s Region III proceedings. In a decision issued on March 16, 2004, the CPUC determined that SCW failed to seek the CPUC’s approval to effectuate the lease and is to pay a fine of \$180,000. The decision also ordered SCW to refund 70 percent of the total amount of lease revenues received since 1994, plus interest, to customers. Pursuant to the order, SCW recorded a \$6.2 million regulatory liability with a corresponding charge against non-operating income (net of taxes of \$2.5 million) during the fourth quarter of 2003. Management disagrees with the CPUC’s decision and intends to file an appeal to the decision in which it will vigorously defend its position. Pursuant to the order, the apportionment of any lease revenues that SCW may collect in the future will be determined by a later decision. Beginning in the first quarter of 2004, all amounts billed to the City of Folsom are included as a regulatory liability. For the three months ended March 31, 2004, SCW recorded an additional \$269,000 in the regulatory liability account.

There were no other significant changes in regulatory matters during the three months ended March 31, 2004.

Note 3 — Earnings Per Share / Capital Stock: Basic earnings per common share are calculated pursuant to Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings per Share*, and are based on the weighted average number of common shares outstanding during each period and net income after deducting preferred dividend requirements. Diluted earnings per common share are based upon the weighted average number of common shares including both outstanding and shares potentially issued in connection with stock options granted under Registrant's 2000 Stock Incentive Plan, and net income after deducting preferred dividend requirements. At March 31, 2004 and 2003, there were 476,254 and 333,679 options outstanding, respectively. Outstanding stock options issued by the Registrant represent the only dilutive effect reflected in diluted weighted average shares outstanding. The difference between basic and diluted EPS is the effect of stock options that, under the treasury share method, give rise to common stock equivalents.

During the three months ended March 31, 2004 and 2003, Registrant issued 24,212 and 18,904 common shares which totaled approximately \$609,000 and \$402,000, respectively, under the Registrant's Common Share Purchase and Dividend Reinvestment Plan (DRP) and 401(k) Plan.

During the three months ended March 31, 2004 and 2003, AWR paid quarterly dividends to the shareholders, totaling approximately \$3.4 million or \$0.221 per share.

Note 4 – Notes Payable To Banks: Registrant maintains a \$75 million revolving credit facility maturing in June 2005. Total borrowings outstanding under this credit facility amounted to \$47 million at March 31, 2004 included in current liabilities. The credit agreement for this facility includes, among other things, certain financial covenants. One of those covenants is maintenance of an interest coverage ratio of at least 3.25x, as defined and calculated in the credit agreement, based on trailing twelve-month results. The Company violated this interest coverage ratio for the trailing twelve-month period ended March 31, 2004 and has requested and received a waiver from its lending syndicate, which excludes in the calculation, certain charges booked by SCW following certain CPUC decisions in the fourth quarter of 2003. The waiver cured the default at March 31, 2004 and allowed for the exclusion of those charges from the calculation of the trailing twelve-month interest coverage ratio through September 30, 2004.

Note 5 – Stock Incentive Plan: Registrant has a Stock Incentive Plan and applies Accounting Principles Board Opinion (APB) No. 25, "*Accounting for Stock Issued to Employees*", in accounting for its stock options. Accordingly, no compensation cost for the Plan has been recognized for options granted at fair value at the date of grant. Registrant has also adopted the disclosure only requirements of SFAS No. 123, "*Accounting for Stock-Based Compensation*".

If Registrant had elected to adopt the optional recognition provisions of SFAS No. 123 for its stock options, net income and earnings per share applicable to common shareholders would have been changed to the pro forma amounts indicated below:

Note 5 – Stock Incentive Plan (Continued):

dollars in thousands except EPS	Three Months Ended March 31,	
	2004	2003
Earnings available – common:		
As reported	\$1,146	\$2,990
Add: Stock-based compensation expense included in reported net income, net of tax	—	—
Less: Stock-based compensation expense determined under the fair-value accounting method, net of tax	(76)	(72)
Pro forma	<u>\$1,070</u>	<u>\$2,918</u>
Basic earnings per share:		
As reported	\$ 0.08	\$ 0.20
Pro forma	<u>\$ 0.07</u>	<u>\$ 0.19</u>
Diluted earnings per share:		
As reported	\$ 0.08	\$ 0.20
Pro forma	<u>\$ 0.07</u>	<u>\$ 0.19</u>

Note 6 – Employee Benefit Plans: The components of net periodic benefit costs for Registrant’s pension plan, postretirement plan, and Supplemental Executive Retirement Plan (“SERP”) for the three months ended March 31, 2004 and 2003 are as follows:

(dollars in thousands)	Pension Benefits		Other Postretirement Benefits		SERP	
	2004	2003	2004	2003	2004	2003
Components of Net Periodic Benefits						
Cost:						
Service Cost	\$ 701	\$ 545	\$101	\$ 87	\$ 32	\$10
Interest Cost	906	800	148	139	31	11
Expected Return on Plan Assets	(830)	(679)	(64)	(52)	—	—
Amortization of Transition	—	—	105	105	—	—
Amortization of Prior Service Cost	40	13	(50)	(50)	37	12
Amortization of Actuarial (Gain) Loss	90	70	30	20	—	—
Net Periodic Pension Cost	<u>\$ 907</u>	<u>\$ 749</u>	<u>\$270</u>	<u>\$249</u>	<u>\$100</u>	<u>\$33</u>

Registrant expects to contribute \$3,315,000 and \$900,000 to pension and postretirement plans in 2004, respectively. No contributions were made during the three months ended March 31, 2004.

Note 7 — New Accounting Pronouncements:

In January 2003, the Financial Accounting Standards Board (“FASB”) issued Interpretation (“FIN”) No. 46, “*Consolidation of Variable Interest Entities (VIE)*,” (revised in December 2003 by FIN No. 46R), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN No. 46R, which was issued in December 2003, replaces FIN No. 46. The adoption of FIN No. 46R did not have any impact on the Registrant’s financial position, results of operations or cash flows as the Registrant does not have any variable interests in VIEs.

In December 2003, the SEC issued Staff Accounting Bulletin No. 104 (“SAB 104”), “*Revenue Recognition*.” SAB 104 supercedes SAB 101, “*Revenue Recognition in Financial Statements*.” The primary purpose of SAB 104 is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superceded as a result of the issuance of Emerging Issues Task Force (EITF) Issue No. 00-21, “*Revenue Arrangements with Multiple Deliverables*.” Additionally, SAB 104 rescinds the SEC’s Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (“the FAQ”) issued with SAB 101 that had been codified in SEC Topic 13, “*Revenue Recognition*”. Selected portions of the FAQ have been incorporated into SAB 104. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104. The adoption of SAB 104 did not have any impact on Registrant’s financial position, results of operations or cash flows.

In December 2003, the FASB issued SFAS No. 132 (Revised), “*Employers’ Disclosures About Pensions and Other Postretirement Benefits – An Amendment of FASB Statements Nos. 87, 88, and 106 and a revision of FASB Statement No. 132*”. This statement revises employers’ disclosures about pension plans and other postretirement benefits plans. It does not change the measurement or recognition of those plans. The new disclosures were generally effective for 2003 calendar year-end financial statements and for interim periods beginning first quarter of 2004. Registrant has included the new required disclosures in Note 6.

Note 8 – Contingencies:

Water Quality-Related Litigation:

SCW has been named as a defendant in twenty-two lawsuits that allege that SCW and other water utilities, delivered unsafe water to their customers. Plaintiffs in these actions seek damages, including general, special, and punitive damages, according to proof at trial, as well as attorney’s fees on certain causes of action, costs of suit, and other unspecified relief. Nineteen of the lawsuits involve customer service areas located in Los Angeles County in the southern portion of California; three of the lawsuits involve a customer service area located in Sacramento County in northern California. On September 1, 1999, the Court of Appeal in San Francisco held that the CPUC had preemptive jurisdiction over regulated public utilities and ordered dismissal of a series of these lawsuits. On October 11, 1999, one group of plaintiffs appealed the decision to the California Supreme Court.

Note 8 – Contingencies (Continued):

On February 4, 2002, the California Supreme Court concluded that (i) the CPUC had preemptive jurisdiction over claims seeking injunctive relief and claims based on the theory that a public utility regulated by the CPUC provided unsafe drinking water even though it had complied with federal and state drinking water standards, but (ii) the CPUC did not have preemptive jurisdiction over damage claims alleging violations of federal and state drinking water standards by public utilities regulated by the CPUC. As a result, damage claims based on allegations of violations of federal and state drinking water standards may proceed while the other claims must be dismissed. In light of the breadth of plaintiffs' claims, the lack of factual information regarding plaintiffs' claims and injuries, if any, the impact of the California Supreme Court decision on plaintiffs' claims and the fact that no discovery has yet been completed, SCW is unable at this time to determine what, if any, potential liability it may have with respect to claims based on allegations of violation of federal and state drinking water standards. Based upon the information currently available to it, Registrant believes that these claims are without merit and intends to vigorously defend against these claims.

SCW is subject to self-insured retention provisions in its applicable insurance policies and has either expensed the self-insured amounts or has reserved against payment of these amounts as appropriate. SCW's various insurance carriers have, to date, provided reimbursement for costs incurred above the self-insured amounts for defense against these lawsuits, subject to a reservation of rights. In addition, on March 16, 2004, the CPUC issued a decision which authorizes SCW to establish a memorandum account to accumulate costs to comply with certain contamination remediation requirements for future recovery. Based on the decision, SCW reversed \$1.0 million of water quality related reserves into income during the fourth quarter of 2003.

Order Instituting Investigation (OII):

In March 1998, the CPUC issued an OII to regulated water utilities in the state of California, including SCW. The purpose of the OII was to determine whether existing standards and policies regarding drinking water quality adequately protect the public health and whether those standards and policies were being uniformly complied with by those water utilities. On November 2, 2000, a final decision from the CPUC concluded that the CPUC has the jurisdiction to regulate the service of water utilities with respect to the health and safety of that service; that the California Department of Health Services (DOHS) requirements governing drinking water quality adequately protect the public health and safety; and that, based on an extensive review of 25 years of water quality records, regulated water utilities, including SCW, have satisfactorily complied with past and present drinking water quality requirements, except for one small unrelated water utility in Northern California.

The CPUC has authorized the establishment of memorandum accounts to capture expenses related to the OII. Under the memorandum account procedure, SCW may recover litigation costs from ratepayers to the extent authorized by the CPUC. As of March 31, 2004 and December 31, 2003, SCW had incurred a net cost of \$890,000 related to the OII for which it had established a reserve in prior years due to uncertainty of recoverability. In a decision issued by the CPUC on March 16, 2004, SCW is now allowed to recover these costs through a special condition surcharge over a twelve-month period. Based on the decision, SCW reversed the \$890,000 OII reserve into income during the fourth quarter of 2003. SCW was also authorized to recover the carrying cost associated with this matter and therefore, recorded an additional \$168,000 to the memorandum account during the first quarter of 2004.

Note 8 – Contingencies (Continued):

Other Water Quality Litigation:

On October 25, 1999, SCW sued Aerojet-General Corporation (Aerojet) for causing the contamination of eastern portions of the Sacramento County groundwater basin. On October 10, 2003, Registrant entered into a confidential Memorandum of Understanding (“MOU”) with the Aerojet-General subsidiary of GenCorp, Inc. for the settlement of legal actions brought by SCW. The MOU sets forth the present financial terms and the structure of a settlement to cover, over time, capital and litigation related costs incurred by SCW resulting from the contamination. The MOU and the settlement embodied therein was found to be binding by the Sacramento Superior Court on January 18, 2004. Further documentation incorporating the terms of the MOU is presently underway. However, documentation is not complete and management is presently unable to predict when a comprehensive set of settlement documents will be completed.

Based on the financial terms in the MOU, SCW established a receivable from Aerojet in an amount of \$16.7 million at the end of 2003, of which \$8.7 million has been received in early 2004 and was included in current “Other Accounts Receivable” on the balance sheets. The remainder of the costs is subject to further settlement documentation. Reimbursements received from Aerojet have been applied directly to reduce SCW’s costs of utility plant and purchased water. Prior to the MOU, Aerojet had reimbursed SCW \$4.3 million in capital costs and \$171,000 for additional water supply.

In an action related to the draft settlement agreement, Registrant and Aerojet have signed three separate agreements requiring Aerojet to pay for certain transmission pipelines and upgrades to the Coloma Treatment Plant as a contingency plan should additional wells be impacted prior to the high summer demand period of 2004. The value of the three agreements approximates \$6.8 million in capital improvements. In addition, SCW is in negotiations with the County of Sacramento regarding the County’s plan to construct a treatment plant to provide the Registrant with a replacement water supply, for wells lost due to the contamination by Aerojet.

The CPUC has authorized memorandum accounts to allow for recovery, from customers, of costs incurred by SCW in prosecuting the suits filed against the State and Aerojet, less any recovery from the defendants or others. As of March 31, 2004, approximately \$16.3 million in legal and consulting related costs has been recorded as deferred charges and included in “Regulatory Assets” on the balance sheets. The CPUC has authorized SCW to increase rates, effective April 28, 2001, for recovery over a six-year period of approximately \$1.8 million, in expenses that were incurred on or before August 31, 2000, in the Aerojet matter recorded as a regulatory asset (Note 2). As part of an abbreviated application for SCW’s Region I filed in 2003, SCW requested a long-term amortization of the balance of costs included in the Aerojet litigation memorandum account, net of any reimbursement amount. The draft agreement also addresses the possible recovery of SCW’s deferred charges through revenues in new development areas. Management believes these costs are recoverable through rates; however, it is management’s intention to offset any settlement proceeds from Aerojet that may occur from these actions, against the balance in the memorandum accounts at the time of settlement. Management cannot give assurance that the CPUC will ultimately allow recovery of all or any of these costs.

Note 8 – Contingencies (Continued):

The compound MTBE has been detected in a well serving SCW's Los Osos water system. For some time, SCW has been working with the Regional Water Quality Control Board as well as the owner of a service station. Although the owner of the service station has attempted remediation with funds provided through the California Underground Storage Tank Fund ("CUSTF"), it appears there will be insufficient funds from the CUSTF to complete remediation sufficient to return the well to service. In order to prevent the running of the statute of limitations, on August 12, 2002 SCW filed suit in the Superior Court of the State of California for the County of San Luis Obispo against the operators and owners of the service station facility, and Chevron USA Products, Inc., the supplier. A settlement with Chevron has been reached and all suits against the station owners and operators have been dismissed. The impacted well may need to be removed permanently from service and the settlement with Chevron is expected to afford SCW sufficient funds to commence site development and construction of a replacement well.

Perchlorate and/or Volatile Organic Compounds (VOC) have been detected in five wells servicing SCW's San Gabriel System. SCW filed suit, along with two other affected water purveyors and the San Gabriel Basin Water Quality Authority (WQA), in the federal court against some of those responsible for the contamination. Some of the other potential defendants settled with SCW, other water purveyors and the WQA on VOC related issues prior to the filing of the lawsuit. In response to the filing of the Federal 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 defendant's motions. A key ruling of the court was that the water purveyors, including the Registrant, by virtue of their ownership of wells contaminated with hazardous chemicals are themselves PRPs under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). Registrant 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.

On August 29, 2003, the US Environmental Protection Agency issued Unilateral Administrative Orders ("UAO") against 41 parties deemed responsible for polluting the groundwater in that portion of the San Gabriel Valley from which SCW's two impacted wells draw water. SCW was not named as a party to the UAO. The UAO requires that these parties remediate the contamination. As a result of the issuance of the UAO, these parties have begun settlement discussions regarding the Federal lawsuits with SCW, the other two affected water purveyors and WQA. Registrant is presently unable to predict the ultimate outcome of these settlement discussions.

MCO Properties, Inc. (MCO), a real estate developer, filed a complaint against AWR and CCWC in the Superior Court of Maricopa County on June 6, 2003 alleging breach of contract, breach of the implied covenant of good faith and fair dealing, interference with prospective economic advantage, negligence and negligent misrepresentation and seeking a declaratory judgment. The complaint arises out of allegations by MCO that AWR has failed to comply with the terms of the Stock Purchase Agreement between MCO and AWR pursuant to which AWR acquired CCWC from MCO and has thereby interfered with MCO's ability to develop its real property in the Town of Fountain Hills. A revised complaint was filed on December 12, 2003 further alleging that CCWC has not maintained its designation of assured supply as required in the Stock Purchase Agreement. Similar allegations have been filed by MCO against CCWC with the Arizona Corporation Commission ("ACC"). A recent settlement has been executed which dismisses the complaint filed in the Superior Court of Maricopa County as well as the complaint filed with the ACC. In addition, CCWC has undertaken actions that revised its assured water supply designation in a manner that will enable CCWC to provide water service to new real estate developments in the Town of Fountain Hills, including properties owned by MCO.

Note 8 – Contingencies (Continued):

Condemnation of Properties:

The laws of the State of California 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 in the public interest. In addition, however, the laws of the State of California also provide: (1) that the owner of the utility property may contest whether the condemnation is actually in the public interest; and (2) that the owner is entitled to receive the fair market value of its property if the property is ultimately taken. Although the City of Claremont, California located in SCW's Region III has not initiated the formal condemnation process pursuant to California law, the City hired a consultant to perform an appraisal of the value of Registrant's water system serving that city. On April 27, 2004, the City Counsel voted 3 to 2 to make an offer to and enter into negotiations with SCWC to acquire the Claremont water system. The City's appraisal consultant has valued the system at \$40 million to \$45 million. SCW's estimate of system value is significantly greater. SCW has informed the City that the Claremont water system is not for sale and that it will vigorously defend against any action initiated by the City to take the system through an eminent domain proceeding. SCW is unable to predict the ultimate outcome of any such proceeding. As of March 31, 2004, the recorded net book value of the Claremont water system is approximately \$32 million.

Other Litigation:

Registrant is also subject to ordinary routine litigation incidental to its business. Other than those disclosed above, no other legal proceedings are pending, which are believed to be material. 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.

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Note 9 — Business Segments: AWR has three principal business units: water and electric distribution units, through its SCW subsidiary, a water service utility operation conducted through its CCWC unit, and a non-regulated activity unit through the ASUS subsidiary. All activities of SCW currently are geographically located within California. All activities of CCWC are located in the state of Arizona. Both SCW and CCWC are regulated utilities. 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 SCW's water and electric operating segments, CCWC, and non-regulated businesses, consisting of ASUS and AWR corporate expenses. Included in the amounts set forth, certain assets, revenues and expenses have been allocated. 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 the Company.

(dollars in thousands)	As of and for the Three Months Ended March 31, 2004					
	SCW		CCWC Water	Non- Regulated*	Eliminations	Consolidated AWR
	Water	Electric				
Operating revenues	\$ 37,461	\$ 7,627	\$ 1,281	\$ 305	(\$23)	\$ 46,651
Operating income (loss) before income taxes	6,350	918	111	(887)		6,492
Interest expense, net	3,789	338	122	72		4,321
Identifiable assets	540,212	38,111	31,767	116		610,206
Depreciation and amortization expense	4,527	410	236	4		5,177
Capital additions	11,110	1,738	527	24		13,399

(dollars in thousands)	As of and for The Three Months Ended March 31, 2003				
	SCW		CCWC Water	Non- Regulated*	Consolidated AWR
	Water	Electric			
Operating revenues	\$ 38,169	\$ 7,004	\$ 1,256	\$ 247	\$ 46,676
Operating income (loss) before income taxes	9,704	(197)	177	(134)	9,550
Interest expense, net	3,939	351	121	154	4,565
Identifiable assets	511,190	26,890	29,012	57	567,149
Depreciation expense	4,326	392	229	—	4,947
Capital additions	7,294	735	390	(10)	8,409

* Includes amounts from ASUS and AWR.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Forward-Looking Information

Certain matters discussed in this report (including the documents incorporated herein by reference) are forward-looking statements intended to qualify for the "safe harbor" from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements can generally be identified as such because the context of the statement will include words such as Registrant "believes," "anticipates," "expects" or words of similar import. Similarly, statements that describe Registrant's future plans, objectives, estimates or goals are also forward-looking statements. Such statements address future events and conditions concerning capital expenditures, earnings, litigation, rates, water quality and other regulatory matters, adequacy of water supplies, SCW's ability to recover electric and water supply costs from ratepayers, liquidity and capital resources, and accounting matters. Actual results in each case could differ materially from those currently anticipated in such statements, by reason of factors such as changes in utility regulation, including ongoing local, state and federal activities; future economic conditions, including changes in customer demand and changes in water and energy supply cost; future climatic conditions; and legislative, regulatory and other circumstances affecting anticipated revenues and costs. See the section entitled "*Risk Factors*" for more information.

General

American States Water Company (AWR) is the parent company of Southern California Water Company (SCW), American States Utility Services, Inc. (ASUS) and Chaparral City Water Company (CCWC). SCW is a California public utility company engaged principally in the purchase, production, distribution and sale of water (SIC No. 4941). SCW also distributes electricity in one customer service area (SIC No. 4911). SCW is regulated by the Public Utilities Commission of the State of California (CPUC) and was incorporated on December 31, 1929. SCW is organized into one electric customer service area and three water service regions operating within 75 communities in 10 counties in the State of California and provides water service in 21 customer service areas. Region I incorporates 7 customer service areas in northern and central California; Region II has 4 customer service areas located in Los Angeles County; Region III incorporates 10 water customer service areas in eastern Los Angeles County, and in Orange, San Bernardino and Imperial counties. SCW also provides electric service to the City of Big Bear Lake and surrounding areas in San Bernardino County through its Bear Valley electric service division.

SCW served 250,564 water customers and 22,327 electric customers at March 31, 2004, or a total of 272,891 customers, compared with 270,952 total customers at March 31, 2003.

SCW's utility operations exhibit seasonal trends. Although SCW's water utility operations have a diversified customer base, residential and commercial customers account for the majority of SCW's water sales and revenues. Revenues derived from commercial and residential water customers accounted for approximately 94.7% of total water revenues for the three months ended March 31, 2004 as compared to 94.7% for the three months ended March 31, 2003.

AWR also owns two other subsidiaries. American States Utility Services, Inc. (ASUS) contracts to lease, operate and maintain water and wastewater systems owned by others and to provide related services, such as billing and meter reading, to approximately 90,000 accounts. Chaparral City Water Company (CCWC) is an Arizona public utility company serving 12,258 customers as of March 31, 2004, compared with 11,625 customers at March 31, 2003. 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.

Neither AWR nor ASUS is directly regulated by either the CPUC or the ACC.

Consolidated Results of Operations – Three Months Ended March 31, 2004 and 2003

	3MOS ENDED 3/31/2004	3MOS ENDED 3/31/2003	\$ CHANGE	% CHANGE
OPERATING REVENUES				
Water	\$38,742	\$39,425	\$ (683)	-1.7%
Electric	7,627	7,004	623	8.9%
Other	282	247	35	14.2%
Total operating revenues	<u>46,651</u>	<u>46,676</u>	<u>(25)</u>	<u>-0.1%</u>
OPERATING EXPENSES				
Water purchased	8,881	7,888	993	12.6%
Power purchased for pumping	1,717	1,956	(239)	-12.2%
Power purchased for resale	4,829	3,856	973	25.2%
Unrealized (gain) loss on purchased power contracts	(557)	283	(840)	-296.8%
Groundwater production assessment	1,822	1,667	155	9.3%
Supply cost balancing accounts	221	958	(737)	76.9%
Other operating expenses	4,437	4,040	397	9.8%
Administrative and general expenses	9,079	7,524	1,555	20.7%
Depreciation and amortization	5,177	4,947	230	4.6%
Maintenance	2,327	1,950	377	19.3%
Taxes on income	942	1,995	(1,053)	-52.8%
Other taxes	2,226	2,057	169	8.2%
Total operating expenses	<u>41,101</u>	<u>39,121</u>	<u>1,980</u>	<u>5.1%</u>
Operating income	<u>5,550</u>	<u>7,555</u>	<u>(2,005)</u>	<u>-26.5%</u>
OTHER INCOME — NET	<u>(83)</u>	<u>—</u>	<u>(83)</u>	<u>-100.0%</u>
INTEREST CHARGES	<u>4,321</u>	<u>4,565</u>	<u>(244)</u>	<u>-5.3%</u>
NET INCOME	<u>\$ 1,146</u>	<u>\$ 2,990</u>	<u>\$(1,844)</u>	<u>-61.7%</u>

Net income for the three months ended March 31, 2004 decreased 61.7% to \$1.1 million, equivalent to \$0.08 per common share on a basic and fully diluted basis, compared to \$3.0 million or \$0.20 per share for the three months ended March 31, 2003. The decrease in recorded results underscores the importance of receiving adequate and timely rate increases from the CPUC. Registrant had anticipated an increase in the Region III customer service area of SCW, effective the beginning of the fourth quarter of 2003. In fact, that rate increase was not effective until March 22, 2004. The delay resulted in lost revenues of approximately \$2 million or \$0.08 per share for the first quarter. Exacerbating the delay in revenues was an increase in supply costs due to more purchased water in SCW's resource mix that negatively impacted earnings by \$1 million or \$0.04 per share. Furthermore, changes in weather conditions experienced this year as compared to the same time last year resulted in a decrease in water demand.

Operating Revenues

For the three months ended March 31, 2004, revenues from water operations decreased by 1.7% to \$38.7 million, compared to \$39.4 million for the three months ended March 31, 2003. Lower water revenues reflect a decrease of 3% in water consumption resulting from changes in weather conditions. Differences in temperature and rainfall in Registrant's service areas impact sales of water to customers,

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causing fluctuations in Registrant's revenues and earnings between comparative periods. The decrease in consumption was offset by two rate increases for SCW's Region II, effective on January 21, 2003 and February 4, 2003, respectively. These two rate increases are expected to generate additional revenues of approximately \$6.2 million annually.

For the three months ended March 31, 2004, revenues from electric operations increased by 8.9% to \$7.6 million compared to \$7.0 million for the three months ended March 31, 2003. The increase reflects an increase of 3% in kilowatt-hour consumption and an increase in "on-peak" consumption which resulted in higher "on-peak" demand charges for the industrial customers.

Other operating revenues consist of nonregulated water related services and operations on a contract basis ranging from services such as billing and meter reading, to full operation of water utility related systems, all performed by AWR's subsidiary, American States Utility Services, Inc. ("ASUS"). For the three months ended March 31, 2004, other operating revenues increased by 14.2% to \$282,000 compared to \$247,000 for the three months ended March 31, 2003 due to the addition of a new meter reading contract with the City of Santa Fe Springs which increased revenues by approximately \$15,000. ASUS is pursuing growth and new business development for AWR, most specifically in the area of privatization of water and wastewater systems at military bases. As such, ASUS has carefully reviewed growth opportunities and exercised prudence in the pursuit of increased revenues and earnings from contract operations that are congruent with AWR's core competencies. ASUS has been an active participant in the privatization of military bases, currently with 9 active bids for such opportunities. To date, ASUS has received preliminary notification that it will be awarded a 50-year contract to own and operate the water and wastewater systems at Ft. Bliss, located near El Paso, Texas. ASUS plans to continue to bid on and negotiate for other military bases during 2004. ASUS has also worked to develop an operating contract for the water services in a rapidly developing area presently served by a mutual water company in northern California. ASUS anticipates signing definitive agreements in 2004 and expects development to take place in this area beginning in 2005.

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

Operating Expenses

For the three months ended March 31, 2004, purchased water costs increased by 12.6% to \$8.9 million compared to \$7.9 million for the three months ended March 31, 2003. The increase is due primarily to additional purchased water necessary during the three months ended March 31, 2004 to replace groundwater supply lost due to wells being removed from service as a result of water quality issues and mechanical problems, particularly in SCW's Metropolitan and Foothill districts which together increased the cost of purchased water by \$1.0 million. Changes in the water resource mix between water supplied from purchased sources and that supplied from Registrant's own wells can increase actual supply-related costs relative to that approved for recovery through rates, thereby impacting earnings either negatively or positively. Registrant has the opportunity to change the supply-related costs recovered through rates by application to the appropriate regulatory body. Registrant believes that its applications for recovery of supply-related costs accurately reflect the water supply situation as it is known at the time. However, it is impossible to adequately protect earnings from adverse changes in supply costs related to unforeseen contamination. For the three months ended March 31, 2004, 45% of our supply mix was purchased water as compared to 43% purchased water for the three months ended March 31, 2003.

For the three months ended March 31, 2004, cost of power purchased for pumping decreased by 12.2% to \$1.7 million compared to \$2.0 million for the three months ended March 31, 2003 due to lower consumption and additional wells down for maintenance and water quality issues.

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For the three months ended March 31, 2004, cost of power purchased for resale to customers in SCW's Bear Valley Electric division increased by 25.2% to \$4.8 million compared to \$3.9 million for the three months ended March 31, 2003. The increase was due primarily to the reversal of a \$644,000 gain generated from a one-time sale of energy on the spot market in April 2001. The gain, which was previously recorded in April 2001 to the supply cost balancing account, was ordered by the Federal Energy Regulatory Commission ("FERC") in March 2004 to be refunded, plus interest, to Mirant Marketing. The FERC's order responded to a complaint filed by Mirant Marketing where Mirant Marketing, the purchaser of the energy, was seeking to be refunded all or a portion of the gain. This refund increased the cost of power purchased for resale during the three months ended March 31, 2004, with a corresponding amount booked to the provision for supply cost balancing account which resulted in no net impact on earnings. The sale of excess energy on the spot market in 2001 resulted from a one-month overlap of energy purchase agreements.

Unrealized gain and loss on purchased power contracts represents gains and losses recorded for SCW's purchased power agreements with Pinnacle West Capital Corporation (PWCC), which qualify as a derivative instruments under Statement of Financial Accounting Standards (SFAS) No. 133, "*Accounting for Derivative Instruments and Hedging Activities*". The \$557,000 pre-tax unrealized gain on purchased power contracts for the three months ended March 31, 2004 is due to an increase in the current forward market prices since December 31, 2003. Unrealized gains and losses at Bear Valley Electric will continue to impact earnings during the life of the contract with PWCC, through August, 2008.

For the three months ended March 31, 2004, groundwater production assessments increased by 9.3% to \$1.8 million compared to \$1.7 million for the three months ended March 31, 2003 due to increases in assessment rates levied against groundwater production, effective July 2003, offset by a decrease in pumped water. The decrease in pumped water was due primarily to wells in the Metropolitan and Foothill districts being down for maintenance and water quality reasons, which resulted in increased purchased water and less pumping.

A positive entry for the provision for supply cost balancing accounts reflects recovery of previously under-collected supply costs. Conversely, a negative entry for the provision for supply cost balancing accounts reflects an under-collection of previously incurred supply costs. A decrease of \$737,000 during the three months ended March 31, 2004 in the provision for supply cost balancing accounts as compared to the three months ended March 31, 2003 primarily reflects the \$644,000 refund to Mirant Marketing previously discussed in cost of power purchased for resale.

For the three months ended March 31, 2004, other operating expenses increased by 9.8% to \$4.4 million compared to \$4.0 million for the three months ended March 31, 2003 due primarily to higher labor, chemicals and water treatment costs which increased by almost \$300,000.

For the three months ended March 31, 2004, administrative and general expenses increased by 20.7% to \$9.1 million compared to \$7.5 million for the three months ended March 31, 2003 due primarily to (i) approximately \$483,000 increase in outside legal and consulting services incurred in connection with new business development, most specifically in the area of privatization of water and wastewater systems at military bases, (ii) approximately \$680,000 increase in pensions and benefits due to actuarial assumption changes in the discount rate and expected long-term rate of return on plan assets, and increases in various benefit costs, and (iii) an increase in labor costs of approximately \$380,000. Registrant believes that prudent administrative expenses incurred in the operation and management of its regulated subsidiaries will be recovered through water and electric rates.

Registrant plans through its non-regulated subsidiary, American States Utility Services, Inc., to continue with the analysis and preparation of bids for submission to the Department of Defense ("DOD")

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pursuant to DOD's initiative to privatize the water and wastewater assets and operations of military bases. The analysis and preparation of these bids is an extensive process and, as such, Registrant expects to incur approximately \$2 million in legal and consulting expenses in 2004 for such efforts due to the volume of Requests for Proposals available from the DOD. Registrant expects that it will be awarded its first privatization of a military base during 2004 and will enter into negotiations for several other bases as well.

For the three months ended March 31, 2004, depreciation and amortization expense increased by 4.6% to \$5.2 million compared to \$4.9 million for the three months ended March 31, 2003 reflecting, among other things, the effects of recording approximately \$35 million in utility plant during 2003, depreciation on which began in January 2004. Registrant anticipates that depreciation expense will continue to increase due to Registrant's on-going construction program at its regulated subsidiaries. Registrant believes that depreciation expense related to property additions approved by the appropriate regulatory agency will be recovered through water and electric rates.

For the three months ended March 31, 2004, maintenance expense increased by 19.3% to \$2.3 million compared to \$2.0 million for the three months ended March 31, 2003 due principally to increased maintenance on SCW's wells and water supply sources and maintenance of water mains.

For the three months ended March 31, 2004, taxes on income decreased by 52.8% to \$942,000 compared to \$2.0 million for the three months ended March 31, 2003 due primarily to lower pre-tax operating income. The effective income tax rate ("ETR") applicable to the first quarter results of 2004 reflects an increase of approximately two percentage points, from 40.6% to 42.5% (an approximately four percent increase in the ETR), compared to the first quarter results of 2003. This is a result of differences that are added to book income to arrive at taxable income that are permanent in nature and that are treated as flow-through items increasing in the first quarter of 2004 as compared to the first quarter of 2003, while pre-tax book income decreased.

For the three months ended March 31, 2004, other taxes increased by 8.2% to \$2.2 million compared to \$2.1 million for the three months ended March 31, 2003 reflecting additional property taxes resulting from higher assessed values, and increases in payroll taxes based on increased labor costs.

Other Income (Loss)

For the three months ended March 31, 2004, other income decreased to an \$83,000 loss compared to other income and loss that netted to zero for the three months ended March 31, 2003. The net decrease reflects a CPUC decision on March 16, 2004 that ordered SCW to refund to its customers, amounts of lease revenues received from the City of Folsom to customers. Pursuant to the order, the apportionment of any lease revenues that SCW may collect in the future will be determined by a later decision. All amounts billed to the City of Folsom are included in a regulatory liability account. During the three months ended March 31, 2003, approximately \$263,000 was billed to the City of Folsom and recorded in other income. Amounts invoiced during the three months ended March 31, 2004 of approximately \$269,000 were reported as a regulatory liability. The decrease was offset by decreases in taxes of approximately \$147,000.

Interest Charges

For the three months ended March 31, 2004, interest expense decreased by 5.3% to \$4.3 million compared to \$4.6 million for the three months ended March 31, 2003 due primarily to repayment of \$12.5 million long-term debt in October of 2003 and recovery of carrying cost for water quality OII matter authorized by the CPUC, partially offset by increases in short-term borrowing. Registrant anticipates that interest costs will increase in future periods due to the need for additional external capital to fund its construction program and to the likelihood that interest rates will be increasing generally and due to the recent downgrade of AWR's credit rating by Standard & Poor's Ratings Service (S&P) from A+ to A-

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with a negative outlook. Registrant 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.

S&P debt ratings range from AAA (highest rating possible) to D (obligation is in default).

Critical Accounting Policies

Critical accounting policies 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. These judgments are based on AWR's historical experience, terms of existing contracts, AWR's observance of trends in the industry, information provided by customers and information available from other outside sources, as appropriate. Actual results may differ from these estimates under different assumptions or conditions.

The critical accounting policies used in the preparation of the Registrant's financial statements that we believe affects the more significant judgments and estimates used in the preparation of our consolidated financial statements presented in this report are described in the "*Management's Discussion and Analysis of Financial Condition and Results of Operation*" included in our Annual Report on Form 10-K for the year ended December 31, 2003. There have been no material changes to the critical accounting policies.

Liquidity and Capital Resources

AWR

Net cash provided by operating activities was \$19.1 million for the three months ended March 31, 2004 as compared to \$13.2 million for the three months ended March 31, 2003. The increase of \$5.9 million was primarily attributable to the receipt of \$8.7 million from Aerojet in connection with the Memorandum of Understanding (MOU), offset by the timing of cash receipts and disbursements related to working capital items. (For more information about the MOU, see the section entitled "*Environmental Matters*" included in Part I, Item 2 in Management's Discussion and Analysis of Financial Condition and Results of Operation).

Net cash used in investing activities was \$13.4 million for the three months ended March 31, 2004 as compared to \$8.4 million for the three months ended March 31, 2003 due to higher capital expenditures consistent with budgeted increases.

Net cash used in financing activities was \$9.5 million for the three months ended March 31, 2004 as compared to \$6.8 million for the three months ended March 31, 2003. The increase was due primarily to an increase of \$4 million in short-term bank borrowing against the revolving credit line, offset by a \$1.1 million decrease in receipt of advances for and contributions in aid of construction.

AWR funds its operating expenses and pays dividends on its outstanding Common Shares primarily through dividends from its subsidiaries, principally SCW. AWR has a Registration Statement on file with the Securities and Exchange Commission (SEC) for issuance, from time to time, of up to \$60 million in Common Shares, Preferred Shares and/or debt securities. As of March 31, 2004, approximately \$31.1 million remained for issuance under this Registration Statement.

In June 2002, AWR established a \$75 million revolving credit facility, which matures in June 2005. Up to \$15 million of this facility may be used for letters of credit. As of March 31, 2004, an aggregate of \$47 million in cash borrowing included in current liabilities and approximately \$7.5 million

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of letters of credit were outstanding under this facility. The credit agreement for this facility includes, among other things, certain financial covenants. One of those covenants is maintenance of an interest coverage ratio of at least 3.25x, as defined and calculated in the credit agreement, based on trailing twelve-month results. The Company violated this interest coverage ratio for the trailing twelve-month period ended March 31, 2004 and has requested and received a waiver from its lending syndicate, which excludes in the calculation, certain charges booked by SCW following certain CPUC decisions. The waiver cured the default at March 31, 2004 and allowed for the exclusion of those charges from the calculation of the trailing twelve-month interest coverage ratio through September 30, 2004.

SCW

Net cash provided by operating activities was \$20.2 million for the three months ended March 31, 2004 as compared to \$13.3 million for the three months ended March 31, 2003. The increase of \$6.9 million in cash provided by operations was primarily attributable to the receipt of \$8.7 million from Aerojet in connection with the MOU, offset by the timing of cash receipts and disbursements related to working capital items.

Net cash used in investing activities increased to \$12.8 million for the three months ended March 31, 2004 as compared to \$8.0 million for the same period of 2003 due to increased capital expenditures consistent with budgeted increases.

Net cash used in financing activities was \$12.4 million for the three months ended March 31, 2004 as compared to \$9.8 million for the three months ended March 31, 2003, reflecting primarily an increase of \$3.9 million in intercompany borrowings.

SCW funds the majority of its operating expenses, payments on its debt, and dividends on its outstanding Common Shares 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 SCW's ability to recover these supply costs, and timing of rate relief. For further information, see the sections entitled "*Risk Factors*" and "*Electric Energy Situation in California*" included in Part I, Item 2 in Management's Discussion and Analysis of Financial Condition and Results of Operation.

SCW also relies on external sources, including equity investments and short-term borrowings from AWR, long-term debt, contributions-in-aid-of-construction, advances for construction and install-and-convey advances, to fund the majority of its construction expenditures.

CCWC

CCWC funds the majority of its operating expenses, payments on its debt and dividends, if any, through internal sources. 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

ASUS funds its operating expenses primarily through contractual management fees and investments by or loans from AWR.

Contractual Obligations and Other Commitments

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 principal interest payments are generally made from cash flow from operations. In the case of the \$12,500,000 in notes that were due October 2003, SCW used proceeds from short-term borrowings, which it intends to repay or refinance through the issuance of notes in the public or private markets.

The following table reflects Registrant’s contractual obligations and commitments to make future payments pursuant to contracts as of March 31, 2004. All obligations and commitments are obligations and commitments of SCW unless otherwise noted.

(\$ in thousands)	Payments/Commitments Due by Period ⁽¹⁾				
	Total	Less than 1 Year	1-3Years	4-5 Years	After 5 Years
Notes/Debentures ⁽²⁾	\$173,100	—	—	—	\$173,100
Private Placement Notes ⁽³⁾	28,000	—	—	—	28,000
Tax-Exempt Obligations ⁽⁴⁾	18,886	76	163	189	18,458
Other Debt Instruments ⁽⁵⁾	2,218	183	430	459	1,146
Advances for Construction ⁽⁶⁾	79,313	3,025	5,314	4,500	66,474
Purchased Power Contracts ⁽⁷⁾	56,185	11,973	23,947	20,265	—
Unconditional purchase obligations ⁽⁸⁾	11,057	11,057	—	—	—
Operating leases ⁽⁹⁾	6,162	2,013	3,009	1,136	4
Employer contributions ⁽¹⁰⁾	19,462	4,215	7,170	8,077	—
Other Commitments ⁽¹¹⁾	48,491	—	—	—	—
Chaparral City Water Co ⁽¹²⁾	8,206	560	781	580	6,285
TOTAL	\$451,080	\$33,102	\$40,814	\$35,206	\$293,467

(1) Excludes interest, dividends, commitment, and facility fees.

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

(3) The private placement notes are issued pursuant to the terms of Note Agreements with substantially similar terms. The Note Agreements contain restrictions on the payment of dividends, minimum interest coverage requirements, maximum debt to capitalization ratio and a negative pledge. Pursuant to the Note Agreements, SCW must maintain a minimum interest coverage ratio of two times interest expense. SCW does not currently have any outstanding mortgages or other encumbrances on its properties.

(4) Consists of obligations under a loan agreement supporting \$8 million in debt issued by the California Pollution Control Financing Authority, \$6 million in obligations supporting \$6 million in certificates of participation issued by the Three Valleys Municipal Water District and \$5.5 million of obligations incurred by SCW 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. SCW’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

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Wells Fargo Bank. In regards to its SWP entitlement, SCW has entered into agreements with various developers for 422 acre-feet, in aggregate, of its 500 acre-foot entitlement to water from the SWP.

- (5) Consists of \$1.5 million outstanding under a fixed rate obligation incurred to fund construction of water storage and delivery facilities with the Three Valleys Municipal Water District, \$0.6 million 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 \$0.4 million 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) 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 at rates ranging from 10% to 22% of the revenue received from the installation for which funds were advanced or in equal annual installments over periods of time ranging from 10 to 40-year periods.
- (7) Consists of the remaining balance of the purchased power contracts from November 2002 to December 2008.
- (8) Consists of noncancelable commitments primarily for capital projects under signed contracts.
- (9) Reflects Registrant's future minimum payments under non-cancelable operating leases.
- (10) Registrant's expected contributions (all by employer) for its pension and postretirement plans are approximately \$3,315,000 and \$900,000, respectively, for the year ended December 31, 2004. These amounts are subject to change based on, among other things, the limits established for federal tax deductibility (pension plan). In addition, for years after 2004, Registrant has included as an obligation the estimated minimum required contributions to its pension plan computed by its actuary. These amounts are subject to change based on the significant impact that returns on plan assets and changes in discount rates might have on such amounts.
- (11) Other commitments consist of (i) \$75 million syndicated revolving credit facility, expiring in June 2005 of which \$47.0 million is outstanding as of March 31, 2004, (ii) an amount of \$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 \$6,000,000 is reflected under tax-exempt obligations), (iii) an irrevocable letter of credit in the amount of \$600,000 that expires on October 2004 for the deductible in Registrant's business automobile insurance policy (v) an irrevocable letter of credit that expires March 31, 2005 for its energy scheduling agreement with Automated Power Exchange as security for the purchase of power; the amount of the credit is \$585,000 for the months from November to March, and \$270,000 to cover the months from April to October, and (vi) outstanding performance bonds of \$9,550 to secure performance under franchise agreements with governmental agencies. 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 Baa1 or BBB+. The Company violated the interest coverage ratio for the trailing twelve-month period ended March 31, 2004 and has requested and received a waiver from its lending syndicate, which excludes in the calculation, certain charges booked by SCW following certain CPUC decisions. The waiver cured the default at March 31, 2004 and allowed for the exclusion of those charges from the calculation of the trailing twelve-month interest coverage ratio through September 30, 2004.

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- (12) Consists of \$7.9 million of obligations under a loan agreement supporting Industrial Development Revenue Bonds due in 2006 and a \$1.0 million repayment obligation to the United States Bureau of Reclamation. The loan agreement contains provisions that establishes a maximum of 65% debt in the capital structure, limits cash distributions when the percentage of debt in the capital structure exceeds 55% and requires a debt service coverage ratio of two times. The Bureau of Reclamation obligation does not contain any financial covenants believed to be material to Registrant or any cross default provisions.

Under the terms of its power purchase contracts with Mirant Marketing and PWCC, SCW is required to post security, at the request of the seller, if SCW is in default under the terms of the contract and the future value of the contract is greater than the future value of contracts of a similar term on the date of default. SCW will be in default under the terms of these contracts if its debt is rated less than BBB- by Standard & Poor's Ratings Service ("S&P") or Fitch, Inc. ("Fitch") or less than Baa3 by Moody's Investor Services, Inc ("Moody's"). SCW currently has a rating of A- by S & P and A2 by Moody's, in each case with a negative outlook. Fitch does not rate SCW.

S&P debt ratings range from AAA (highest rating possible) to D (obligation is in default). Moody's debt ratings range from Aaa (best quality) to C (lowest quality). 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.

Electric Energy Situation in California

Background Information

On January 17, 2001, the Governor of the State of California proclaimed a state of emergency in California due to shortages of electricity available to certain of California's utilities (resulting in blackouts), the unanticipated and dramatic increases in electricity prices and the insufficiency of electricity available from certain of California's utilities to prevent disruption of electric service in California. The Federal Energy Regulatory Commission ("FERC") also implemented a number of changes to the tariff for the California Independent Operator System ("Cal ISO") beginning in December 15, 2000 in an attempt to stabilize the market. The reasons for the high cost of energy are under investigation but are reported to include, among other things, limited supply caused by a lack of investment in new power plants to meet growth in demand, planned and unplanned outages of power plants, decreased availability of hydroelectric power from the Pacific Northwest due to lower than usual precipitation and higher demand for electricity in the region, transmission line constraints, increased prices for natural gas, the fuel used in many of the power plants serving the region, a dysfunctional power market and market manipulation through the withholding of generation and a variety of "gaming" strategies.

As of March 31, 2004, SCW had accrued \$22.7 million in under-collected power costs that SCW mostly incurred during the energy crisis in connection with providing service to its Bear Valley Electric customers. SCW is authorized to include up to a weighted annual energy purchase cost of \$77 per MWh each year through August, 2011 in its electric supply cost balancing account. To the extent that actual weighted average annual cost for power purchased exceeds the \$77 per MWh amount, SCW will not be able to include these amounts in its balancing account and such amounts will be expensed, unless the CPUC approves adjustments.

Power Supply Arrangements at SCW's Bear Valley Electric Service Area

All electric energy sold by SCW to customers in its Bear Valley Electric customer service area is purchased from others. Under the terms of contracts with Dynegy Power Marketing, Inc. (Dynegy) that expired on April 30, 2001, Dynegy provided electric energy to SCW, acted as scheduling coordinator and provided other ancillary services. Beginning April 1, 2001, SCW entered into a five-year and nine-month, block forward purchase contract with Mirant Marketing for 15 MWs of electric energy at a price of \$95 per MWh through December 31, 2006. Mirant Marketing filed a complaint with the FERC seeking to be refunded all or a portion of the gain, \$644,000, from Registrant's sale of excess energy on the spot market in 2001 resulted from a one-month overlap of energy purchase agreements. In March 2004, the FERC issued an order that SCW is to refund the \$644,000, plus interest, to Mirant Marketing. This refund increased the cost of power purchased for resale during the three months ended March 31, 2004, with a corresponding amount booked to the provision for supply cost balancing account.

On December 20, 2001, SCW filed a complaint with FERC seeking to reduce the amount charged by Mirant Marketing under the terms of this contract to a just and reasonable price. In June 2003, the FERC issued a final order denying SCW's complaint. On November 10, 2003, the FERC denied SCW's rehearing request. SCW is currently reviewing its options with respect to the FERC's latest order denying rehearing and is determining if it will appeal the decision in Federal Court. On July 14, 2003, Mirant Marketing announced that, to facilitate its financial restructuring, it filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. At this time, Registrant expects no interruption in the delivery of electric energy under the Mirant Marketing contract.

In June 2001, SCW executed an agreement with PWCC for an additional 8 MWs of electric energy to meet peak winter demands. The contract provided for pricing of \$75 per MWh from November 1, 2001 to March 31, 2002, \$48 per MWh from November 1, 2002 to March 31, 2003 and \$36 per MWh from November 1, 2003 to March 31, 2004.

In September 2002, SCW entered into a series of purchased power contracts with PWCC. Under the agreements, SCW will sell 15 MWs to PWCC of electric energy at a price of \$95 per MWh beginning November 1, 2002 through December 31, 2006, and the 8 MWs of electric energy covered under the energy purchase agreement with PWCC discussed previously. In return, PWCC will supply SCW with 15 MWs of electric energy at a price of \$74.65 per MWh beginning November 1, 2002 through December 31, 2008, and an additional 8 MWs at \$74.65 per MWh beginning on November 1, 2002 through March 31, 2003 and each succeeding November 1 through March 31 period through March 31, 2008, and for the period November 1, 2008 through December 31, 2008.

The average minimum monthly load at SCW's Bear Valley Electric customer service area has been approximately 12 MWs. The average winter load has been 18 MWs with a winter peak of 39 MWs when the snowmaking machines at the ski resorts are operating. In addition to the power purchase contracts, SCW buys additional energy from the spot market to meet peak demand and sells surplus power to the spot market as well. The average cost of power purchased, including the transactions in the spot market, was approximately \$81.3 per MWh for the three months ended March 31, 2004 as compared to \$80.5 per MWh for the same period of 2003. SCW's average energy costs are impacted by pricing fluctuations on the spot market.

Transmission Constraints

Demand for energy in SCW's Bear Valley Electric customer service area generally has been increasing. However, the ability of SCW to deliver purchased power to these customers is limited by the ability of the transmission facilities owned by Southern California Edison Company (Edison) to transmit this power. On December 27, 2000, SCW filed a lawsuit against Edison for breach of contract as a result of delays in upgrading these transmission facilities as well as for violations of good faith and fair dealing, negligent misrepresentation, intentional misrepresentation and unjust enrichment. A settlement has been reached between SCW and Edison, in which (i) SCW is to pay \$5 million project abandonment fee to Edison, (ii) Edison will file an application to the FERC for approval of the entire \$5.0 million settlement payment as abandoned project costs to be in Edison's wholesale rate to SCW over a 15 year period, and (iii) Edison is to sell the Goldhill substation and associated transmission line to SCW at its book value. Management believes that the FERC's approval of Edison's filing is probable and the abandonment costs included in Edison's wholesale rate to SCW are recoverable through rates. As a result, the \$5.0 million obligation to Edison arising from this settlement was recorded as a liability and a regulatory asset in the fourth quarter of 2003. The settlement agreement was signed March 17, 2004 and required the first payment of \$1.4 million to be made to Edison during the first quarter of 2004.

New Generation Facility

As a means of meeting these increasing demands for energy, SCW is constructing a natural gas-fueled 8.4 MW generation facility to be owned by SCW. A Certificate of Public Convenience and Necessity filed with the CPUC seeking authorization for construction of the generation facility was approved on July 10, 2003. It is expected that the generator will be on line during the second quarter of 2004, and should assist SCW in controlling its spot purchase prices, as discussed above.

Southern California Wild Fires

The October 2003 wild fires in Southern California had limited impact on SCW. While the firestorms approached several water customer service areas, SCW experienced minimal damage to its water facilities. In SCW's Bear Valley Electric area, located in the mountains north of Los Angeles, electric service was maintained throughout the fire event in spite of isolated damage to certain electric distribution facilities. SCW will be filing with the CPUC for recovery of the extra expenses incurred in meeting these community needs. These costs are being accumulated in Catastrophic Event Memorandum Accounts (CEMA) and will be amortized pursuant to prescribed procedures after review by the CPUC.

Construction Program

SCW maintains an ongoing water distribution main replacement program throughout its customer service areas based on the priority of leaks detected, fire protection enhancement and a reflection of the underlying replacement schedule. In addition, SCW upgrades its electric and water supply facilities in accordance with industry standards, local requirements and CPUC requirements. SCW's Board of Directors has approved anticipated net capital expenditures of approximately \$61.7 million for 2004 principally reflecting water supply related projects such as drilling and equipping of new wells, building a new reservoir, and distribution and street improvement projects. As of March 31, 2004, SCW has unconditional purchase obligations for capital projects of approximately \$11.1 million.

CCWC's Board of Directors has approved a net capital budget of \$3.1 million for 2004 primarily reflecting a new treatment plant addition and distribution improvements to its Golden Eagle Plant.

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AWR and ASUS have no material capital commitments. However, ASUS actively seeks opportunities to own, lease or operate water and wastewater systems for governmental entities, which may involve significant capital commitments.

Registrant does not have any material capital expenditures for specific environmental control facilities or measures.

Regulatory Matters

Rate Regulation

SCW is subject to regulation by the CPUC, which has broad powers with respect to service and facilities, rates, classifications 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 regulation by the ACC.

Rates that SCW 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 an 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 return on rate base. Rate base generally consists of the original cost of utility plant in service, construction work-in-progress, 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 such as advances and contributions in aid of construction.

Neither AWR nor ASUS are directly regulated by the CPUC. The CPUC does, however, regulate certain transactions between SCW and its affiliates. The ACC also regulates certain transactions between CCWC and its affiliates.

For rate-making purposes, the 22 customer service areas of SCW are grouped into 9 water districts and 1 electric district. Water rates vary among the 9 water ratemaking districts due to differences in operating conditions and costs. SCW monitors operations on a regional basis in each of these districts so that applications for rate changes may be filed, when warranted. Under the CPUC's practices, rates may be increased by three methods: (i) general rate case increases (GRC's), (ii) offsets for certain expense increases including but not limited to supply cost offset and balancing account amortization, and (iii) advice letter filings related to certain plant additions and other operating cost increases. GRC's are typically for three-year periods, which include step increases for the second and third year. Rates are based on a forecast of expenses and capital costs. GRC's have a typical regulatory lag of one year. Offset rate increases and advice letter filings typically have a two to four month regulatory lag.

Changes in Rates

On January 16, 2003, the CPUC approved rate increases of approximately \$2.7 million annually, effective January 22, 2003, in SCW's Metropolitan district to recover costs associated with an increase in Region II rate base due to SCW's 2002 infrastructure replacement program and, additionally, to recover general increases in operating expenses. On January 31, 2003, the CPUC also approved SCW's Advice Letter filed for the 2003 infrastructure replacement program with rate increases of \$3.5 million annually effective February 4, 2003.

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In October 2002, SCW filed an application to increase water rates in the customer service areas that comprise Region III. SCW also filed a concurrent application requesting a rate increase applicable to SCW's entire customer base to recover costs associated with the general office functions of SCW. On March 16, 2004, the CPUC issued its Region 3 decision, under which (i) new water rates will generate an initial annual increase in revenues of approximately \$8.1 million, (ii) a special condition surcharge in rates is approved to amortize the water quality OII memorandum account balance, and (iii) SCW is authorized to establish a memorandum account to accumulate costs to comply with certain contamination remediation requirements. Based on the decision, SCW reversed an \$890,000 OII reserve and a \$1.0 million water quality related reserves into income during the fourth quarter of 2003.

In 1994, SCW entered a contract to lease, to the City of Folsom, 5,000 acre-feet per year of water rights to the American River and has included all associated revenues in a non-operating income account. The issue was raised by the ORA in the Region III proceeding. In a decision issued on March 16, the CPUC determined that SCW failed to seek the CPUC's approval to effectuate the lease and is to pay a net fine of \$180,000. The decision also orders SCW to refund 70 percent of the total amount of lease revenues since 1994, plus interest, to customers. Pursuant to the order, SCW recorded \$6.2 million as a regulatory liability with a corresponding charge against income (less taxes) during the fourth quarter of 2003. Management disagrees with the CPUC's decision and has appealed the decision in which it will vigorously defend its position. During the three months ended March 31, 2004, SCW recorded an additional \$269,000 of lease payments subject to refund. Pursuant to the order, the apportionment of any lease revenues that SCW may collect in the future will be determined by a later decision. Beginning in the first quarter of 2004, all amounts billed to the City of Folsom are included in a regulatory liability account.

As of March 31, 2004, SCW had accrued approximately \$22.7 million in under-collected purchased power costs included in its Bear Valley Electric balancing account. In 2001, the CPUC approved two Advice Letters which allow SCW to collect \$11.1 million in aggregate over five years, equivalent to 2.2¢ per kilowatt hour, for recovery of its under-collection in the electric balancing account.

On July 17, 2002, CPUC approved a settlement agreement reached among SCW, all intervening parties and the Office of Ratepayer Advocates (ORA). The authorization permits SCW to recover \$77 per MWh of purchased power costs through rates. SCW is allowed to include its actual purchased power costs up to an average annual weighted cost of \$77 per MWh each year, through August 2011, in its balancing account. To the extent SCW's actual average annual weighted cost for purchased power is less than \$77 per MWh, the differential would offset 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, SCW would not be able to include these amounts in its balancing account and such amounts would be expensed.

The CPUC settlement also extended the previously approved surcharges of 2.2¢ per kilowatt hour for an additional five years through August of 2011 to allow SCW an opportunity to collect amounts remaining in its electric cost balancing account. SCW anticipates that electricity sales will be sufficient to enable SCW to fully recover the under-collection in its balancing account during this period.

The CPUC settlement requires SCW to pursue its complaint filed with FERC in which SCW has requested FERC to reduce the prices in its power purchase contract with Mirant Marketing to a just and reasonable price. If FERC rules a price reduction, SCW is required, based on the settlement, to file an Advice Letter to notify the CPUC within 30 days of the ruling. On December 19, 2002, the FERC Administrative Law Judge issued an initial decision denying SCW's request to reduce the charges under the contract. SCW has appealed the initial decision which results in the complaint being reviewed by all member commissioners at the FERC. On November 10, 2003, the FERC denied SCW's rehearing request. SCW is currently reviewing its options with respect to the FERC's latest order denying rehearing and is determining if it will appeal the decision in Federal Court. On July 14, 2003, Mirant Marketing

announced that, to facilitate its financial restructuring, it filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code. At this time, Registrant expects no interruption in the delivery of electric energy under the Mirant Marketing contract.

See the section entitled “*Electric Energy Situation in California*” included in Part I, Item 2 in Management’s Discussion and Analysis of Financial Condition and Results of Operation.

Pending Rate Changes

On July 10, 2003, the CPUC approved the Certificate of Public Convenience and Necessity (CPCN) filed by SCW in March 2002 seeking authorization to construct an 8.4 MW natural gas-fueled generation facility on a portion of its property in the City of Big Bear Lake. The capital cost of the generating facility is estimated to be approximately \$13 million. The CPUC’s order authorizes construction and enables SCW to file a rate application to generate an annual revenue increase of about \$2.4 million. SCW will file for increased rates using a special filing called a “Major Adjustment Clause” or “MAC” filing that should result in at least 75% of the revenue requirement related to this facility being included in rates. The remainder will be subject to recovery in a general rate case filing.

Registrant filed an application to increase water rates in the Region II customer service areas on September 11, 2003, which was accepted by the CPUC on October 6, 2003. The new water rates in this filing, as stipulated, would generate an annual increase in revenues of \$4.7 million for 2004, \$5.1 million and \$5.2 million for 2005 and 2006, respectively, subject to earnings tests. The increases for 2004 are retroactive, less the interim increase as discussed below, to January 1, 2004. A decision is not expected until the third quarter of 2004. Due to delays in the CPUC’s review of this GRC application which have delayed the processing of the application, SCW sought authority for interim rate relief by motion filed on December 23, 2003. The Administrative Law Judge at the CPUC in a ruling issued in February 2004 granted SCW’s motion for interim rate relief and ordered SCW to file an advice letter implementing interim rates for Region II, commencing January 1, 2004, subject to refund. The interim rates are expected to generate additional approximately \$1.4 million annual revenues. Management expects no refunds will be made.

On October 30, 2003, SCW also filed an abbreviated application to the CPUC to request an inflationary increase in three of the Region I customer services areas, totaling \$388,500 annually. As part of the Region I filing, SCW requested a long-term amortization of the balance of costs included in the Aerojet litigation memorandum account, net of any reimbursement amount. For more information, see the section entitled “*Other Water Quality Litigation*” included in Part I, Item 3 in Legal Proceedings.

An Interim Decision issued by the CPUC on May 8, 2003 approved a settlement between the City of Santa Monica (City) and SCW. The settlement agreement conveyed SCW water rights to the City and relieved SCW from its participation in a number of pending lawsuits related to the Charnock Groundwater Basin. A Proposed Decision (PD) issued on December 19, 2003 proposing the ratemaking treatment of the settlement proceeds and the treatment of contamination payments made to SCW by Potentially Responsible Parties (PRPs) since 1998. In summary, the PD directs SCW to (i) invest all net settlement proceeds received from the City in infrastructure improvements within eight years, and (ii) refund to ratepayers the net proceeds received from PRPs, for which \$3.5 million was recorded as a liability in December 2003. In April of 2004, the CPUC also issued an alternate decision which proposes to resolve the ratemaking treatment of the settlement proceeds to be received from the City of Santa Monica. The alternate decision orders SCW to refund to ratepayers the net proceeds to be received from the City pursuant to the settlement agreement. SCW is in the final stages of finalizing the settlement agreement with the City of Santa Monica on the Charnock issue. Total settlement is approximately \$5.7 million of which \$2.0 million is for facilities and \$3.7 million is for the water rights. The Santa Monica city council is expected to approve the settlement at its meeting on May 11, 2004. SCW has been informed by the City that the settlement proceeds will be available 30 days after the city council approval.

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SCW will book the net settlement proceeds from the City in accordance with the final CPUC decision to be issued later this year. For more information, see the section entitled “*Environmental Matters*” included in Part I, Item 2 in Management’s Discussion and Analysis of Financial Condition and Results of Operation.

In 1993, the CPUC disallowed \$1.6 million of costs incurred in construction of a water treatment facility in SCW’s Clearlake customer service area and Registrant wrote off the disallowed amount at that time. Based on new water quality standards, in 2000, SCW re-applied to the CPUC for inclusion of the disallowed amount in rate base. A draft decision issued on March 30, 2001 by the CPUC would have allowed SCW to include \$500,000 of the \$1.6 million in the regulated rate base. An alternate draft decision issued by one of the CPUC Commissioners proposed to deny the relief sought by SCW in its application. An Administrative Law Judge subsequently reopened the proceeding in August 2001 requiring additional information. Registrant cannot predict when the final order will be issued, nor can it give assurance that the CPUC will ultimately allow recovery of all or any of the remaining costs through rates.

Other Regulatory Matters

On November 29, 2001, the CPUC adopted an Order Instituting Rulemaking (OIR) to (i) evaluate existing rate making practices and policies, (ii) determine whether new procedures or policies for processing offset rate increases and balancing accounts should be made and (iii) determine whether the new memorandum account procedures adopted on November 29, 2001 should be made permanent.

Pursuant to a resolution issued by the CPUC on December 17, 2002, SCW filed advice letters on March 17, 2003 requesting recovery of \$2.2 million of under-collections remaining in the balancing accounts for water supply costs incurred prior to November 29, 2001. On June 19, 2003, the CPUC authorized increases in rates in total of \$2.1 million, effective June 24, 2003, for SCW to recover the pre-November 29, 2001 balances.

In a decision issued on June 19, 2003, the CPUC concluded that (i) if a utility is within its rate case cycle and does not earn over its authorized rate of return, the utility shall recover its costs in the memorandum supply cost account subject to reasonableness review by the CPUC; (ii) if a utility is either within or outside of its rate case cycle and earns over the authorized return, the utility’s recovery of expenses from the memorandum supply cost account will be reduced by the amount exceeding the authorized rate of return; and (iii) a utility is required to seek review of under and over collections by filing an advice letter annually. SCW has recently filed advice letters for Regions I and II and will file Region III shortly, seeking recovery for under-collected balances of \$2.3 million for the period of November 29, 2001 through December 31, 2002, and \$1.7 million for the year of 2003. For more information, see the section entitled “*Accounting for Supply Costs*” included in Part I, Item 2 in Management’s Discussion and Analysis of Financial Condition and Results of Operation.

CCWC is planning to file its next rate case with the Arizona Corporation Commission in 2004. Currently, there are no active regulatory proceedings affecting CCWC or its operations.

Environmental Matters

1996 Amendments to Federal Safe Drinking Water Act

The U.S. Environmental Protection Agency (EPA) can only regulate contaminants that may have adverse health effects, 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 EPA has published a list of contaminants for possible regulation and must update that list every five years. In addition, every five years, the EPA must select at least five contaminants on that list and determine whether to regulate them. This law allows the EPA to bypass the selection process and adopt interim regulations for contaminants in

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order to address urgent health threats. The DOHS, acting on behalf of the EPA, administers the EPA's program in California. The Arizona Department of Environmental Quality (ADEQ) administers EPA's program in Arizona.

The EPA may base primary drinking water regulations on risk assessment and cost/benefit considerations and on minimizing overall risk. The EPA must base regulations on best available, peer-reviewed science and data from best available methods. For proposed regulations that involve the setting of maximum contaminant levels (MCL's), the EPA must use, and seek public comment on, an analysis of quantifiable and non-quantifiable risk-reduction benefits and costs for each such MCL.

SCW and CCWC currently test their wells and water systems according to requirements listed in the Safe Drinking Water Act ("SDWA"). Water from wells found to contain levels of contaminants above the established MCL's is treated to reduce contaminants to acceptable levels before it is delivered to customers. If treatment is not possible, the wells are shut down. Since the SDWA became effective, SCW and CCWC have experienced increased operating costs for testing to determine the levels, if any, of the constituents in their sources of supply and additional expense to lower the level of any contaminants in order to meet the MCL standards. Such costs and the costs of controlling any other contaminants may cause SCW and/or CCWC to experience additional capital costs as well as increased operating costs. The CPUC and ACC ratemaking processes provide SCW and CCWC with the opportunity to recover prudently incurred capital and operating costs associated with water quality. Management believes that such incurred and expected future costs should be authorized for recovery by the CPUC and ACC, as applicable.

Enhanced Surface Water Treatment Rules

The EPA has adopted the Enhanced Surface Water Treatment Rule (ESWTR), which required increased surface-water treatment to decrease the risk of microbial contamination. These rules apply to each of SCW's five surface water treatment plants and CCWC's surface water treatment plant. Registrant anticipates that all plants will achieve compliance within the three-year to five-year time frames identified by EPA. Registrant is required to be in compliance by June 1, 2006. SCW has initiated phased construction of a new treatment plant in the Calipatria-Niland customer service area (see further discussion below under *Regulation of Disinfectant/Disinfection By-Products*) to bring that facility into compliance. Once this project is completed, all the surface water plants in SCW and CCWC should be in compliance with these rules.

Regulation of Disinfection/Disinfection By-Products

SCW and CCWC are also subject to regulations concerning disinfection/disinfection by-products (DBP's). Stage I of the regulations was effective in November 1998 with full compliance required for systems serving 10,000 or more persons by 2002 and for systems serving fewer than 10,000 persons by 2004. Stage I requires reduction of trihalomethane contaminants from 100 micrograms per liter to 80 micrograms per liter. SCW has already implemented modifications to the treatment process in its Bay Point and Cordova systems to achieve compliance and the Calipatria plant has undergone treatment modifications, which will also address the requirements under the ESWTR, in order to comply with the DBP's.

The EPA is not allowed to use the cost/benefit analysis provided for in the 1996 SDWA amendments for establishing the Stage II rules applicable to DBP's but may utilize the regulatory negotiating process provided for in the 1996 SDWA amendments to develop the Stage II rule. The final rule is not expected until later this year.

The Stage 2 Disinfectants/Disinfection By-Products Rule (DBPR) and the Long-Term 2 Enhanced Surface Water Treatment Rule (LT2ESWTR)

The LT2ESWTR proposal was published in the *Federal Register* on August 11, 2003, and the Stage 2 DBPR was published shortly thereafter on August 18. These proposed Rules are very complex and EPA has asked for comments on hundreds of technical issues. EPA will likely publish the final rules in early to mid-2005, since the close of public comments was in January 2004, and it typically takes EPA 12-18 months to finalize rules after the close of the comment period. Registrant is currently waiting for the EPA to finalize these proposed rules to determine the impact.

Ground Water Rule

On May 10, 2000, the EPA published the proposed Ground Water Rule (GWR), which establishes multiple barriers to protect against bacteria and viruses in drinking water systems that use ground water. The proposed rule will apply to all U.S. public water systems that use ground water as a source. The proposed GWR includes system sanitary surveys conducted by the state to identify significant deficiencies; hydrogeologic sensitivity assessments for undisinfected systems; source water microbial monitoring by systems that do not disinfect and draw from hydrogeologically sensitive aquifers or have detected fecal indicators within a distribution system; corrective action; and compliance monitoring for systems which disinfect to ensure that they reliably achieve 4-log (99.99%) inactivation or removal of viruses. It was anticipated that the GWR would be issued as a final regulation by the end of 2003, but this has been delayed until later this year. While no assurance can be given as to the nature and cost of any additional compliance measures, if any, SCW and CCWC do not believe that such regulations will impose significant compliance costs, since they already currently engage in disinfection of the majority of their groundwater systems.

Regulation of Radon and Arsenic

On October 31, 2001, EPA announced that the arsenic standard in drinking water would be 10 parts per billion (ppb). Compliance with an MCL of 10 ppb will require implementation of wellhead treatment remedies for eight affected wells in SCW's system and two wells in CCWC's system. The effective date for utilities to comply with the standard is January 2006. The California DOHS Office of Environmental Health Hazard Assessment (OEHHA) published the final Public Health Goal (PHG) of 4.0 parts per trillion in April 2004. This is the first step for California to adopt its own MCL for arsenic. The California DOHS will take this number and begin the formal MCL process for California. The DOHS MCL process is expected to take up to a year (even as an emergency regulation). In that interim period, the current MCL in California will remain at 50 parts per billion. The USEPA MCL has been changed to 10 ppb, but it is not effective until 2006.

The EPA has proposed new radon regulations following a National Academy of Sciences risk assessment and study of risk-reduction benefits associated with various mitigation measures. The National Academy of Sciences study is in agreement with much of EPA's original findings but has slightly reduced the ingestion risk initially assumed by EPA. EPA established an MCL of 300 Pico Curies per liter based on the findings and has also established an alternative MCL of 4000 Pico Curies per liter, based upon potential mitigation measures for overall radon reduction. Registrant is currently waiting for the EPA to establish a MCL to determine the impact.

Voluntary Efforts to Provide Treated Surface Water Below Minimum Surface Water Treatment Requirements

SCW is a voluntary member of the EPA's Partnership for Safe Water, a national program designed to further protect the public from diseases caused by cryptosporidium and other microscopic organisms. As a volunteer in the program, SCW commits to treat surface water to levels much lower than the minimum operating requirements governing surface water treatment, optimize surface water treatment plant operations and seeks to have its surface water treatment facilities perform as efficiently as possible.

Unregulated Contaminants Monitoring Rule

EPA has revised the Unregulated Contaminant Monitoring Rule (UCMR). The data generated by the UCMR will be used to evaluate and prioritize contaminants on the Drinking Water Contaminant Candidate List, a list of contaminants EPA is considering for possible new drinking water standards. This data will help to ensure that future decisions on drinking water standards are based on sound science.

A tiered approach will be utilized with the three monitoring lists to provide the maximum capability to monitor up to the statutory limit of no more than 30 contaminants in any 5-year monitoring cycle. Therefore, as List 3 contaminants are found to occur in public water systems, they may move up to List 2, and likewise, List 2 contaminants may move up to List 1, when the UCMR is revised again later this year. The law requires that EPA publish a new contaminant-monitoring list every 5 years. When the EPA adds contaminants to their list, they will also include a compliance date. Registrant will evaluate the impact and necessary actions as additions are made to the contaminant lists.

Fluoridation of Water Supplies

SCW is required to fluoridate water supplies for public water systems serving more than 10,000 service connections if funds have been made available to cover capital and operating costs. The CPUC is required to authorize cost recovery through rates should funds for the operation of fluoridation facilities, once installed, become unavailable in future years. Currently, funds have been made available to public agencies only. SCW has not been offered any funding and has not installed any fluoridation facilities.

Perchlorate Action Level Activities

In January 2002, DOHS reduced the action level from 18 ppb to a level of 4 ppb, based upon new reference dose for health risk information from EPA. California has a law requiring DOHS to establish an MCL for perchlorate by January 1, 2004. This has been delayed due to the lack of a final Public Health Goal. SCW has removed eight wells from service in its Rancho Cordova system and six additional wells in various other systems since they contained perchlorate in amounts in excess of this reduced action level of 4 ppb. On December 6, 2002, the OEHHA published a revised draft perchlorate Public Health Goal (PHG) of 2 to 6 ppb. This is the first step in the establishment of an MCL in California. The PHG of 6 ppb was adopted in the first quarter of 2004 after which DOHS revised the state Action Level for perchlorate from 4 ppb to 6 ppb. The California MCL for perchlorate is expected to be finalized in 2005. SCW is continuing to periodically monitor all of its wells to determine that levels of perchlorate are below the action level currently in effect.

Nitrosodimethylamine (NDMA) Action Level

In February 2002, DOHS increased the action level from 2 parts per trillion (ppt) to 10 ppt. NDMA is an additional by-product from the production and use of rocket fuels.

Matters Relating to SCW's Arden-Cordova Water System

In SCW's Rancho Cordova system, four wells have been removed from service and destroyed due to contamination from perchlorate. The supply has been replaced for three of these wells. An additional three wells are currently out of service due to perchlorate levels above the EPA trigger level of 4 ppb as defined in the EPA's Administrative Orders, and two wells are out of service due to detectable levels of NDMA above the action level. SCW continues to monitor all of its active groundwater wells in the Rancho Cordova system for perchlorate and NDMA. Aerojet-General Corp. (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 such contamination is also related to the activities of Aerojet. SCW has filed suit against Aerojet for contamination of SCW's ground water supply in its Rancho Cordova system.

On October 10, 2003 Registrant entered into a confidential Memorandum of Understanding (MOU) with the Aerojet-General subsidiary of GenCorp, Inc. for the settlement of legal actions brought by SCW. The MOU sets forth the present financial terms and the structure of a settlement to cover all SCW's costs incurred resulting from the contamination. The MOU and the settlement embodied therein was found to be binding by the Sacramento Superior Court on January 18, 2004. Further documentation incorporating the terms of the MOU is presently underway. However, documentation is not complete and management is presently unable to predict when a comprehensive set of settlement documents will be completed.

To date, Aerojet has reimbursed SCW for constructing a pipeline to interconnect with the City of Folsom water system to provide an alternative source of water supply in SCW's Rancho-Cordova customer service area and has reimbursed SCW for a portion of the costs associated with the drilling and equipping of new wells. Aerojet had, prior to the MOU, reimbursed SCW \$4.3 million of the approximately \$20 million in capital costs SCW has incurred, and \$171,000 for additional water supply costs. Based on the financial terms in the MOU, SCW established a receivable from Aerojet in an amount of \$16.7 million at the end of 2003, of which \$8.7 million was received in early 2004. The remainder of the costs is subject to further settlement documentation. Reimbursements received from Aerojet have been applied directly to reduce SCW's costs of utility plant and purchased water. Management believes these costs are recoverable through rates; however, proceeds from any settlement agreement with Aerojet would be applied to reduced amounts collected from customers. Management cannot give assurance that the CPUC will ultimately allow recovery of all or any of these costs. For further information regarding litigation related to contamination of ground water in Sacramento County, see the section entitled "*Other Water Quality Litigation*" included in Part I, Item 3, Legal Proceedings.

Matters Relating to SCW's Culver City Water System

The compound, methyl tertiary butyl ether (MTBE), an oxygenate used in reformulated fuels, has been detected in the Charnock Basin, located in the vicinity of the City of Santa Monica and within SCW's Culver City customer service area. At the request of the Regional Water Quality Control Board, the City of Santa Monica and the California Environmental Protection Agency, SCW removed two of its wells in the Culver City water system from service in October 1996 to help in efforts to avoid further spread of the MTBE contamination plume. Neither of these wells has been found to be contaminated with MTBE. SCW is purchasing water from the Metropolitan Water District of Southern California (MWD) at an increased cost to replace the water supply formerly pumped from the two wells removed from service.

On September 22, 1999, the U.S. EPA and the Los Angeles Regional Water Quality Control Board ordered Shell Oil Company, Shell Oil Products Company, Equilon Enterprises LLC and others to provide replacement drinking water to both SCW and the City of Santa Monica due to MTBE contamination in the Charnock Basin. The EPA has ordered Shell Oil and others to reimburse SCW for water replacement costs. In March 2002, SCW reached a settlement agreement with the City of Santa

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Monica, in which SCW assigned its rights against all the potentially responsible parties, who stored, transported and dispensed gasoline containing methyl tertiary butyl ether (MTBE) in underground storage tanks, pipelines or other related infrastructure, and its water rights in the Charnock Basin to the City of Santa Monica and Santa Monica took over the prosecution against the potentially responsible parties in exchange for an assignment payment. On May 8, 2003, the CPUC issued a decision approving the settlement agreement. Pursuant to the resolution, SCW has subsequently filed a report that sets forth specific details as to SCW's plans to reinvest the net proceeds from the settlement agreement with the City of Santa Monica. A Proposed Decision (PD) issued on December 19, 2003 proposes the ratemaking treatment of the settlement proceeds and the treatment of contamination payments made to SCW by Potentially Responsible Parties (PRPs) since 1998. In summary, the PD directs SCW to (i) invest all net settlement proceeds received from the City in infrastructure improvements within eight years, and (ii) refund to ratepayers the net proceeds received from PRPs, for which \$3.5 million was recorded as a liability in December 2003. In April of 2004, the CPUC also issued an alternate decision which proposes to resolve the ratemaking treatment of the settlement proceeds to be received from the City of Santa Monica. The alternate decision orders SCW to refund to ratepayers the net proceeds to be received from the City pursuant to the settlement agreement. SCW is in the final stages of finalizing the settlement agreement with the City of Santa Monica on the Charnock issue. Total settlement is approximately \$5.7 million of which \$2.0 million is for facilities and \$3.7 million is for the water rights. The Santa Monica city council is expected to approve the settlement at its meeting on May 11, 2004. SCW has been informed by the City that the settlement proceeds will be available 30 days after the city council approval. SCW will book the net settlement proceeds from the City in accordance with the final CPUC decision to be issued later this year.

Matters Relating to SCW's Yorba Linda Water System

The compound MTBE has been detected in three wells serving SCW's Yorba Linda water system. Two of the wells are currently inactive, and to date the third well has not shown MTBE above the DOHS secondary standard of 5.0 ppb. SCW has constructed an interconnection with the Metropolitan Water District of Southern California to provide for the needed supply for this system in the event the third well experiences levels of detection in excess of the DOHS standard.

SCW has met with the Regional Water Quality Control Board, the Orange County Water District, (OCWD), the City of Anaheim, the DOHS and three potentially responsible parties (PRPs) to define the extent of the MTBE contamination plume and assess the contribution from the PRP's. The PRP's have voluntarily initiated a work plan for regional investigation. While there have not been significant disruptions to the water supply in Yorba Linda at this point in time, no assurances can be given that MTBE contamination will not increase in the future. In December 2003, a settlement was reached between SCW and the PRPs. Under the settlement agreement, the PRPs are to pay SCW (i) \$581,250 for reimbursement of costs related to the issue, and (ii) up to \$260,000 per year for five years for incremental supply costs should the MTBE level in the third well exceed the DOHS action level. SCW received payment of the \$581,250 in January 2004.

Matters Relating to SCW's Los Osos Water System

The compound MTBE has been detected in a well serving SCW's Los Osos water system. For some time SCW has been working with the Regional Water Quality Control Board as well as the owner of a service station. Although the owner of the service station has attempted remediation with funds provided through the California Underground Storage Tank Fund ("CUSTF"), it appears there will be insufficient funds from the CUSTF to complete remediation sufficient to return the well to service. In order to prevent the running of the statute of limitations, on August 12, 2002 SCW filed suit in the Superior Court of the State of California for the County of San Luis Obispo against the operators and owners of the service station facility, and Chevron USA Products, Inc., the supplier. A settlement with Chevron has been reached and fully executed. The impacted well may need to be removed permanently

from service and the settlement payment from Chevron is expected to afford SCW sufficient funds to commence site development and construction of a replacement well.

Matters Relating to SCW's San Gabriel Water Systems

Perchlorate and/or Volatile Organic Compounds (VOC) have been detected in five wells servicing SCW's San Gabriel System. SCW filed suit, along with two other affected water purveyors and the San Gabriel Basin Water Quality Authority (WQA), in federal court against some of those responsible for the contamination. Some of the other potential defendants settled with SCW, other water purveyors and the WQA on VOC related issues prior to the filing of the lawsuit resulting in reimbursement to SCW of the \$1 million in capital cost of VOC treatment facilities and contribution of approximately \$380,000 towards future operating and maintenance (O&M) costs of the facilities.

In response to the filing of the Federal lawsuit, the Potentially Responsible Party (PRP) defendants filed motions to dismiss the suit or strike certain portions of the suit. Following a hearing on these motions on March 31, 2003, the judge issued a ruling on April 1, 2003 granting in part and denying in part the defendant's motions. A key ruling of the court was that the water purveyors, including the Registrant, by virtue of their ownership of wells contaminated with hazardous chemicals are themselves PRPs under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). Registrant 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.

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 SCW's two impacted wells draw water. SCW was not named as a party to the UAO. The UAO requires that these parties remediate the contamination. As a result of the issuance of the UAO, these parties have begun settlement discussions regarding the Federal lawsuits with SCW, the other two affected water purveyors, WQA and, separately, EPA. Registrant is presently unable to predict the ultimate outcome of these settlement discussions.

Three other wells serving customers in SCW's San Gabriel customer service area are also impacted by VOC contamination. A settlement with several potentially responsible parties together with federal funds administered by WQA resulted in reimbursement of 100% of the \$1.1 million in capital costs, \$205,000 of past operations and maintenance costs and 100% of future operations and maintenance costs for a period of up to 30 years for VOC treatment facilities at these wells.

Bark Beetle Infestation in SCW's Bear Valley Electric Service Area

In a Proclamation issued on March 7, 2003 former Governor Gray Davis declared a State of Emergency with respect to a severe fire risk caused by dead and dying trees plagued by drought and a major bark beetle infestation in the counties of Riverside, San Bernardino, and San Diego of the State of California. The threat is continuing and shows no sign of abating. On April 3, 2003, the CPUC issued an order requiring Southern California Edison Company, San Diego Gas & Electric Company and Bear Valley Electric to take all reasonable and necessary actions to mitigate the increased fire hazard by removing dead, dying or diseased trees from falling or contacting distribution and transmission lines within their rights of way and to ensure compliance with existing vegetation clearance statutes and regulations. The utilities, including Bear Valley Electric, are authorized to make annual advice letter filings requesting recovery of the costs of removal and mitigation. SCW has determined the scope and magnitude of the bark beetle infestation in its Bear Valley Electric service territory to date and has formulated a course of action to mitigate the fire potential in its rights-of-way. Estimated costs of dead tree removal totals \$620,000 based on experiences with other utility vegetation management programs

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and current information gathered and assessed for the Big Bear Lake area. These costs represent only the cost of addressing the problem to date. If the drought continues, the infestation will likely spread and mitigation costs may increase. SCW expects that current and future costs incurred in remediation of Bark Beetle Infestation will be recoverable in rates through the annual Advice Letter filings, as the April 2003 order issued by the CPUC contained cost recovery provisions. As of March 31, 2004, approximately \$17,000 has been incurred and is included in the CEMA accounts.

Security Issues

Since the tragic events of September 11, 2001, water utilities, including Registrant, have been advised to increase security at key facilities in order to avoid contamination of water supplies and other disruptions of service. In compliance with “*The Public Health Security and Bioterrorism Preparedness Act of 2002*” (HR 3448), Registrant has continued to implement measures to increase security, which includes a vulnerability assessment of its large systems. In addition to large system assessments, all systems operated by Registrant were assessed to identify potential areas requiring enhancements. These assessments resulted in a prioritized listing of recommended facility upgrades to enhance the safety of water system operations. Costs associated with capital improvements identified as a result of the assessment process, of approximately \$15 million, have been included in an application filed with the CPUC in October 2002.

Water Supply

SCW’s Water Supply

For the three months ended March 31, 2004, SCW supplied a total of 16,863,000 CCF of water. Of this amount, approximately 54% came from pumped sources and 45% was purchased from others, principally the Metropolitan Water District of Southern California (MWD). The remaining was surface water principally supplied by the Bureau of Reclamation (the Bureau) under a no-cost contract and by the Sacramento Municipal Utility District (SMUD), the cost of which is being reimbursed by Aerojet-General Corp. pursuant to a Memorandum of Understanding. For more information, please see the section entitled “*Environmental Matters*” included in Part I, Item 2 in Management’s Discussion and Analysis of Financial Condition and Results of Operation. During the same period of 2003, SCW supplied 16,483,000 CCF of water, 56% of which came from pumped sources, 43% was purchased, and the Bureau and SMUD supplied the remainder.

The MWD is a water district organized under the laws of the State of California for the purpose of delivering imported water to areas within its jurisdiction. Registrant has 58 connections to the water distribution facilities of MWD and other municipal water agencies. MWD imports water from two principal sources: the Colorado River and the SWP. Available water supplies from the Colorado River and the SWP have historically been sufficient to meet most of MWD’s requirements.

On October 17, 2003 Federal government, State government, and four Southern California water agency officials, including the MWD, met to sign the Quantification Settlement Agreement (QSA) which divides up each state’s share of the Colorado River. Under the QSA, MWD will have access (as in the past) to Colorado River water and up to 1.6 million acre feet of additional water that the Imperial Irrigation District proposes to conserve and sell to the state. With the signing of this agreement California once again has access to excess Colorado River water for the next 13 years. However for the near term, excess water may not be available due to the recent drought in the Colorado watershed. MWD has also publicly stated that it is stepping up a number of efforts including desalination, conservation, recycling, transfer and storage, to increase water supplies.

SCW’s water supply and revenues are significantly affected, both in the short-run and the long run, by changes in meteorological conditions. The current water year for California has generally been drier than last year with state wide precipitation at 95% and snow pack at 85% of average, versus 100%

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and 117%, respectively, during last year. Particularly March has seen much warmer and drier weather. However, reservoir levels are up from last year with the current statewide level at 105% of normal as opposed to 100% last year. Runoff is forecasted to be 80% of normal from April 2004 to July 2004.

Although overall groundwater conditions remain at adequate levels, certain of SCW's groundwater supplies have been affected to varying degrees by various forms of contamination which, in some cases, has caused SCW to increase its reliance on purchased water in its supply mix. For further information, see Part I, Item 3 in Legal Proceedings.

A sudden and unexplained drop in groundwater water supply severely impacted SCW's Wrightwood customer service area in the third quarter of 2002. In response to this emergency situation, SCW undertook a number of steps to provide water service, including trucking water into the area from nearby sources, bringing a formerly shut down well into service, taking steps to increase capacity at existing wells and expediting the drilling and equipping of a new well. SCW experienced increased operating costs associated with the trucking of water of approximately \$1.4 million (approximately \$1.26 million was incurred in 2002 and \$166,000 in the first quarter of 2003). Due to the actions of SCW and conservation efforts of consumers, the situation has stabilized and the water hauling ceased at end of January 2003. Management is unable to predict the extent to which additional costs may be incurred or the extent to which additional problems may be encountered. An additional well and filtration equipment have been installed during the past 12 months and, along with voluntary conservation by the community, water supplies have been sustained throughout 2003 even though water levels in Wrightwood are still low. We will be evaluating other alternatives to secure water supply. The cause of the unexplained and sudden drop in groundwater supply has not been identified, but it is believed to be partially drought-related.

CCWC's Water Supply

Arizona will continue to experience drought conditions. During this water year, precipitation has been well below normal, except for the southeastern portion of the state. The warm March melted much of the snow pack to levels below 20% of normal. The Natural Resource Conservation Service warned users to expect reduced water supplies through the spring and summer of 2004. In the Colorado river basin Lake Mead is at 15,255,000 acre feet, 56% of normal and Lake Powell is 10,180,000 acre feet , or 69% of normal. The forecast of steam flow into Lake Powell is for 50% of average.

The Arizona Water Banking Authority (AWBA) was created to store Arizona's unused Colorado River water entitlement in western, central and southern Arizona to develop long-term storage credits to: (i) firm existing water supplies for municipal and industrial users during Colorado River shortages or Central Arizona Project (CAP) service interruptions; (ii) help meet the water management objectives of the Arizona Groundwater Code; and (iii) assist in the settlement of American Indian water rights claims. The ABWA successfully recharged more than 209,000 acre-feet in 2003 allowing for the second year in a row for Arizona to use its full allocation of Colorado River entitlement of 2.8 million acre-feet. This banked water can be used as a hedge against future drought conditions. Further, 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 2003, creating a buffer for users such as CCWC. Though it is difficult to predict drought conditions with certainty, the activities of AWBA, and the priority for users of CAP, such as CCWC, provides an improved outlook for CCWC supplies.

CCWC obtains its water supply from two operating wells and from Colorado River water delivered by the CAP. The majority of CCWC's water supply is obtained from its CAP allocation and well water is used for peaking capacity in excess of treatment plant capability, during treatment plant shutdown, and to keep the well system in optimal operating condition.

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CCWC has an Assured Water Supply designation, by decision and order of the Arizona Department of Water Resources (ADWR), providing in part that, subject to its requirements, CCWC has a sufficient supply of ground water and CAP water which is physically, continuously and legally available to satisfy current and committed demands of its customers, plus at least two years of predicted demands, for 100 years.

CCWC has, however, received a letter from the ADWR stating that the current and committed demand for water in CCWC's service area has exceeded CCWC's supply of water in its proven assured water supply account by 400 acre-feet per year. ADWR's letter requires CCWC to make up this accounting deficit by securing additional water supplies and/or providing information to ADWR that would allow ADWR to issue a new decision that CCWC's current and committed demands are within the proven available supplies in CCWC's assured water supply account. The ADWR letter is part of a routine administrative review of all water providers. ADWR's review will have no impact on CCWC's ability to deliver water to its existing customers.

CCWC has since undertaken actions requested by the ADWR, including (i) joining the Central Arizona Groundwater Replenishment District as a Member Service Area, (ii) submitting an application to the ADWR to modify its assured supply designation in a manner that will enable CCWC to provide water service to new real estate developments in the Town of Fountain Hills, and (iii) filing a report supporting the modification of designation of assured water supply. On April 7, 2004 ADWR issued a revised decision confirming that CCWC has demonstrated the physical, legal and continuous availability of CAP water and groundwater, consistent with the management goal, in an aggregate volume of 9,828 acre-feet per year for a minimum of 100 years which is greater than CCWC's projected demand for the calendar year 2014 of approximately 8,000 acre-feet. The 9,828 is comprised of our existing CAP allocation of 6,978 acre-feet per year, and groundwater usage of; incidental recharge credits of 500 acre-feet per year, our existing groundwater account balance of 35,829 acre-feet that would provide approximately 350 acre-feet per year for a hundred years and our Central Arizona Groundwater Replenishment District (CAGR) contract of 2,000 acre-feet per year.

Notwithstanding an assured water supply designation, CCWC's water supply may be subject to interruption or reduction, in particular owing to interruption or reduction of CAP water. In the event of interruption or reduction of CAP water, CCWC can currently rely on its well water supplies for short-term periods. However, in any event, 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. CCWC also has the physical capability to deliver water far in excess of that which is currently accounted for in CCWC's assured water supply account.

Risk Factor Summary

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

Our liquidity and earnings could be adversely affected by changes in water supply costs

Prior to November 29, 2001, we recovered certain water supply costs through a balancing account mechanism. Water supply costs include the cost of purchased water and power and groundwater production assessments. Changes in the unit costs did not directly affect earnings. The balancing account was not, however, designed to insulate our earnings against changes in supply mix. As a result, we were not permitted to recover increased costs due to increased use of purchased water, which is generally more expensive than groundwater, through the balancing account mechanism. Increased costs of this nature were only recoverable, on a prospective basis, through the filing of a general rate case.

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On November 29, 2001, the CPUC ordered us to suspend the use of the current water balancing account, and instead start a memorandum account for each offsettable expense of purchased water, purchased power and pump tax for our water service areas. Changes in water supply costs compared to the authorized amount, as well as any future authorized offset increases may directly affect our earnings. In June 2003, we received the CPUC's authorization to increase our rates to recover the pre- November 29, 2001 balance in our supply costs balancing account.

In a decision issued on June 19, 2003 for memorandum supply accounts, the CPUC concluded that our recovery of deferred water supply costs for providing water service will be reduced if we are earning more than our authorized rate of return. Pursuant to the resolution, we recently filed advice letters seeking recovery for under-collected balances of \$2.5 million for the period of November 29, 2001 through December 31, 2002, and approximately \$1.7 million for the 2003 under-collected balance. Future recovery of the under-collected balances is subject to the earning tests and the CPUC's review of the reasonableness of the cost. For more information, see the section entitled "Accounting for Supply Costs" included in Part I, Item 2 in Management's Discussion and Analysis of Financial Condition and Results of Operation.

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

Under California law, we are permitted to file for a rate increase to recover electric power costs not being recovered in current rates. Increases in electric power costs generally have no direct impact on profit margins, unless recovery of these costs is disallowed, but do affect cash flows and can therefore impact the amount of our capital resources. Electric power costs increased substantially in California during the fall of 2000 until the summer of 2001. On July 17, 2002, the FERC extended and modified the mitigation measures that were set to expire on September 30, 2002, citing delays in construction of new generation resources in California and throughout the West, delays in adopting a new market design and market rules by the Cal ISO, transmission line constraints, constraints on natural gas pipeline capacity and continuing dysfunctions in the power market. It remains unclear how long the FERC will leave its mitigation measures in place. The premature termination of such mitigation measures could result in a substantial increase in spot market prices and the prices of long-term contracts for power and capacity. In addition, a number of market reforms are under consideration at FERC. Certain of these reforms, if adopted, could result in significantly increased electric supply reserve requirements that have the potential for further cost increases.

On July 17, 2002, the CPUC approved a settlement authorizing us to include \$0.077 per kilowatt-hour (KWh) in rates to recover electric power costs at our Bear Valley Electric operation. If our actual annual costs exceed this amount, we cannot recover the excess and the amount will be expensed against income. If our actual annual energy costs are less than \$0.077 per KWh, we can use this difference to collect amounts previously included in the balancing account. The CPUC also has authorized SCW to collect a surcharge from its customers of 2.2¢ per Kwh for a period through August 2011, to enable SCW to recover the under-collection in its balancing account arising out of the energy crisis. SCW anticipates that the 2.2¢ surcharge on its electricity sales during this period will be sufficient to enable SCW to recover the amount of this under-collection, with interest.

In March 2001, SCW entered into a five-year nine-month, block forward purchase contract with Mirant Marketing to supply its Bear Valley Electric customer service area with 15 MWs of electric energy at a price of \$95 per MWh beginning April 1, 2001 through December 31, 2006. Effective November 2002, SCW entered into a series of purchase power contracts with PWCC. The purchased power agreements with PWCC enable SCW to purchase a contractual volume of power at \$74.65 per megawatt hour (MWh). SCW also buys additional energy from the spot market to meet peak demand and sell surplus power to the spot market from time to time. SCW should be able to recover these costs up to the annual recovery cap of \$77 per MWh, unless the CPUC determines that the costs incurred by SCW

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for purchasing power are not reasonable. The CPUC has not yet reviewed the purchased power agreements with PWCC or SCW's spot market practices for reasonableness.

Significant claims have been asserted against us in water quality litigation

SCW and others have been sued in twenty-two water quality related lawsuits alleging personal injury and property damage as a result of the delivery of water that was allegedly contaminated. Nineteen of the lawsuits involve plaintiffs who received water from two groundwater basins in Los Angeles County. The other lawsuits involve plaintiffs in Sacramento County.

In March 1998, the CPUC issued an Order Instituting Investigation as a result of water quality lawsuits being filed against water utilities in California. On November 2, 2000, the CPUC issued a final order concluding that (i) the CPUC has jurisdiction to regulate the service of water utilities with respect to the health and safety of that service; (ii) DOHS requirements governing drinking water quality adequately protect the public health and safety; and (iii) regulated water utilities, including SCW, have satisfactorily complied with past and present drinking water quality requirements.

On February 5, 2002, the California Supreme Court ruled that water utilities regulated by the CPUC may only be sued for damages based on allegations and ultimate proof that the utility failed to comply with federal and state safe drinking water requirements. As a result, plaintiffs may proceed on their claims against SCW to the extent that these claims are based on violations of federal and state law.

Persons that are potentially responsible for causing the contamination of groundwater supplies have also been increasingly asserting claims against water distributors on a variety of theories and have thus far successfully brought them within the class of potentially responsible parties thereby increasing the costs of seeking recovery from the potentially responsible parties and the risks associated with seeking recovery of these costs. Management believes that rate recovery, proper insurance coverage and reserves are in place to insure against these claims.

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

Our operations have been impacted by groundwater contamination in certain of our service territories. We have taken a number of steps to address this contamination, including the removal of wells from service, the construction of water treatment facilities and securing alternative sources of supply from other areas not affected by the contamination.

In some cases, potentially responsible parties have reimbursed us for our costs. In other cases, we have taken legal action against parties that we believe to be potentially responsible for the contamination. To date, the CPUC has also permitted SCW to establish memorandum accounts for recovery of these types of costs.

Environmental regulation has increased, and is expected to continue to increase our operating costs

SCW and CCWC are subject to increasingly stringent environmental regulations that will result in increasing capital and operating costs. These regulations include:

- The 1996 amendments to the Safe Drinking Water Act that require increased testing and treatment of water to reduce specified contaminants to maximum contaminant levels
- Approved regulations requiring increased surface-water treatment to decrease the risk of microbial contamination; these regulations affect SCW's five surface water treatment plants and two CCWC plants

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- Additional regulation of disinfection/disinfection byproducts
- Additional regulations requiring disinfection of certain groundwater systems
- Regulation of arsenic and radon
- Changes in the action level and the proposed adoption of maximum contamination levels for perchlorate and other by products of the production of rocket fuel

SCW and CCWC may be able to recover costs incurred to comply with these regulations through the ratemaking process. In a recent rate case, the CPUC has authorized SCW to establish a memorandum account for future recovery of costs associated with compliance and remediation. We may also be able to recover certain of these costs under our contractual arrangements with municipalities. In certain circumstances, we may be able to recover costs from parties responsible or potentially responsible for contamination, either voluntarily or through specific court action.

The adequacy of our water supplies depends upon a variety of factors beyond our control

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

- Rainfall
- Availability of Colorado River water and imported water from northern California
- The amount of water stored in reservoirs and groundwater basins
- The amount of water used by our customers and others
- Water quality
- Legal limitations on use

Population growth and increases in the amount of water used have increased limitations on use to prevent over-drafting of groundwater basins. The importation of water from the Colorado River, one of SCW's important sources of supply, is expected to decrease in future years due to the requirements of the Central Arizona Project ("CAP") and other limitations on the amount of water that the Metropolitan Water District of Southern California is entitled to take from the Colorado River. We have also taken wells out of service due to groundwater contamination. MWD is expected to increase its efforts to secure additional supplies from conservation, desalination and water exchanges with the agricultural water users.

CCWC obtains its water supply from operating wells and from the Colorado River through the CAP. CCWC's water supply may be subject to interruption or reduction if there is an interruption or reduction in CAP water. 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 its assured water supply account.

Water shortages may affect us in a variety of ways:

- They adversely affect supply mix by causing us to rely on more expensive purchased water.
- They adversely affect operating costs.
- They may result in an increase in capital expenditures for building pipelines to connect to alternative sources of supplies and reservoirs and other facilities to conserve or reclaim water.

We may be able to recover increased operating and construction costs for our regulated systems through the ratemaking process. We may also be able to recover certain of these costs from third parties that may be responsible, or potentially responsible, for groundwater contamination.

Our earnings are greatly affected by weather during different seasons

The demand for water and electricity varies by season. Therefore, the results of operations for one period may not indicate results to be expected in another period. For instance, most water consumption occurs during the third quarter of each year when weather tends to be hot and dry. On warm days, use of water by residential and commercial customers may be significantly greater than on cold days because of the increased use of water for outdoor landscaping. Likewise the demand for electricity in our Bear Valley Electric service area is greatly affected by winter snows. An increase in winter snows reduces the use of snow making machines at ski resorts in the Big Bear area and, as a result reduces electric revenues. Likewise, unseasonably warm weather during a skiing season may result in temperatures too high for snowmaking conditions which also reduces electric revenues.

Variability of weather from normal temperatures or changes in snow or rainfall can materially impact results of operations. As a result, weather has been and will continue to be one of the dominant factors in our financial performance.

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 that we are permitted to charge our customers and our ability to recover our costs in these rates on a timely basis, including the ability to recover the costs of purchased water, groundwater assessments and electric power costs in rates. We have filed for increased water rates to recover operating costs from customers in all our water regions as well as for costs associated with general office activities, but have been experiencing increasing delays in the processing of our applications. In addition, we will be seeking CPUC authorization to recover in rates for constructing an 8.4 MW natural gas-fueled generator facility to meet increasing demand in our Bear Valley customer service area.

The CPUC's resolution ordering SCW to suspend the use of the current water balancing account, and instead to start a memorandum account for its supply costs has and will directly impact our earnings since the recovery of deferred water supply costs is reduced if we are earning an amount in excess of our authorized rate of return. We have also been adversely affected by electric restructuring in California and the limitations that have been placed on our ability to recover these costs in rates.

Our costs have increased as a result of increasing environmental regulation, requirements to increase security at our water facilities and requirements to mitigate fire hazard risks in our Bear Valley Electric service area arising out of the drought and a major bark beetle infestation.

The regulatory authority's decision can impact prospective revenues and earnings as well as overturning past decisions.

Our business requires significant capital expenditures

The utility business is capital intensive. On an annual basis, we spend significant sums for additions to or replacement of property, plant and equipment. During the three months ended March 31, 2004 and 2003, Registrant spent \$13,399,000 and \$8,409,000, respectively, for these purposes. Our net budgeted capital expenditures for calendar year 2004 for these purposes are approximately \$61.7 million. There is no capital expenditure for environmental control facilities budgeted for 2004.

We obtain funds for these capital projects from operations, contributions by developers and others and advances from developers (which must be repaid). We also periodically borrow money or issue

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equity for these purposes. In addition, we secured a syndicated bank facility that we can use for these purposes. We cannot assure you 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.

New Accounting Pronouncements

Registrant is subject to newly issued as well as changes in existing requirements issued by the Financial Accounting Standard 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 7* of Notes to Consolidated Financial Statements.

Item 3. 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. There have been no material changes regarding Registrant's market risk position from the information provided in its Annual Report on Form 10-K for the year ended December 31, 2003. The quantitative and qualitative disclosures about market risk are discussed in *Item 7A-Quantitative and Qualitative Disclosures About Market Risk*, contained in Registrant's Annual Report on Form 10-K.

Item 4. Controls and Procedures

As of the end of the period covered by this report, Registrant carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15(b) and 15d-15(b) under the Exchange Act. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective. There were no significant changes in the Company's internal controls over financial reporting or in other factors identified in connection with this evaluation that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

Item 1. Legal Proceedings

Water Quality-Related Litigation

SCW is a defendant in twenty-two lawsuits involving claims pertaining to water quality. Nineteen of the lawsuits involve customer service areas located in Los Angeles County that have been filed in Los Angeles Superior Court: Robert Arenas, et al. v. Suburban Water Systems, Inc., et al., Case No. KC037559, Anthony John Bell, et al. v. City of Pomona, et al., Case No. KC038796, Adler, et al. v. Southern California Water Company, et al., Case No. BC169892, Santamaria, et al. v. Suburban Water Systems, et al., Case No. KC025995, Georgianna Dominguez et al. v. Southern California Water Company, et al., Case No. GC021657, Anderson, et al. v. Suburban Water Company, et al., Case No. KC028524, Abarca, et al. v. City of Pomona, et al., Case No. K027795, Celi, et al. v. San Gabriel Valley Water Company, Case No. GC020622, Boswell et al. v. Suburban Water Systems, et al., Case No. KC027318, Demciuc et al. v. Suburban Water Systems, et al., Case No. KC028732, Antoinette Adejare, et al. v. City of Pomona, et al., Case No. KC031096, Almelia Brooks, et al. v. Suburban Water System, et al., Case No. KC032915, Lori Alexander, et al. v. Suburban Water Systems, et al., Case No. KC031130, David Arnold, et al. v. City of Pomona, et al., Case No. KC034636, Gilda Ambrose-Dubre, et al. v. City of Pomona, et al., Case No. KC032906, Melissa Garrity Alvarado, et al. v. Suburban Water Systems et al., Case No. KC034953, Charles Alexander, et al. v. City of Pomona, et al., Case No. KC035526, Criner, et al. v. San Gabriel Valley Water Company, et al., Case No. GC021658, and Donerson, et al. v. City of Pomona, et al., Case No. KC035987. The lawsuits filed in Los Angeles County Superior Court are based on the allegations that SCW and the other defendants have provided and continue to provide plaintiffs with contaminated water from its wells, several of which are located in an area of the San Gabriel Valley that has been designated a federal superfund site, that the maintenance of this contaminated well water has resulted in contamination of the soil, subsurface soil and surrounding air with solvents and other substances, and that plaintiffs have been injured and their property damaged as a result. Three of the lawsuits involve a customer service area located in Sacramento County that have been filed in Sacramento County Superior Court: Nathaniel Allen, Jr. v. Aerojet-General Corporation, et al., Case No. 97AS06295, Daphne Adams, et al. v. Aerojet-General Corporation, et al., Case No. 98AS01025, and Wallace Andrew Pennington et al. v. Aerojet-General Corporation, et al., Case No. 00AS02622. The lawsuits filed in Sacramento County Superior Court are based on the allegations that SCW and other defendants have delivered water to plaintiffs that are contaminated with a number of chemicals, including trichloroethylene, perchloroethylene, carbon tetrachloride, perchlorate, Freon-113, hexavalent chromium and other unnamed chemicals and that plaintiffs have been injured and their property damaged as a result.

On September 1, 1999, the Court of Appeals in San Francisco held that the CPUC had preemptive jurisdiction over regulated public utilities with respect to water quality matters and ordered dismissal of a series of these lawsuits. On October 11, 1999, one group of plaintiffs appealed this decision to the California Supreme Court. On February 4, 2002, the California Supreme Court concluded that (i) the CPUC had preemptive jurisdiction over claims seeking injunctive relief and claims based on the theory that a public utility regulated by the CPUC provided unsafe drinking water even though it had complied with federal and state drinking water standards, but (ii) the CPUC did not have preemptive jurisdiction over damage claims based on allegations of violations of federal and state drinking water standards by public utilities regulated by the CPUC. As a result, damage claims based on allegations of violations of federal and state drinking water standards may proceed while the other claims must be dismissed.

In light of the breadth of plaintiff's claims, the lack of factual information regarding plaintiffs' claims and injuries, if any, the impact of the California Supreme Court decision on plaintiffs' claims and the fact that investigation is presently underway, SCW is unable at this time to determine what, if any, potential liability it may have with respect to these claims. Based upon the information currently available

to it, Registrant believes that these claims are without merit and intends to vigorously defend against these claims.

SCW is subject to self-insured retention provisions in its applicable insurance policies and has either expensed the self-insured amounts or has reserved against payment of these amounts as appropriate. SCW's various insurance carriers have, to date, provided reimbursement for costs incurred above the self-insured amounts for defense against these lawsuits, subject to a reservation of rights.

Order Instituting Investigation (OII)

In March 1998, the CPUC issued an OII to regulated water utilities in the state of California, including SCW. The purpose of the OII was to determine whether existing standards and policies regarding drinking water quality adequately protect the public health and whether those standards and policies were being uniformly complied with by those water utilities. On November 2, 2000, a final decision from the CPUC concluded that the CPUC has the jurisdiction to regulate the service of water utilities with respect to the health and safety of that service; that the DOHS requirements governing drinking water quality adequately protect the public health and safety; and that, based on an extensive review of 25 years of water quality records, regulated water utilities, including SCW, have satisfactorily complied with past and present drinking water quality requirements, except for one small unrelated water utility in Northern California.

The CPUC had previously authorized establishment of memorandum accounts to capture expenses related to the OII. Under the memorandum account procedure, SCW may recover litigation costs from ratepayers to the extent authorized by the CPUC. As of March 31, 2004, SCW has incurred a net cost of \$890,000 related to the OII. In a decision issued by the CPUC on March 16, 2004, SCW is allowed to recover the cost through a special condition surcharge over a twelve-month period.

Other Water Quality Litigation

On October 25, 1999, SCW sued Aerojet-General Corporation (Aerojet) for causing the contamination of eastern portions of the Sacramento County groundwater basin. On October 10, 2003 Registrant entered into a confidential memorandum of understanding (MOU) with the Aerojet-General subsidiary of GenCorp, Inc. for the settlement of legal actions brought by SCW. The MOU sets forth the present financial terms and the structure of a settlement to cover, over time, capital and litigation related costs incurred by SCW resulting from the contamination. The MOU and the settlement embodied therein was found to be binding by the Sacramento Superior Court on January 18, 2004. Further documentation incorporating the terms of the MOU is presently underway. However, documentation is not complete and management is presently unable to predict when a comprehensive set of settlement documents will be completed.

Based on the financial terms in the MOU, SCW established a receivable from Aerojet in an amount of \$16.7 million for capital project and purchased water reimbursements at the end of 2003, of which \$8.7 million has been received in early 2004. The remainder of the costs is subject to further settlement documentation. Reimbursements received from Aerojet have been applied directly to reduce SCW's costs of utility plant and purchased water. Prior to the MOU, Aerojet had reimbursed SCW \$4.3 million in capital costs and \$171,000 for additional water supply.

In an action related to the draft settlement agreement, Registrant and Aerojet have signed three separate agreements requiring Aerojet to pay for certain infrastructure and upgrades to Registrant's Coloma Treatment Plant as a contingency plan should additional wells be impacted prior to the high summer demand period of 2004. The value of the three agreements approximates \$6.8 million in capital improvements. In addition, SCW is in negotiations with the County of Sacramento regarding a replacement of water supply.

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The CPUC has previously authorized memorandum accounts to allow for recovery, from customers, of costs incurred by SCW in prosecuting the suits filed against the State and Aerojet, less any recovery from the defendants or others. As of March 31, 2004, approximately \$16.3 million in legal and consulting related costs has been recorded as deferred charges and included as "Regulatory Assets" on the balance sheets. The CPUC has authorized SCW to increase rates, effective April 28, 2001, for recovery over a six-year period of approximately \$1.8 million in expenses that were incurred on or before August 31, 2000, in the Aerojet matter. As part of an abbreviated application for SCW's Region I, SCW requested a long-term amortization of the balance of costs included in the Aerojet litigation memorandum account, net of any reimbursement amount. The draft agreement with Aerojet also addresses the possible recovery of SCW's deferred charges through revenues in new development areas. Management believes these costs are recoverable through rates; however, proceeds from any settlement agreement with Aerojet would be applied to reduce amounts collected from customers. Management cannot give assurance that the CPUC will ultimately allow recovery of all or any of these costs. See the section entitled "*Regulatory Matters*" and "*Environmental Matters*" in Part I, Item 2 in Management's Discussion and Analysis of Financial Conditions and Results of Operation.

The compound MTBE has been detected in a well serving SCW's Los Osos water system. For some time SCW has been working with the Regional Water Quality Control Board as well as the owner of a service station. Although the owner of the service station has attempted remediation with funds provided through the California Underground Storage Tank Fund ("CUSTF"), it appears there will be insufficient funds from the CUSTF to complete remediation sufficient to return the well to service. In order to prevent the running of the statute of limitations, on August 12, 2002 SCW filed suit in the Superior Court of the State of California for the County of San Luis Obispo against the operators and owners of the service station facility, and Chevron USA Products, Inc., the supplier. A settlement with Chevron has been reached and a filing has been made for dismissal by the Court. SCW has dismissed all other parties. The impacted well may need to be removed permanently from service and the settlement with Chevron is expected to afford SCW sufficient funds to commence site development and construction of a replacement well.

Perchlorate and/or Volatile Organic Compounds (VOC) have been detected in five wells servicing SCW's San Gabriel System. SCW filed suit, along with two other affected water purveyors and the San Gabriel Basin Water Quality Authority (WQA), in the federal court against some of those responsible for the contamination. Some of the other potential defendants settled with SCW, other water purveyors and the WQA on VOC related issues prior to the filing of the lawsuit. In response to the filing of the Federal 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 defendant's motions. A key ruling of the court was that the water purveyors, including the Registrant, by virtue of their ownership of wells contaminated with hazardous chemicals are themselves PRPs under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). Registrant 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 the future costs associated with the treatment of these wells.

On August 29, 2003, the US Environmental Protection Agency issued Unilateral Administrative Orders ("UAO") against 41 parties deemed responsible for polluting the groundwater in that portion of the San Gabriel Valley from which SCW's two impacted wells draw water. SCW was not named as a party to the UAO. The UAO requires that these parties remediate the contamination. As a result of the issuance of the UAO, these parties have begun settlement discussions regarding the Federal lawsuits with SCW, the other two affected water purveyors and WQA. Registrant is presently unable to predict the ultimate outcome of these settlement discussions.

MCO Properties, Inc., a real estate developer (MCO), has filed a complaint against AWR and CCWC in the Superior Court of Maricopa County (CV 2003-011184) on June 6, 2003 alleging breach of

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contract, breach of the implied covenant of good faith and fair dealing, interference with prospective economic advantage, negligence and negligent misrepresentation and seeking a declaratory judgment. The complaint arises out of allegations by MCO that AWR has failed to comply with the terms of the Stock Purchase Agreement between MCO and AWR pursuant to which AWR acquired CCWC from MCO and has thereby interfered with MCO's ability to develop its real property in the Town of Fountain Hills. A revised complaint was filed on December 12, 2003 further alleging that CCWC has not maintained its designation of assured supply as required in the Stock Purchase Agreement. Similar allegations have been filed by MCO against CCWC with the Arizona Corporation Commission (Docket No. W-02113A-3-0383). A settlement agreement between CCWC and MCO was executed which dismisses all claims. In addition, CCWC has undertaken actions requested by the Arizona Department of Water Resources (ADWR), including (i) joining the Central Arizona Groundwater Replenishment District as a Member Service Area, (ii) submitting an application to the ADWR to modify its designation of assured supply that revised its assured water supply designation in a manner that will enable CCWC to provide water service to new real estate developments in the Town of Fountain Hills, and (iii) filing a report supporting the modification of designation of assured water supply. On April 7, 2004 ADWR issued a revised decision confirming that CCWC has the physical, legal and continuous availability of Central Arizona Project water and groundwater for 100 years, in excess of its projected demands through 2014.

For further information on CCWC's assured water supply designation, see "Item 2. Management's Discussion and Analysis of Financial Conditions and Results of Operation-Water Supply-CCWC's Water Supply".

Electric Service Litigation

SCW has been, in conjunction with the Southern California Edison (Edison) unit of Edison International, planning to upgrade transmission facilities to 115kv (the 115kv Project) in order to meet increased energy and demand requirements for SCW's Bear Valley Electric service area. On December 27, 2000, SCW filed a lawsuit against Edison for declaratory relief and seeking damages for breach of contract as a result of delays in the 115kv Project, violations of good faith and fair dealing, negligent misrepresentation, intentional misrepresentation and unjust enrichment. Subsequently Edison filed a cross-complaint against SCW for breach of contract, anticipatory breach, and quantum meruit. SCW has also sought declaratory relief from Edison's claims. To date, SCW has spent approximately \$3.4 million in this matter, all of which has been expensed. A settlement has been reached between SCW and Edison, in which (i) SCW is to pay Edison \$5.0 million as the cost of abandoning and terminating the 115kv Project, (ii) Edison shall make a filing with the Federal Energy Regulatory Commission (FERC) to include the cost in a FERC rate schedule under the Transmission Service Agreement between SCW and Edison, and (iii) Edison is to sell the Goldhill substation and associated transmission line to SCW at its book value. Management believes that the FERC's approval on Edison's filing is probable and this cost is within the meaning of the CPUC's Code of "Abandonment Fee" which is recoverable through the supply cost balancing account. As a result, the \$5.0 million obligation to Edison arising from the settlement was recorded as a liability and a regulatory asset in the fourth quarter of 2003, of which \$1.4 million was paid in the first quarter of 2004. A final settlement agreement was reached on March 17, 2004.

Other Litigation

Registrant is also subject to ordinary routine litigation incidental to its business. Other than as disclosed above, no other legal proceedings are pending, which are believed to be material. 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.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

- (a) None
- (b) None
- (c) None
- (d) None
- (e) None

Item 3. Defaults Upon Senior Securities

Registrant maintains a \$75 million revolving credit facility maturing in June 2005. Total borrowings outstanding under this credit facility amounted to \$47 million at March 31, 2004 included in current liabilities. The credit agreement for this facility includes, among other things, certain financial covenants. One of those covenants is maintenance of an interest coverage ratio of at least 3.25x, as defined and calculated in the credit agreement, based on trailing twelve-month results. The Company violated this interest coverage ratio for the trailing twelve-month period ended March 31, 2004 and has requested and received a waiver from its lending syndicate, which excludes in the calculation, certain charges booked by SCW following certain CPUC decisions. The waiver cured the default at March 31, 2004 and allowed for the exclusion of those charges from the calculation of the trailing twelve-month interest coverage ratio through September 30, 2004.

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

No items were submitted during the first quarter of the fiscal year covered by this report to a vote of security holders through the solicitation of proxies or otherwise. However, on or about April 2, 2004, common and preferred shareholders of AWR were mailed a Notice of Annual Meeting and a Proxy Statement. Shareholders were requested to vote their shares to: (1) elect four Class II directors to the Board of Directors to serve until their successors are elected and qualified; (2) approve the 2003 Non-Employee Directors Stock Plan; (3) ratify the appointment of PricewaterhouseCoopers, LLP as the independent auditors; and (4) to transact any other business, which may properly come before the meeting or any adjournment thereof.

The Annual Meeting of Shareholders will be held on May 11, 2004.

Item 5. Other Information

On April 27, 2004, the Board of Directors of Registrant declared a regular quarterly dividend of \$0.221 per common share. The dividend will be paid June 1, 2004 to shareholders of record as of the close of business on May 10, 2004.

Item 6. Exhibits and Reports on Form 8-K

(a) The following documents are filed as Exhibits to this report:

- 10.25 Amendment No. 2 to the Credit Agreement between American States Water Company dated April 29, 2004 with Wells Fargo Bank, N.A., as Administrative Agent ⁽¹⁾
- 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 ⁽¹⁾
- 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 ⁽¹⁾
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ⁽²⁾
- 32.2 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 ⁽²⁾

⁽¹⁾ Filed concurrently herewith

⁽²⁾ Furnished concurrently herewith.

(b) Registrant filed a Form 8-K with the Securities and Exchange Commission (SEC) dated March 17, 2004 under Item 12. No financial statements were filed with this report.

SIGNATURE

Pursuant to the requirements of Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized and as its principal financial officer.

AMERICAN STATES WATER COMPANY
and its subsidiary

SOUTHERN CALIFORNIA WATER COMPANY

By: /s/ McClellan Harris III
McClellan Harris III
Senior Vice President-Finance, Chief Financial Officer,
Treasurer and Corporate Secretary

Dated: May 10, 2004

**AMENDMENT NO. 2
TO CREDIT AGREEMENT**

This Amendment No. 2 to Credit Agreement (this "Amendment"), dated as of April 29, 2004, is entered into with reference to the Credit Agreement (as amended, supplemented or otherwise modified from time to time, the "Credit Agreement") dated as of June 6, 2002 among American States Water Company, a California corporation ("Borrower"), each lender from time to time a party thereto (each a "Lender" and collectively, the "Lenders"), and Wells Fargo Bank, National Association, as Administrative Agent (in such capacity, the "Administrative Agent") and Lead Arranger. Capitalized terms not otherwise defined herein shall have the meanings set forth for such terms in the Credit Agreement. Section references herein are to sections of the Credit Agreement unless otherwise indicated.

Borrower and the Administrative Agent, acting with the consent of the Requisite Lenders, hereby agree as follows:

1. Waiver.(a) Borrower hereby acknowledges that an Event of Default under Section 6.13 of the Credit Agreement has occurred with respect to Borrower's Interest Coverage Ratio for the Rolling Periods ended December 31, 2003 and March 31, 2004 (such defaults being referred to as the "Existing Defaults"). According to financial information provided to Administrative Agent by Borrower for the Rolling Periods ended on such dates, Borrower's Interest Coverage Ratio was 3.13:1.00 and 3.00:1.00, respectively. Section 6.13 of the Credit Agreement requires that the Borrower's Interest Coverage Ratio for such periods be not less than 3.25:1.00.

(b) As of the Amendment No. 2 Effective Date, as defined below, the Administrative Agent and the Lenders hereby irrevocably waive the Existing Defaults. The waivers set forth herein are one time waivers only and shall pertain solely to the matters set forth herein. These waivers shall in no way be construed to waive any rights or remedies that the Lenders or the Administrative Agent may have with respect to any other Default or Event of Default under the Credit Agreement or the other Loan Documents. Borrower should not assume that because no remedial action has been taken as of the date hereof, that default rights and remedies will not be exercised in the future with respect to any such other Default or Event of Default.

2. Section 6.13 — Interest Coverage Ratio. Solely for the Rolling Periods ending June 30, 2004 and September 30, 2004 (collectively, the "Amended Periods"), and solely with respect to the calculation of the Interest Coverage Ratio for such Amended Periods, the one-time "Refund of Water Rights Lease Revenues" related to the "City of Folsom Lease" (as more specifically described in the Annual Report on Form 10-K of Borrower for the Fiscal Year ended December 31, 2003), shall be added to Net Income (but only to the extent that such amount was deducted from the determination of Net Income for such periods) for purposes of calculating EBITDA for such Amended Periods. For all Rolling Periods ending subsequent to September 30, 2004, the Interest Coverage Ratio shall be calculated as set forth in the Credit Agreement without regard to the provisions of this Section 2.

3. Effectiveness. This Amendment shall become effective on such date as the Administrative Agent shall have received each of the following in form and substance satisfactory to the Administrative Agent (the "Amendment No. 2 Effective Date"):

- (a) duly executed counterparts of this Amendment executed by the parties hereto;
- (b) written consent of the Requisite Lenders as required under Section 11.2 of the Credit Agreement in the form of Exhibit A to this Amendment; and
- (c) such other assurances, certificates, documents or consents related to the foregoing as the Administrative Agent or any Lender may reasonably request.

4. Representations and Warranties. Except (i) for representations and warranties which expressly speak as of particular date or are no longer true and correct as a result of a change permitted by the Credit Agreement or the other Loan Documents or (ii) as disclosed by Borrower and approved in writing by the Requisite Lenders, and giving effect to the waiver herein contained, Borrower hereby represents and warrants that each representation and warranty made by Borrower in Article 4 of the Credit Agreement (other than Sections 4.4, 4.6 (first sentence), 4.9 and 4.16) are true and correct as of the date hereof as though such representations and warranties were made on and as of the date hereof. Without in any way limiting the foregoing, Borrower represents and warrants to the Administrative Agent and the Lenders that, giving effect to the waiver herein contained, no Default or Event of Default has occurred and remains continuing or will result from the amendments or transactions set forth herein or contemplated hereby.

5. Confirmation. In all respects, the terms of the Credit Agreement and the other Loan Documents, in each case as amended hereby or by the documents referenced herein, are hereby confirmed.

[THIS SPACE INTENTIONALLY LEFT BLANK-

SIGNATURE PAGES TO FOLLOW]

IN WITNESS WHEREOF, Borrower and the Administrative Agent, acting with the consent of the Requisite Lenders, have executed this Agreement as of the date first set forth above by their duly authorized representatives.

AMERICAN STATES WATER COMPANY,
a California corporation

By: /s/ MCCLELLAN HARRIS III

Name: McClellan Harris III
Title: Sr. Vice President — Finance
Chief Financial Office, Treasurer & Secretary

By: /s/ FLOYD E. WICKS

Name: Floyd E. Wicks
Title: President & CEO

WELLS FARGO BANK, NATIONAL
ASSOCIATION,
as Administrative Agent

By: /s/ ANTHONY TURNER

Name: Anthony Turner
Title: Vice President

Exhibit A

CONSENT OF LENDER

Reference is hereby made to that certain Credit Agreement dated as of June 6, 2002 (as amended, the "Credit Agreement") among American States Water Company, a California corporation ("Borrower"), each lender from time to time a party thereto (each a "Lender" and collectively, the "Lenders"), and Wells Fargo Bank, National Association, as Administrative Agent (in such capacity, the "Administrative Agent") and Lead Arranger. Capitalized terms used but not defined herein are used with the meanings set forth for those terms in the Credit Agreement.

The undersigned Lender hereby consents to the execution and delivery of Amendment No. 2 to Credit Agreement by the Administrative Agent on its behalf, substantially in the form of the draft dated April 29, 2004 presented to the undersigned Lender.

Date: April 29, 2004

Wells Fargo Bank, National Association

By: /s/ ANTHONY TURNER

Anthony Turner
Vice President

Exhibit-A

Exhibit 31.1

***Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(18 U.S.C. Section 1350)***

I, Floyd E. Wicks, Chief Executive Officer, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2004 of American States Water Company and of Southern California Water Company (both referred to as "the Registrant");
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
- 4) The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting.
- 5) The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls over financial reporting.

Dated: May 10, 2004

By: /s/ FLOYD E. WICKS
Floyd E. Wicks
Chief Executive Officer

Exhibit 31.2

***Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
(18 U.S.C. Section 1350)***

I, McClellan Harris III, Chief Financial Officer, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q for the period ended March 31, 2004 of American States Water Company and of Southern California Water Company (both referred to as "the Registrant");
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Registrant as of, and for, the periods presented in this report;
- 4) The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the Registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter (the Registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the Registrant's internal control over financial reporting.
- 5) The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls over financial reporting.

Dated: May 10, 2004

By: /s/ McCLELLAN HARRIS III
McClellan Harris III
Chief Financial Officer, Senior Vice
President-Finance, and Corporate Secretary

Exhibit 32.1

***Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(18 U.S.C. Section 1350)***

I, Floyd E. Wicks, Chief Executive Officer of American States Water Company and Southern California Water Company (the "Registrant"), do hereby certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), that, to my knowledge:

- (1) the Quarterly Report on Form 10-Q of the Registrant for the quarter ended March 31, 2004, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Registrant.

/s/ Floyd E. Wicks

Floyd E. Wicks
Chief Executive Officer

Date: May 10, 2004

Exhibit 32.2

***Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
(18 U.S.C. Section 1350)***

I, McClellan Harris III, Chief Financial Officer of American States Water Company and Southern California Water Company (the "Registrant"), do hereby certify, pursuant to § 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350), that, to my knowledge:

- (1) the Quarterly Report on Form 10-Q of the Registrant for the quarter ended March 31, 2004, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Registrant.

/s/ McClellan Harris III

McClellan Harris III
Chief Financial Officer

Date: May 10, 2004