

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2002  
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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 1-13883

CALIFORNIA WATER SERVICE GROUP

-----  
(Exact name of registrant as specified in its charter)

Delaware

77-0448994

-----  
(State or other jurisdiction (I.R.S. Employer identification No.)  
of incorporation or organization)

1720 North First Street, San Jose, CA.

95112

-----  
(Address of principal executive offices)

(Zip Code)

1-408-367-8200

-----  
(Registrant's telephone number, including area code)

Not Applicable

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

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

APPLICABLE ONLY TO ISSUES INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No  
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APPLICABLE ONLY TO CORPORATE ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE LAST FIVE YEARS

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. Common shares outstanding as of July 31, 2002 - 15,182,046.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

The financial information presented in this 10Q filing has been prepared by management and has not been audited.

CONDENSED CONSOLIDATED BALANCE SHEET

(In thousands, except per share data)	June 30, 2002	December 31, 2001
	-----	-----
<b>ASSETS</b>		
Utility plant:		
Utility plant	\$ 939,619	\$ 909,658
Less accumulated depreciation and amortization	295,824	285,316
	-----	-----
Net utility plant	643,795	624,342
	-----	-----
Current assets:		
Cash and cash equivalents	1,185	953
Receivables	28,507	22,800
Unbilled revenue	10,076	7,291
Materials and supplies at average cost	2,606	2,147
Taxes and other prepaid expenses	4,649	7,224
	-----	-----
Total current assets	47,023	40,415
	-----	-----
Other assets:		
Regulatory assets	39,324	38,893
Other assets	10,230	6,564
	-----	-----
Total other assets	49,554	45,457
	-----	-----
	\$ 740,372	\$ 710,214
	=====	=====
<b>CAPITALIZATION AND LIABILITIES</b>		
Capitalization:		
Common stock, \$.01 par value	\$ 152	\$ 152
Additional paid-in capital	49,984	49,984
Retained earnings	147,267	147,299
Accumulated other comprehensive loss	(816)	(816)
	-----	-----
Total common stockholders' equity	196,587	196,619
Preferred stock	3,475	3,475
Long-term debt, less current maturities	222,290	202,600
	-----	-----
Total capitalization	422,352	402,694
	-----	-----
Current liabilities:		
Current maturities of long-term debt	5,381	5,381
Short-term borrowings	24,000	22,000
Accounts payable	27,242	24,032
Accrued expenses and other liabilities	25,729	27,576
	-----	-----
Total current liabilities	82,352	78,989
	-----	-----
Unamortized investment tax credits	2,882	2,882
Deferred income taxes	31,252	28,816
Regulatory and other liabilities	20,656	20,680
Advances for construction	108,956	106,657
Contributions in aid of construction	71,922	69,496
Commitments		
	-----	-----
	\$ 740,372	\$ 710,214
	=====	=====

See Notes to Condensed Consolidated Financial Statements

CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATED STATEMENT OF INCOME  
(In thousands, except per share data)

For the three months ended:	June 30, 2002	June 30, 2001
	-----	-----
Operating revenue	\$ 69,183	\$ 66,958
	-----	-----
Operating expenses:		
Operations	45,436	44,733
Maintenance	2,935	3,106
Depreciation and amortization	5,389	4,777
Income taxes	4,573	3,790
Property and other taxes	2,551	2,502
	-----	-----
Total operating expenses	60,884	58,908

	-----	-----
Net operating income	8,299	8,050
Other income and expenses		
Other income, net	614	632
Gain on the sale of non-utility assets+B60	1,922	1,177
	-----	-----
	2,536	1,809
	-----	-----
Income before interest expense	10,835	9,859
	-----	-----
Interest expense:		
Long-term debt interest	3,837	3,509
Other interest	380	586
	-----	-----
Total interest expense	4,217	4,095
	-----	-----
Net income	\$ 6,618	\$ 5,764
	=====	=====
Earnings per share		
Basic	\$ 0.43	\$ 0.38
	=====	=====
Diluted	\$ 0.43	\$ 0.37
	=====	=====
Weighted average shares outstanding		
Basic	15,182	15,182
	=====	=====
Diluted	15,185	15,193
	=====	=====
Dividends per share of common stock	\$0.28000	\$0.27875
	=====	=====

See Notes to Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATED STATEMENT OF INCOME  
(In thousands, except per share data)

For the six months ended:	June 30,	June 30,
	2002	2001
	-----	-----
Operating revenue	\$120,794	\$113,966
	-----	-----
Operating expenses:		
Operations	80,210	77,853
Maintenance	5,355	5,845
Depreciation and amortization	10,783	9,593
Income taxes	5,852	3,932
Property and other taxes	5,014	4,901
	-----	-----
Total operating expenses	107,214	102,124
	-----	-----
Net operating income	13,580	11,842
Other income and expenses		
Other income, net	1,067	926
Gain on the sale of non-utility assets	1,974	1,276
	-----	-----
	3,041	2,202
	-----	-----
Income before interest expense	16,621	14,044
	-----	-----
Interest expense:		
Long-term debt interest	7,368	7,026
Other interest	706	1,033
	-----	-----
Total interest expense	8,074	8,059
	-----	-----
Net income	\$ 8,547	\$ 5,985
	=====	=====
Earnings per share		
Basic	\$ 0.56	\$ 0.39
	=====	=====
Diluted	\$ 0.56	\$ 0.39
	=====	=====
Weighted average shares outstanding		
Basic	15,182	15,182

Diluted	=====	=====
	15,185	15,187
	=====	=====
Dividends per share of common stock	\$0.56000	\$0.55750
	=====	=====

See Notes to Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
(In thousands)

<TABLE>  
<CAPTION>  
For the six months ended:

	June 30, 2002	June 30, 2001
	-----	-----
<S>	<C>	<C>
Operating activities		
Net income	\$ 8,547	\$ 5,985
	-----	-----
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,783	9,593
Deferred income taxes, investment tax credits		
regulatory assets and liabilities, net	1,981	271
Gain on sale of non-utility assets	(1,974)	(1,276)
Changes in operating assets and liabilities:		
Receivables	(5,707)	(6,060)
Unbilled revenue	(2,785)	(1,790)
Taxes and other prepaid expenses	2,575	734
Accounts payable	3,210	3,234
Other current assets and liabilities	(2,306)	(341)
Other changes, net	(1,797)	(1,332)
	-----	-----
Net adjustments	3,980	3,033
	-----	-----
Net cash provided by operating activities	12,527	9,018
	-----	-----
Investing activities:		
Utility plant expenditures	(31,275)	(27,245)
Deposit for acquisition of Rio Grande Utilities Corp.	(2,300)	--
Proceeds from sale of non-utility assets	2,095	1,345
	-----	-----
Net cash used by investing activities	(31,480)	(25,900)
	-----	-----
Financing activities:		
Net short-term borrowings	2,000	17,402
Proceeds from long-term debt	20,000	--
Advances for construction	4,352	4,542
Refunds of advances for construction	(2,053)	(1,749)
Contributions in aid of construction	3,465	3,023
Dividends paid	(8,579)	(8,530)
	-----	-----
Net cash provided by financing activities	19,185	14,688
	-----	-----
Change in cash and cash equivalents	232	(2,194)
Cash and cash equivalents at beginning of period	953	3,241
	-----	-----
Cash and cash equivalents at end of period	\$ 1,185	\$ 1,047
	=====	=====

</TABLE>

See Notes to Condensed Consolidated Financial Statements

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CALIFORNIA WATER SERVICE GROUP  
Notes to Condensed Consolidated Financial Statements  
June 30, 2002

Note 1. Seasonal Business

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

Note 2. Interim Financial Statements

The interim financial information is unaudited. In the opinion of management, the accompanying financial statements reflect all adjustments that are necessary to provide a fair statement of the results for the periods covered. The adjustments consist only of normal recurring adjustments.

Note 3. Earnings Per Share

Basic earnings per share is calculated by dividing income available for common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by dividing income available for common stockholders by the weighted average number of common shares outstanding including potentially dilutive shares as determined by application of the Treasury Stock method. Income available for common stockholders is determined by subtracting from net income dividends paid on preferred stock which were \$38,000 for the quarters ended June 30, 2002 and 2001. For the six months ended June 30, 2002 and 2001, preferred dividends were \$76,000. The difference between basic and diluted weighted average number of common shares outstanding is the effect of dilutive common stock options outstanding.

On January 2, 2002, 55,000 new options were granted at an exercise price of \$25.15 under the Company's Long Term Incentive Plan. No options were exercised during the first six months of 2002 or 2001.

Common stock options to purchase 107,000 and 56,000 shares for the quarters ended June 30, 2002 and 2001, respectively, were excluded from the diluted per share calculation due to their anti-dilutive effect. For the six months ended June 30, 2002 and 2001, common stock options to purchase 107,000 shares in each period were excluded from the dilutive per share calculation due to their anti-dilutive effect.

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Shares used in the basic and dilutive earnings per share calculations for the three months ending June 30, 2002 were:

	In Thousands	
	2002	2001
Shares used to calculate basic earnings per share	15,182	15,182
Dilutive common stock options outstanding	3	11
	-----	-----
Shares used to calculate dilutive earnings per share	15,185	15,193
	-----	-----

Shares used in the basic and dilutive earnings per share calculations for the six months ending June 30, 2002 were:

	In Thousands	
	2002	2001
Shares used to calculate basic earnings per share	15,182	15,182
Dilutive common stock options outstanding	3	5
	-----	-----
Shares used to calculate dilutive earnings per share	15,185	15,187
	-----	-----

Note 4. Significant Accounting Policies

A summary of significant accounting policies and detailed information regarding the Company's financial statements are included in the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

Note 5. Lines of Business

The Company operates primarily in one business segment providing water utility services.

Note 6. New Accounting Standards

In July 2001, the Financial Accounting Standards Board issued Statement No. 142, "Goodwill and Other Intangible Assets". Statement 142 specifies that goodwill and intangible assets with indefinite useful lives will no longer be amortized, but instead be tested for impairment at least annually in accordance with the provisions of the statement. Statement 142 also requires that intangible assets with determinable useful lives be amortized over their useful lives to their estimated residual values, and reviewed for impairment. The Company adopted Statement No. 142 on January 1, 2002. Since the Company does not have goodwill or other intangible assets subject to Statement No. 142, its adoption did not have a material impact on the

financial position or results of operation.

In August 2001, Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," was issued. The statement sets forth requirements for measuring impairment of a long-lived asset that is defined as the condition that exists when the carrying amount of a long-lived asset exceeds its fair value. The statement also establishes criteria in which an impairment loss must be recognized. The Company adopted Statement No. 144 on January 1, 2002. Its adoption did not have a material impact on the financial position or results of operation.

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#### Note 7. Issuance of Long-term Debt

In May 2002, the Company completed the issue of the \$20 million, 7.11%, 30-year Series E Senior Notes. The notes were issued to two institutional investors under an exemption from registration in Section 4(2) of the Securities Act of 1933 ("Securities Act").

#### Note 8. Acquisition - Subsequent Events

On July 1, 2002, after receiving state regulatory approval, the Company acquired the assets of Rio Grande Utility Corporation (Rio Grande) through its wholly-owned subsidiary, New Mexico Water Service Company ("NMWSC"). The purchase includes the water and wastewater assets of Rio Grande, which serves 2,265 water and 1,600 sewer customers in unincorporated areas of Valencia County, New Mexico, located 30 miles south of Albuquerque. The purchase price was \$2,300,000 in cash, plus assumption of \$3,100,000 in outstanding debt. Rate base for the system is approximately \$5,400,000.

In June 2002, NMWSC signed an agreement to purchase National Utilities Corporation for approximately \$700,000. National Utilities serves 1,600 water customers and had 2001 revenue of \$575,000 and total assets of \$1,425,000. Its net utility plant in service at December 31, 2001 was \$1,143,000. The purchase is subject to the approval of the New Mexico Public Regulation Commission which is expected in the first quarter of 2003.

In August 2002, the Company agreed to acquire the Kaanapali Water Corporation ("KWC") for \$7.7 million in cash. KWC provides water utility services to 500 customers in Maui, Hawaii. It had 2001 revenues of \$3.3 million, and has net plant of approximately \$7.3 million and current assets of \$0.4 million. The acquisition is subject to approval of the Hawaii Public Utilities Commission which is expected in mid-2003.

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#### Item 2

#### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### FORWARD LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning established by the Private Securities Litigation Reform Act of 1995 ("Act"). The forward-looking statements are intended to qualify under provisions of the federal securities laws for "safe harbor" treatment established by the Act. Forward-looking statements are based on currently available information, expectations, estimates, assumptions and projections, and management's judgment about the Company, the water utility industry and general economic conditions. Such words as expects, intends, plans, believes, estimates, anticipates, projects or variations of such words or similar expressions are intended to identify forward-looking statements. The forward-looking statements are not guarantees of future performance. Actual results may vary materially from what is contained in a forward-looking statement. Factors which may cause a result different than expected or anticipated include: governmental and regulatory commissions' decisions, changes in regulatory commissions' policies or procedures, the timeliness of regulatory commissions' actions concerning rate relief, new legislation, electric power interruptions, increases in suppliers' prices and the availability of supplies including water and power, changes in environmental compliance requirements, acquisitions, the ability to successfully implement business plans, changes in customer water use patterns and the impact of weather on operating results, especially as it impacts water sales. The Company assumes no obligation to provide public updates of forward-looking statements.

#### CRITICAL ACCOUNTING POLICIES

The Company maintains its accounting records in accordance with accounting principles generally accepted in the United States of America and as directed by the regulatory commissions to which the Company's operations are

subject. Management believes that the following accounting policies may involve a higher degree of complexity and judgement and the use of different judgements or different assumptions on which judgements are based can cause a material change in the Company's results of operations and financial condition.

Revenue Recognition. Revenue from metered customers includes billings to customers based on monthly meter readings plus an estimate of water used between the customer's last meter reading and the end of the accounting period. The unbilled revenue amount is recorded as a current asset on the balance sheet under the caption "Unbilled Revenue." At June 30, 2002, the unbilled amount was \$10.1 million and at December 31, 2001 the amount was \$7.3 million. The amount recorded as unbilled revenue varies depending on water usage, the number of days between meter reads for each billing cycle, and the

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number of days between each cycle's meter reading and the end of the accounting cycle. The amount is generally higher during the summer months when water sales are higher.

Flat rate customers are billed in advance at the beginning of the service period. The revenue is prorated so that the portion of revenue applicable to the current accounting period is included in that period's revenue. The portion related to a subsequent accounting period is recorded as unearned revenue on the balance sheet and recognized as revenue when earned in the subsequent accounting period. The unearned revenue liability was \$1.7 million at June 30, 2002 and December 31, 2001. It is included in "accrued expenses and other liabilities" on the balance sheet.

Expense Balancing and Memorandum Accounts. Expense balancing and memorandum accounts reflect rate increases charged to the Company by suppliers for purchased water and purchased power, and pump tax increases that are not included in customer water rates. The Company does not record expense balancing or memorandum accounts in revenue, nor record a receivable until the California Public Utilities Commission ("CPUC") has authorized a change in customer rates and the customer has been billed. The cost increases tracked in expense balancing and memorandum accounts are referred to as "Offsetable Expenses" because under certain circumstances they are recoverable from customers in future rate increases designed to offset the higher costs.

In October 2001, the CPUC adopted a resolution implementing its staff's interim recommendation concerning practices and policies that enable water utilities to recover cost increases in purchased water, purchased power and pump taxes costs. The interim recommendation requires that future Company requests to recover offsetable expenses will be processed only if an operating district has filed a General Rate Case ("GRC") application within a three-year period and the district is not earning more than its authorized rate of return on a forward-looking, pro-forma basis. Neither of these requirements applied to offset rate increases prior to adoption of the resolution. The CPUC also directed its staff to open a proceeding to evaluate offsetable expense recovery practices and policies, and recommend permanent revisions. At this time, hearings to evaluate the interim recommendation have not been scheduled.

Historically, offset rate increases enabled water utilities to recover as a pass-through cost increases for offsetable expenses that were not anticipated when customer rates were established and were beyond the utility's control. Offsetable expenses incurred prior to the CPUC's adoption of the staff's interim recommendation were frozen in the balancing accounts. The Company is authorized to track offsetable expenses incurred after the CPUC's change in policy in regulatory memorandum accounts for potential recovery subject to the CPUC's future determination of appropriate practices and policies. Although the Company is hopeful that it will be authorized to recover the offsetable expenses in both the balancing and memorandum accounts, it is unable to predict the timing or amount of such recoveries. Therefore, because of the uncertainty of collection, the Company's accounting policy is not to record the expense balancing and memorandum account amounts until they are included in customer billings.

At December 31, 2001, the amount included in these accounts was \$6.5 million. At March 31, 2002 the amount was \$7.2 million and at June 30, 2002, the amount had increased to \$9.2 million. The amounts related primarily to higher electric costs incurred

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by the Company since 2001 when power rates charged to the Company by electric suppliers, as authorized by the CPUC, increased 48%. Increases in the memorandum accounts are expected to be smaller once current power rates are reflected in customer rates through future GRC decisions.

Utility Accounting. Because the Company operates extensively in a regulated business, it is subject to the provisions of Statement of Financial Accounting Standards ("SFAS") No. 71, "Accounting for the Effects of Certain Types of Regulation." Regulators establish rates that are expected to permit the recovery

of the cost of service and a return on investment. In the event a portion of the Company's operations were no longer subject to the provisions of SFAS No. 71, the Company would be required to write off related regulatory assets and liabilities that are not specifically recoverable and determine if other assets might be impaired. If a regulatory commission determined that a portion of the Company's assets were not recoverable in customer rates, the Company would be required to assess if it had suffered an asset impairment that would require a write down in the assets' valuation. There had been no asset impairment at June 30, 2002.

Income Taxes. Significant judgement by management is required in determining the provision for income taxes. The preparation of consolidated financial statements requires the estimation of income tax expense. The process involves the estimating of current tax exposure together with assessing temporary differences resulting from different treatment of certain items, such as depreciation, for tax and financial statement reporting. These differences result in deferred tax assets and liabilities, which are reported in the consolidated balance sheet. The Company must also assess the likelihood that deferred tax assets will be recovered in future taxable income, and to the extent recovery is unlikely, a valuation allowance would be recorded. If a valuation allowance were required, it could significantly increase income tax expense. In management's view, a valuation allowance is not required at June 30, 2002.

#### RESULTS OF SECOND QUARTER 2002 OPERATIONS

Second quarter net income was \$6,618,000, equivalent to \$0.43 per common share on a diluted basis compared to the \$5,764,000 or \$0.37 per share earned in 2001's second quarter.

#### Revenue

Operating revenue increased \$2,225,000 or 3% to \$69,183,000. Because of cooler weather in this year's second quarter, sales to existing customers were lower. However, revenue from rate increases and usage by 4,400 new customers offset the decline due to usage. Factors that impacted the operating revenue increase are presented in the following table:

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Lower consumption by existing customers	(\$544,000)
Rate increases	2,259,000
Usage by new customers	510,000
	-----
Net revenue increase	\$2,225,000
	=====

Revenue from rate increases includes \$730,000 for recovery of higher purchased power costs in four of the Company's 20 California districts. Recovery of power costs in the other districts was not allowed by the CPUC, but will be processed in accordance with the CPUC's procedures as described in Critical Accounting Policies section of this report.

#### Total Operating Expenses

Total operating expenses were \$60,884,000 in 2002 versus \$58,908,000 in 2001, a 3% increase.

Water production expenses, which consists of purchased water, purchased power and pump taxes, represent the largest components of total operating expenses. During the quarter, these costs accounted for 45% of total operating expenses and increased 3% compared to the second quarter last year. During the quarter, well production provided 53% of the water supply, 46% was purchased from wholesale suppliers and 1% was developed through the Company's surface water treatment plants. The components of water production costs and the changes from last year are shown in the table below:

	Second Quarter 2002 Cost	Change
	-----	-----
Purchased water	\$20,062,000	(\$73,000)
Purchased power	5,334,000	747,000
Pump taxes	1,845,000	42,000
	-----	-----
Total	\$27,241,000	\$716,000
	=====	=====

Purchased water rates increased due to wholesale suppliers' increases in six California districts. The wholesale water supplier in one district lowered rates. The amount of water purchased declined 3%. Despite the wholesale rate increases, the cost of purchased water declined slightly due to the reduction in the amount of water purchased. Purchased water cost was reduced by credits of \$670,000 received in 2002 and \$971,000 in 2001.



Purchased power, which is used to operate pumping equipment, increased 16% due to higher electric rates in effect during the second quarter of 2002. Electric power rates charged to the Company by suppliers increased 38% in May 2001. Through the first half of this year's second quarter, the higher rates resulted in increased purchased power costs. For the remainder of the quarter, rates were equivalent from year-to-year. The Company is not aware of any pending or proposed electric rate increases at this time. About 2% less water was pumped from wells during the quarter.

Labor rate increases that averaged about 3% were effective on January 1, 2002. However, total payroll charged to operations was 1% less than in the second quarter of 2001 because of a reduction in the number of employees and some payroll cost shifting to

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capital projects in support of the Company's expanded construction budget. At June 30, 2002 there were 788 employees and at June 30, 2001 there were 808 employees. Consultants were used to enhance computer technology systems during the second quarter of 2001. That cost has since been eliminated, helping to control operations expenses.

Maintenance expense decreased \$171,000 due to a reduction in unscheduled maintenance required at wells, and fewer water main and service line repairs. Scheduled maintenance during 2002 is expected to be in a range similar to the prior year.

Depreciation expense increased \$612,000 because of a larger investment in depreciable utility plant and an increase in recovery of plant investments recognized in rate proceedings.

Federal and state income taxes increased \$783,000 because of higher income including increased gains on the sale of surplus real properties.

#### Other Income

Other income and expenses was \$2,536,000 compared to \$1,809,000 in 2001. During the second quarter 2002, two surplus real estate properties were sold, adding \$1,922,000 to other income. During the second quarter of 2001, a real estate sale added \$1,177,000 to other income. Other non-regulated income from system operating agreements, antenna site leases and contract work performed for others was \$614,000 in this year's second quarter compared to \$632,000 in last year's second quarter. The decline resulted from less contract work completed for others. However, the volume of work for the full year is expected to be equivalent to last year. Income from the contract work is recorded when a project is completed.

#### Interest Expense

Total interest expense increased \$122,000. Long-term debt interest expense increased because of two additional \$20 million senior note issues that were outstanding in 2002. Borrowings under the short-term bank credit agreement were higher during the second quarter this year than in 2001. However, the interest rate on short-term debt is approximately 3.1% compared to a 5.9% rate at the end of the second quarter in 2001. The lower interest rate has offset the cost of greater borrowings.

#### RESULTS OF SIX MONTHS ENDED JUNE 30, 2002

Net income for the six months ending June 30, 2002 increased \$2,562,000 to \$8,547,000, equivalent to \$0.56 per common share on a diluted basis compared to \$0.39 on a diluted basis for the same period last year.

#### Revenue

Operating revenue increased \$6,828,000 to \$120,794,000. The higher revenue was due to increased usage by existing customers, rate increases and revenue from 2,100 new customers added during the period. Water sales in the first quarter exceeded the prior year, but during the second quarter, 2002 sales were lower than last year. The average revenue per customer increased 5% for the six-month period. A breakdown of the net increase in operating revenue is presented in the following table:

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Increased consumption by existing customers	\$2,268,000
Rate increases	3,693,000
Usage by new customers	867,000
	-----
Net revenue increase	\$6,828,000
	=====

The rate increases came from GRCs totaling \$1,565,000, step rate

increases effective at the start of the year totaling \$886,000 and power cost offset rate increases of \$1,242,000 that are effective for four districts.

#### Total Operating Expenses

Total operating expenses increased 5% over 2001.

Total water production increased 3%. Water production costs were 7% more than last year and made up 42% of total operating expenses. Well production provided 51% of the supply with 48% purchased from wholesale suppliers and 1% produced through the Company's treatment plants, the same ratios as last year.

Wholesale water rate increases from six suppliers and increased deliveries of purchased water cause purchased water expense to increase. As a result of power rate increases that became effective in 2001, purchased power expense increased over 20%. For January, electric rates were 48% more than last year, from February through mid-May the rates were 38% higher, and for the remainder of the period to June 30, 2002, the rates were at the same level as in 2001. The Company is not aware of any future power rate increases. The components of water production expense and the changes from last year are shown in the table below:

	2002 Cost	Change
	-----	-----
Purchased water	\$33,952,000	\$803,000
Purchased power	8,941,000	1,922,000
Pump taxes	2,797,000	146,000
	-----	-----
Total	\$45,690,000	\$2,871,000
	=====	=====

In addition to water production costs, other operations expense categories increased \$2,219,000. Payroll and benefits charged to operations were 1% less in 2002 because there were fewer employees on the payroll. As part of the Company's expense control and budget process, consultants who worked on technology projects were curtailed, reducing these expenses.

Maintenance expenses were lower by \$490,000 due to fewer repairs of pumping equipment, wells, water mains and service lines.

Depreciation and amortization expense increased due to a larger depreciable plant investment on which depreciation expense is calculated and an increase in recovery of plant investments authorized in rate proceedings.

Federal and state income taxes increased \$1,920,000 because of higher taxable income which reflects income tax due on gains of real property sales.

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#### Other Income

The increase in other income and expenses from \$2,202,000 to \$3,041,000 was a result of additional property sales in 2002. During 2002, property sales totaled \$1,974,000 while in 2001 property sales were \$1,276,000. Other income excluding property sales was \$1,067,000 in 2002 and \$926,000 in the prior year.

#### Interest Expense

Overall interest expense reflects a small increase over 2001. Gross long-term interest expense increased \$788,000 because two additional \$20 million senior note issues were outstanding in 2002. Series D notes were issued in 2001 and Series E was issued near the end of May 2002. Because of the increase in construction expenditures especially on several large, lengthy projects such as the Bakersfield treatment plant, the amount of interest capitalized during 2002 increased by \$450,000, reducing interest expense.

#### REGULATORY MATTERS

The CPUC is processing the Company's 15 GRC applications that were filed in July 2001. In April 2002, evidentiary hearings were held for issues that had not been resolved between the Company and the CPUC's staff. Decisions on these applications are anticipated near the end of September or early October 2002. Based on the outcome of evidentiary hearings and meeting with CPUC staff, the Company estimates that the decisions could add between \$10 million and \$11 million in annual revenue, however, the decisions must first be approved by the Commissioners. The decisions are expected to authorize a return on equity of 9.7% with an equity capital structure of 51.5%.

In June 2002, the CPUC authorized the Company to increase rates in its Bakersfield district by \$796,000 on an annual basis. This decision was based on an advice letter filing to cover approximately \$6 million of construction cost incurred to date for a new water treatment plant.

The Company filed GRC applications for seven California districts plus

General Office in July 2002. The Commission's staff has indicated that decisions should be expected in mid-2003 for these filings.

Washington Water Service Company filed a General Rate Case (GRC) application in February 2002. The Washington Utilities and Transportation Commission issued its decision early in April 2002 granting a \$1 million increase in annual revenue.

#### LIQUIDITY

Short-term bank borrowings were \$24,000,000 at June 30, 2002 and \$22,000,000 at December 31, 2001.

In May 2002, the Company completed the issue of the \$20 million, 7.11%, 30-year Series E Senior Notes. The notes were issued to two institutional investors under an exemption from registration in Section 4(2) of the Securities Act of 1933 ("Securities

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Act"). Proceeds from the issue were used to repay outstanding short-term bank borrowings.

During the third quarter, the Company expects to issue \$20 million of Series F Senior Notes under Section 4(2) of the Securities Act of 1933. Terms of the issue have not been finalized. With the proceeds from the Series F notes and cash generated from operations, the Company expects to repay short-term bank borrowings. The senior notes are sold to institutional investors and, therefore, are not registered under the Securities Act.

The second quarter common dividend was paid on May 20, 2002 at \$0.28 per share compared to a quarterly dividend in 2001 of \$0.27875. This was the Company's 230th consecutive quarterly dividend. Annualized, the 2002 dividend rate is \$1.12 per common share compared to \$1.115 in 2001. Based on the 12-month earnings per share at June 30, 2002, the dividend payout ratio is 99%. For the full year 2001, the payout ratio was 115%. On a long-term basis, the Company's goal is to achieve a dividend payout ratio of about 60%.

At their July 24, 2002 meeting, the Board declared the third quarter dividend payable August 19, 2002 to stockholders of record on August 5, 2002. This will be the 231st consecutive quarterly dividend paid by the Company.

About 10% of the outstanding shares participate in the reinvestment program under the Company's Dividend Reinvestment and Stock Purchase Plan ("Plan"). No new common shares were issued under the Plan during the quarter. Shares required for the dividend reinvestment and stock purchase option of the Plan were purchased on the open market. Shares are also purchased on the open market to fulfill the requirements of the Company sponsored Employee Savings Plan (401K). Purchases for this plan are made on a biweekly basis.

Book value per common share was \$12.95 at June 30, 2002 and December 31, 2001.

During the second quarter, utility plant expenditures totaled \$20,934,000, including \$15,564,000 of Company funded projects. Expenditures through June 30, 2002 have been \$31,275,000, including \$25,316,000 of Company funded projects. The 2002 Company-funded construction budget is \$76,800,000.

#### WATER SUPPLY

Based on information from water management agencies and Company developed data, the Company believes that its various sources of water supply are sufficient to meet customer demand for the remainder of the year. Historically, about half of the water source is purchased from wholesale suppliers with the other half pumped from underground wells. A small portion is developed through three local surface treatment plants.

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#### ACQUISITIONS

Rio Grande Utility Corporation.

On July 1, 2002, after receiving state regulatory approval, the Company acquired the assets of Rio Grande Utility Corporation (Rio Grande) through its wholly-owned subsidiary, New Mexico Water Service Company ("NMWSC"). The purchase includes the water and wastewater assets of Rio Grande, which serves 2,265 water and 1,600 sewer customers in unincorporated areas of Valencia County, New Mexico, located 30 miles south of Albuquerque. The purchase price was \$2,300,000 in cash, plus assumption of \$3,100,000 in outstanding debt. Rate base for the system is approximately \$5,400,000. Its total assets were \$9,500,000 at June 30, 2002.

For 2001, Rio Grande had gross revenue of \$1,485,000. Its gross utility plant in service at December 31, 2001 was \$12,458,000 and net utility plant in service was \$9,153,000. The regulatory decision authorizing the purchase of Rio Grande's assets by NMWSC included an authorization to increase annual water rates by \$115,000.

#### National Utilities Corporation.

In June 2002, NMWSC signed an agreement to purchase National Utilities Corporation for approximately \$700,000. National Utilities serves 700 water customers located adjacent to the Rio Grande water system and another 900 water customers located 150 miles south of Albuquerque, New Mexico. The purchase will entitle NMWSC to purchase up to 2,000 acre-feet of water annually as required for its operations. The purchase is subject to the approval of the New Mexico Public Regulation Commission. Regulatory approval is expected in the first quarter of 2003.

National Utilities had 2001 revenue of \$575,000 and total assets of \$1,425,000. Its net utility plant in service at December 31, 2001 was \$1,143,000.

#### Kaanapali Water Corporation

In August 2002, the Company agreed to acquire the Kaanapali Water Corporation ("KWC") for \$7.7 million in cash. KWC provides water utility services to 500 customers in Maui, Hawaii, including 10 resorts and eight condominium projects. It posted 2001 revenues of \$3.3 million, and has net plant of approximately \$7.3 million and current assets of \$0.4 million. The transaction is subject to approval of the Hawaii Public Utilities Commission which is expected in mid-2003.

#### ACCOUNTING PRONOUNCEMENTS

In June 2001, Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" of long-lived assets was issued. The statement is effective for fiscal years beginning after June 15, 2002. The Company has not yet completed a full review of the impact that adopting the statement will have on its financial position or results of operations, and therefore is unable to state the impact that adopting the statement will have on its financial position or results of operations.

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#### MARKET RISK

The Company does not hold, trade in or issue derivative financial instruments and therefore is not exposed to risks these instruments present.

The Company's market risk to interest rate exposure is limited because the cost of long-term financing and short-term bank borrowings, including interest costs, is covered in consumer water rates as approved by the Commission. The Company does not have foreign operations; therefore, it does not have a foreign currency exchange risk.

The Company's sensitivity to commodity prices is most affected by changes in purchased water and purchased power costs. Through the Commission's balancing account procedures, increases in purchased water and purchased power costs can generally be passed on to consumers. The Company manages other commodity price exposure through the duration and terms of its vendor contracts.

#### PART II OTHER INFORMATION

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

Matters voted on by stockholders at their annual meeting on April 24, 2002 were reported in the first quarter Form 10-Q.

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#### PART II OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits required to be filed by Item 601 of Regulation S-K.

None

#### SIGNATURES

Pursuant to the requirement of the Securities and Exchange Act of 1934, the

Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CALIFORNIA WATER SERVICE GROUP

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Registrant

August 2, 2002

By:

/s/ Gerald F. Feeney  
Gerald F. Feeney  
Vice President, Chief Financial Officer  
and Treasurer

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Exhibit Index

Exhibit	Description
2	Asset and Real Estate Property Purchase and Sale Agreement dated November 6, 2000 pertaining to the acquisition of Rio Grande Utility Corporation's water and wastewater assets by New Mexico Water Service Company on July 1, 2002
4.1	Third Supplement to Note Agreement dated as of May 1, 2002, Pertaining to the issuance of \$20,000,000, 7.11% Series E Senior Notes due May 1, 2032
99.1	Chief Executive Officer certification of financial statements pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.2	Chief Financial Officer certification of financial statements pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

ASSET AND REAL PROPERTY PURCHASE AND SALE AGREEMENT

This Asset and Real Property Purchase and Sale Agreement ("Agreement") is entered into as of this 6 day of November, 2000, among NEW MEXICO WATER SERVICE CORPORATION, a New Mexico corporation ("Purchaser"), and RIO GRANDE UTILITY CORPORATION ("Seller"), with reference to the following recitals:

RECITALS

A. Seller is a public water and wastewater utility ("Utility Systems") regulated by the New Mexico Public Regulation Commission ("NMPRC"). The Seller's Utility Systems are located in the area of Rio communities, New Mexico and serve approximately 2,265 water customers and 1,600 wastewater treatment customers.

B. Purchaser is a wholly owned subsidiary of California Water Service Group ("CWSG"), a publicly traded water and wastewater utility company. CWSG organized Purchaser to own and to operate water and wastewater utilities in the State of New Mexico. CWSG has committed to finance and fund Purchaser's acquisitions and operations in the State of New Mexico.

C. Seller and Purchaser believe that the sale of the assets and business hereunder is in the best interest of the population served by the Seller's Utility Systems, in view of Purchaser's expertise and financial resources.

D. Closing of the proposed transaction hereunder is conditional upon the approval of the NMPRC, the New Mexico Environment Department ("NMED") and the United States Environmental Protection Agency ("EPA").

E. Seller desires to sell to Purchaser and Purchaser desires to purchase from Seller all of Seller's water and wastewater utility assets, on the terms and subject to the conditions herein set forth.

AGREEMENT

NOW, THEREFORE, in consideration of the foregoing recitals, which shall be deemed a relevant part of this Agreement, and the mutual covenants, promises, agreements, representations and warranties contained herein, for good and valuable consideration, the parties hereto agree as follows:

1. TRANSFER OF ASSETS

1.1 Agreement to Sell. Upon the terms and subject to all of the conditions contained herein, Seller agrees to sell, assign, transfer and deliver to Purchaser on the Closing Date (as defined in Section 5.1 hereof), and Purchaser hereby agrees to purchase and accept from Seller on the Closing Date, the Acquired Assets (as defined in Section 1.2 hereof). Seller shall deliver to Purchaser at the Closing appropriate bills of sale, assignments, easements, deeds and such other documents of conveyance as are necessary and convenient to effect the transfer of title to the

Acquired Assets to Purchaser on the Closing Date, in form and substance satisfactory to Purchaser and its counsel.

1.2 Description of Assets. For purposes of this Agreement, the term "Acquired Assets" shall refer to the assets described in the following:

(a) Utility Systems. All water and wastewater treatment equipment and facilities, wells, pumping equipment, connections, tanks, reservoirs, mains, meters and hydrants owned by Seller and described in Schedule 1.2 (a) hereof.

(b) Real Property and Easements. All real property, easements and other real property rights held or owned by Seller, as described in Schedule 1.2 (b) hereof (the "Real Property").

(c) Water Rights. Fourteen hundred and ninety one (1,491) acre-feet of ground water rights in the Rio Grande basin, as more particularly described in Schedule 1.2 (c) hereof (the "Water Rights").

(d) Other Assets. All other tangible assets owned by the Seller and used in the Seller's business, including but not limited to vehicles, personal property (office furniture, office and computer equipment, fixtures, computer software and other tangible property) all rights under contracts, all claims and all prepaid expenses, and described in Schedule 1.2 (d) hereof.

(e) Inventory. All inventories owned by Seller, including but not limited to component parts and spare parts and described in Schedule 1.2 (e) hereof.

(f) Accounts Receivable. All accounts receivable owned by

Seller.

(g) Books and Records. Copies of all books, records, files, contracts, and other data of Seller relating to Acquired Assets, whether or not located at 387 East Rio Communities Blvd., Belen, New Mexico, its principal place of business, and whether or not in tangible form or in the form of intangible computer storage media, such as disks, tapes, and other similar storage media.

(h) Licenses. All licenses of Seller described in Schedule 6.22 hereof.

(i) Deposits. All deposits with government agencies, vendors, contractors and other entities described in Schedule 1.2 (i) hereof. Seller shall provide such information to third parties holding deposits as is necessary to transfer Seller's interest in the deposits to Purchaser.

(j) Other Property. All of the interest of Seller in any intangible property owned by the Seller and used in Seller's business and to the extent approved by Purchaser in writing pursuant to the provisions of this Agreement, any and all contracts, warranties, guarantees, agreements, utility contracts, operating and customer account records, maps and drawings, permits, franchises, licenses, claims, prepaid expenses, grants, certificates and privileges and other rights owned by Seller, or in which Seller holds any beneficial interest, relating to or used in connection

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with the ownership, operation, use, occupancy or enjoyment of all or any part of the Seller's business all of which are collectively referred to as the "Other Property". The Other Property shall include, without limitation, all customer service contracts and all site plans, plans and specifications, "as-built" plans and drawings, permits and other governmental reviews, approvals and entitlements related to Utility Systems and such of the foregoing as have been heretofore prepared, applied for, obtained or otherwise are in the name or possession of, under the control of or available to Seller. Other Property is set forth in Schedule 1.2(j).

1.3 Excluded Assets. Any and all assets not to be acquired by the Purchaser shall be considered "Excluded Assets." These Excluded Assets described in Schedule 1.3 hereof shall not be considered Acquired Assets.

## 2. LIABILITIES AND SALES TAXES

2.1 Only Certain Liabilities Being Assumed. Except as described in Schedule 2.1 hereof, Purchaser will not assume or be obligated to satisfy or perform any of the liabilities, or commitments, whether fixed or contingent, which relate to the operation of Seller's business prior to the Closing Date.

2.2 Liabilities Not Being Assumed. Purchaser will not assume or be obligated to satisfy or perform any other liabilities, obligations or commitments of Seller, whether fixed or contingent, or known or unknown, including but not limited to Seller's tax, environmental and water quality liabilities and obligations to its employees.

2.3 Excise and Property Tax. Seller shall pay all sales, gross receipts, use and transfer taxes arising out the transfer of the Acquired Assets and shall pay its portion, prorated as of the Closing Date, of state and local real and personal property taxes of the business. Purchaser shall not be responsible for any taxes of any kind related to any period before the Closing Date.

2.4 Assumption Agreement. Purchaser shall assume only those certain liabilities as described in Schedule 2.1 in an agreement that is set forth in Schedule 2.4 attached hereto.

## 3. PURCHASE PRICE AND PAYMENT THEREFORE; OTHER PAYMENTS.

3.1 Purchase Price. As consideration for the sale, assignment, transfer and delivery of the Acquired Assets by Seller to Purchaser, and upon the terms and subject to all of the conditions contained herein, Purchaser agrees to pay and Seller agrees to accept a cashier's check for \$2,300,000.00 (Two Million, Three-Hundred Thousand and 00/100 Dollars).

3.2 Allocation of Purchase Price. The Purchase Price shall be allocated among the various categories of Acquired Assets in accordance with Schedule 3.2 hereof.

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## 4. PROPERTY DESCRIPTION, TITLE BINDER, SURVEY, ENVIRONMENTAL ASSESSMENT

4.1 Property Description, Current Surveys and Title Policies. Within

fifteen (15) days after the date hereof, Seller shall provide to Purchaser descriptions of the Real Property (the "Property Descriptions"); copies of any existing surveys and title policies, environmental, soils, engineering and any other studies relating to the real property in Seller's possession for Purchaser's review and confirmation of the descriptions and extent of Seller's ownership.

4.2 Water Rights. Within fifteen (15) days after the date hereof, Seller shall provide to Purchaser descriptions of the Water Rights including any and all documents or filings made with the Office of the New Mexico State Engineer, other state and local agencies or courts. Such documents shall include, but not be limited to, declarations, permits, licenses or any other documents evincing the existence and Seller's ownership of the Water Rights. Within the time set forth herein, Seller also shall provide copies of any existing water quality studies, test results, well capacity analyses, water use documents or any other evidence of placement of water to beneficial use and any other water quality or quantity studies or information pertaining to water used in Seller's business, including any such documents filed with the Office of the New Mexico State Engineer or New Mexico Environment Department.

4.3 Title Binder. Within thirty (30) days after the date hereof, Seller shall cause to be delivered to Purchaser a title binder for an ALTA Owner's Policy of Title Insurance covering the Property and furnish to Purchaser legible and true copies of all instruments which are the basis of any exceptions (other than the standard printed exceptions) (the "Exceptions") referred to therein (the "Binder"). Standard printed exceptions 8 and 9 (as to current year taxes) and that portion of standard printed exception 7 which cannot be deleted and the other exceptions which Purchaser approves or waives in the manner provided hereafter shall be deemed "Permitted Exceptions".

4.4 Survey. Within thirty (30) days after the Effective Date hereof and at Seller's expense, Seller shall cause to be delivered to Purchaser surveys sufficient to allow deletion of the Standard Survey exception from the Owner's policy of Title insurance to be issued pursuant to this Purchase Agreement (the "Surveys"). Seller will provide all surveys in its possession, its most recent plat map of the Real Property and all pipeline, utility and other easements benefiting the Real Property, and all deeds, agreements and other documents evidencing such easements. If any additional surveys are deemed necessary by Purchaser they will be performed at Purchaser's expense; provided that Seller shall use its best efforts to assist Purchaser in obtaining such additional surveys. Purchaser may terminate agreement if not satisfied with surveys provided or which Purchaser deems necessary.

4.5 Environmental Assessment; Water Quality and Quantity Analysis. Purchaser shall have the right, at its expense, to conduct Phase One and Phase Two Environmental Assessments of the Real Property following the ASTM standards for Environmental Assessments. Purchaser shall

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also have the right, at its expense to conduct any other studies of water quality or quantity that Purchaser deems appropriate.

4.6 Permits; Agency Filings. Within fifteen (15) days after the Effective Date hereof and at Seller's expense, Seller shall cause to be delivered to Purchaser any and all permits or licenses Seller holds with the New Mexico Public Regulation Commission, the New Mexico Environment Department or EPA. Seller also shall deliver any and all filings made with such agencies, subsequent case filings made by Seller or third parties, and orders entered, if any.

4.7 Personal Property Search. Within thirty (30) days after the date hereof, and at Seller's expense, Seller shall provide a personal property record search of Seller for any liens or encumbrances on all personal property owned by Seller and subject to this Agreement (the "UCC Search").

4.8 Review; Correction of Disapproved Items. Purchaser shall have until the end of the Inspection Period (as defined herein) within which to review the Binder, the Property Descriptions, the Surveys, the Title Policies, the Environmental Assessments, the UCC Search and any other studies, investigations or other matters, whether by Seller or undertaken by Purchaser (collectively referred to herein as the "Due Diligence Items"). Before the expiration of the Inspection Period, Purchaser shall indicate in writing any Due Diligence Items that are not acceptable. Diligence Items not expressly disapproved shall be deemed approved. Seller shall have thirty (30) days after the end of the Inspection Period to cure all disapproved Due Diligence Items ("Seller's Cure Period"). If Seller does not cure the objections within Seller's Cure Period, Purchaser may at its option either cancel this Agreement or waive the objections and proceed to Closing.

4.9 Inspection and Investigation. Purchaser and Purchaser's agents and consultants shall have until sixty (60) days after the Effective Date Hereof (the "Inspection Period") within which to conduct the inspections, investigations and reviews provided by this Article 4. Any delay by Seller in



providing the Due Diligence Items shall entitle Purchaser to an equivalent extension of the Inspection Period. Purchaser shall have the right to enter upon Seller's property at necessary times for the purpose of inspecting the Real Property. Except as provided herein, Purchaser shall be responsible for all inspections, examinations, tests and evaluations.

## 5. THE CLOSING

5.1 Closing Date. The closing ("Closing") of the transactions contemplated by this Agreement shall take place at a location mutually agreed upon by the parties, during regular business hours, on the 5th business day after the effective date of the NMPRC's final order granting approval of the transaction referred to in Section 9.1 or at such other time as the parties may agree ("Closing Date").

5.2 Seller's Obligations at Closing. At the Closing, upon delivery of the items specified in Section 4.3 hereof, Seller shall deliver to Purchaser the Acquired Assets and the documents described in Schedules 1.2(a)-(j) hereof.

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5.3 Purchaser's Obligation at the Closing. At the Closing, Purchaser shall

a. Deliver to Seller the purchase price specified in Section 3.1 in a form mutually agreeable to the Parties, and

b. Offer all current employees of Seller employment with Purchaser or an affiliated company of the Purchaser at their current wages and comparable benefits and fully execute and perform employment offers with certain employees of Valley Improvement Association, set forth on Schedule 5.3 hereof,.

## 6. SELLER'S REPRESENTATIONS AND WARRANTIES

Seller represents and warrants to Purchaser as follows:

6.1 Organization, Good Standing and Qualification. Seller is a corporation duly organized, validly existing and in good standing under the laws of the State of New Mexico and has all necessary corporate powers to own, lease and operate its assets and properties and to carry on its business as now owned and operated by it. Seller is not doing business in any state other than New Mexico. Seller does not own, directly or indirectly, any interest or investment (whether equity or debt) in or control any corporation, partnership, business, trust, joint venture or other entity.

6.2 Authority. Seller has the full corporate power and authority to enter into this Agreement and to carry out the transactions contemplated hereby. The Seller's Board of Directors and Seller's controlling shareholder, Valley Improvement Association, have duly and effectively approved Seller's execution, delivery and performance of this Agreement and the consummation of the transactions contemplated hereby and no other corporate proceeding on the part of Seller is necessary to authorize this Agreement and the transactions that it contemplates. This Agreement has been duly and validly executed by Seller and is a valid and binding agreement of Seller enforceable in accordance with its terms.

6.3 Financial Statements. Seller has delivered to Purchaser the unaudited balance sheets of Seller as of December 31, 1997, 1998 and 1999 and the related unaudited statements of income and retained earnings for the years then ending, certified by the President of Seller. These financial statements are hereinafter collectively referred to as the "Seller Financial Statements." To the best of Seller's knowledge, the Seller Financial Statements are true and correct in all material respects, fairly present the financial position of Seller as of the respective dates of the balance sheets included in the Seller Financial Statements, and the results of its operations for the respective periods indicated.

6.4 Absence of Specified Changes, Claims and Litigation. Except as described in Schedule 6.4 hereof, since December 31, 1999, there has not been any:

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(a) Transaction by Seller except in the ordinary course of business as conducted on that date consistent with past practices;

(b) Capital expenditure by Seller exceeding \$5,000;

(c) Obligations incurred by Seller, except trade or business obligations incurred in the ordinary course of business consistent with past practices;

(d) Cancellation or compromise of any debt or claim, except in the ordinary course of business consistent with past practices;

(e) Material adverse change in the financial condition, liabilities, assets, business, results of operation or prospects of Seller;

(f) Destruction, damage to or loss of any assets of Seller (whether or not covered by insurance) that materially and adversely affects the financial condition, business, operations or prospects of Seller;

(g) Sale or transfer of any asset of Seller, except in the ordinary course of business consistent with past practices;

(h) Execution, creation, amendment or termination of any contract, agreement or license to which Seller is a party, except in the ordinary course of business consistent with past practices;

(i) Waiver or release of any right or claim of Seller, except in the ordinary course of business;

(j) Mortgage, pledge or other encumbrance of any asset of Seller;

(k) Cancellation or the giving of notice of cancellation of any policy insuring Seller, its business or assets;

(l) Other event or condition of any character that has or might reasonably have a material and adverse effect on the financial condition, assets, business, results of operation or prospects of Seller; or

(m) Agreement by Seller to do any of the things described in the preceding clauses (a) through (l) except as agreed to in writing by Purchaser.

6.5 Tax Returns and Audits. Within the times and in the manner prescribed by law, Seller has filed or caused to be filed all federal, state and local tax returns required by law and has

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paid all taxes, assessments and penalties due and payable. These tax returns reflect accurately all liability for taxes of Seller for the periods covered thereby.

6.6 Real Property Leased to or by Seller. Except as described in Schedule 6.6 hereof, Seller is not a party to any agreement for the lease of real property.

6.7 Tangible Personal Property. Except as described in Schedule 6.7 hereof, no personal property used by Seller in connection with its business is held under any lease, security agreement, conditional sales contract, or other title retention or security arrangement or is located other than in possession of Seller. Seller owns all tangible personal property necessary to conduct its business as now conducted.

6.8 Title to and Condition of Assets and Properties. Seller has sole and exclusive good and merchantable title to all of the Acquired Assets and all of its properties and assets reflected in the Seller Financial Statements and all assets acquired by Seller subsequent to December 31, 1999 (except in each case those disposed of in the ordinary course of business since December 31, 1999), free and clear of mortgages, liens, pledges, charges, encumbrances, equities, claims, easements, rights of way, covenants, conditions, or any other restriction or defect in title, except for the liens of current taxes and assessments, and easements, rights of way, encumbrances, restrictions, clouds and defects which do not materially and adversely affect the operations of or the fair market values of its assets or properties. To the best of Seller's knowledge and belief, all of Seller's real property, its pipes, wells and water storage facilities, and all machinery, equipment, fixtures, automobiles, and other physical assets owned, leased, or used by Seller in the conduct of its business as presently conducted are in good operating condition and repair, ordinary wear and tear excepted, and are free from any defects, except (i) such defects that are correctable through routine maintenance, (ii) such minor defects that do not materially interfere with the continued use of such property in the conduct of Seller's normal operations, and (iii) such defects as described in Schedule 6.8 hereof. No officer, director or employee of Seller, owns or has any interest, directly or indirectly, in any of the real or personal property used by Seller in the conduct of its business. Seller does not occupy any real property in violation of any law, regulation or decree.

6.9 Zoning. As of the date hereof, the zoning of each parcel of real property owned or used by Seller in the conduct of its operations permits the presently existing improvements and the continuation of the business presently being conducted on such parcel. Seller is not aware of any facts or circumstances which suggest that a change in zoning which would affect the

present use of Seller's real property is likely.

6.10 Business. Seller is engaged in the business of a public utility water and wastewater company serving the area of Rio Communities, New Mexico in Valencia County, and with respect to which, it holds a valid certificate of public convenience and necessity issued by the NMPRC, copies of which will be delivered to Purchaser by Seller within thirty (30) days after the date hereof in accordance with Paragraph 4. above.

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6.11 Physical Assets. Except as described in Schedule 6.11 hereof, to the best of the Seller's knowledge the physical assets of Seller are in sound operating condition and have been consistently maintained in a manner appropriate to the purposes to which similar water and wastewater utility system equipment and improvements would ordinarily be devoted. There are no material arrears in the maintenance of any such physical assets.

6.12 Litigation. Except as described in Schedule 6.12 hereof, to the best of Seller's knowledge and belief, there is no action, suit, proceeding, claim arbitration, or investigation, audit, inquiry or hearing, at law or in equity, before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, or other person pending or, to the knowledge of Seller, threatened, against Seller or relating to or affecting Seller, its business, assets or properties or any basis for such action, suit, proceeding, claim investigation, audit, inquiry, or hearing to the knowledge of Seller. Seller is not presently engaged in any legal action to recover money due it or damages sustained by it.

6.13 NMPRC/Rates. There are no NMPRC proceedings or investigations pending or, to the knowledge of Seller, threatened against Seller, which might adversely affect the business or financial condition of Seller or the water or wastewater rates of Seller presently in effect.

6.14 NMED. There are no NMED proceedings or investigations pending or, to the knowledge of Seller, threatened against Seller, which might adversely affect the business or financial condition of Seller.

6.15 EPA. There are no EPA proceedings or investigations pending, or to the knowledge of Seller, threatened against Seller, which might adversely affect the business or financial condition of Seller.

6.16 Condemnation. No elections have been held or other actions taken authorizing the commencement of proceedings toward condemnation of any of the properties of Seller, and, to the best knowledge of Seller, no such actions have been proposed.

6.17 Existing Employment Contracts. Seller has no collective bargaining or employment agreements or any agreements that contain severance, termination, vacation or sick pay obligations with any of its officers or employees, other than currently effective vacation and sick policies, copies of which have been furnished to Purchaser. There are no pension, bonus, profit-sharing, stock option, health insurance benefit, or other plans, agreements or arrangements providing for officer or employee remuneration or benefits to which Seller is bound, other than the Seller's currently effective health, disability and life insurance plans and a 401(K) employee/employer contributed plan, copies of which have been furnished to Purchaser. There is no pending or, to the knowledge of Seller, threatened labor dispute, strike or work stoppage affecting Seller's business.

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6.18 Liabilities; Other Contracts. Except as set forth in the Seller's Financial Statements or described in Schedule 6.18 hereof, there are no debts, liabilities or obligations, fixed or contingent, known or unknown, to which Seller, its business or assets are subject, other than those incurred subsequent to December 31, 1999 in the ordinary course of business consistent with past practices. Seller is not a party to, nor are its assets bound by, any agreement not entered into in the ordinary course of business consistent with past practices, any indenture, mortgage, deed of trust, lease or any agreement that is unusual in nature, duration or amount (including, without limitation, any agreement requiring the performance by Seller of any obligation for a period of time extending beyond one year from the Closing Date, calling for consideration of more than \$2,000, or requiring purchase at prices in excess of prevailing market prices). Seller is not a party to, nor is Seller or any of its assets bound by, any agreement that is materially adverse to the business, assets, prospects or financial condition of Seller.

6.19 Compliance with Laws. To the best of Seller's knowledge and belief, except as described in Schedule 6.19 hereof, the Seller has always complied with, and is not in violation of, applicable federal, state or local statutes, laws and regulations (including, without limitation, any applicable environmental, building, zoning, or other law, ordinance or regulation)

affecting its properties or the operation of its business.

6.20 Compliance with Water Quality Regulations and Requirements. To the best of Seller's knowledge and belief, except as described in Schedule 6.20 hereof, the water which Seller provides to its customers has always complied with all applicable federal, state and local regulations and requirements and is otherwise of good, potable quality.

6.21 Water Rights. Seller now has and as of Closing shall have good and merchantable, fee simple title to the Water Rights. The Water Rights are free and clear of all liens, security interests, mortgages, pledges, encumbrances, taxes and assessments and charges or claims of whatever nature. The Water Rights are in good standing with the Office of the New Mexico State Engineer and have not been forfeited or abandoned and are not subject to judgment, suit, lien, receivership or any other encumbrance whatsoever.

6.22 Licenses. Seller possesses and holds in its name all licenses, permits, consents, franchises, approvals, authorization, qualifications, and orders of all governments and governmental agencies (hereinafter collectively referred to as "Licenses") required to enable Seller to conduct its business as presently conducted and to own, lease and operate its assets as presently owned, leased and operated. Schedule 6.22 hereof describes all Licenses that are held by Seller. Except as described in Schedule 6.22, all of the Licenses held by Seller are in full force and effect and there is no default of any provision thereof which would affect the ability of Seller to engage in its business or which would result in imposition of a criminal or monetary penalty in excess of \$250 in any single instance, or \$1,000 in the aggregate. No action is pending or, to Seller's knowledge, threatened, seeking the suspension, modification, cancellation, revocation or limitation of any License and, to their knowledge, there is no basis for such actions.

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6.23 Agreement Will Not Cause Breach or Violation. Neither the entry into this Agreement nor the consummation of the transactions contemplated hereby will result in or constitute any of the following: (i) a breach of any term or provision of this Agreement, (ii) a default or any event that, with notice or lapse of time, or both, would be a default, breach or violation of the Articles of Incorporation or By-Laws of Seller or of any lease, franchise, License, promissory note, conditional sales contract, commitment, indenture, mortgage, deed of trust, or other agreement, instrument, or arrangement to which Seller or is a party or by which the Seller or its assets are bound, (iii) an event that would permit any party to terminate any agreement or policy of insurance or to accelerate the maturity of any indebtedness or other obligation of Seller, (iv) the creation of imposition of any lien, charge or encumbrance on any of the assets of Seller, or (v) the violation of any permit, license, law, regulation, ordinance, judgment, order or decree applicable to or affecting Seller or its business, assets or financial condition.

6.24 Authority and Consents. No approvals or consents of any person other than the NMPRC, NMED or EPA are necessary for or in connection with the execution, delivery and performance of Seller's obligations hereunder.

6.25 Duration of Representation and Warranties. The representation and warranties made hereinabove will be correct and accurate in all material respects as of the Closing Date, and shall survive the Closing Date for the limitation of actions period applicable to contracts in the State of New Mexico.

## 7. PURCHASER'S REPRESENTATIONS AND WARRANTIES

Purchaser hereby represents and warrants to Seller as follows:

7.1 Organization, Good Standing and Qualification. Purchaser is a corporation duly organized, existing and in good standing under the laws of the State of New Mexico, and has all necessary corporate powers to own and operate its properties and to carry on its business as now owned and operated by it.

7.2 Authority and Consents. Purchaser has the right, power, legal capacity and authority to enter into and perform its obligations under the Agreement, and no approvals or consents of any persons, other than the NMPRC or NMED, are necessary in connection therewith. The execution and delivery of this Agreement and the consummation of the transactions hereunder by Purchaser have been, or prior to the Closing will have been, duly authorized by all necessary corporate action of Purchaser, approval by Board of Directors and no further corporate authorization is or will be necessary on the part of Purchaser. This Agreement constitutes a legal, valid and binding obligation of Purchaser enforceable in accordance with its terms.

7.3 Books and Records. Purchaser reviewed the books and records prior to executing this Agreement, and based upon their review, Purchaser satisfied itself as to the financial condition of Seller's business

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7.4 Duration of Representation and Warranties. The representation and warranties made hereinabove will be correct and accurate in all material respects as of the Closing Date, and shall survive the Closing Date for a period of six (6) years.

#### 8. SELLER'S OBLIGATIONS BEFORE CLOSING.

Seller covenants that, except as otherwise agreed or waived in writing by Purchaser, from the date of this Agreement until the Closing:

8.1 Access to Premises and Information. In addition to the right to conduct investigations and inspections as provided in Article 4 hereof, Purchaser and its counsel, accountants and other representatives shall have full access during normal business hours to all Seller's properties, books, accounts, records, contracts and documents of or relating to Seller and its assets, properties and business. Seller shall furnish or cause to be furnished to Purchaser and its representatives all data and information concerning the business, finances and properties of Seller that Purchaser, in its sole discretion, deems material to its decision to close.

8.2 Conduct of Business in Normal Course. Seller shall carry on its business and activities diligently and in substantially the same manner as they have been carried on through December 31, 1999, and shall not make or institute any change in management, accounting or operations that will vary materially from the methods used by the Seller as of that date.

8.3 Preservation of Business and Relationships. Seller shall use its best efforts, without making any commitments or agreements on behalf of Purchaser, to preserve its business organization intact, and to preserve its present relationships with suppliers, customers and others having business relationships with it. Seller shall, within (60) sixty days after the date hereof, provide complete copies of all current supply and customer contracts and other written documentation evidencing such relationships.

8.4 Maintain Insurance. Seller shall continue to carry its existing insurance, subject to variations in amounts required by the ordinary operations of its business. At the request of Purchaser and at Purchaser's sole expense, Seller shall cause the amount of insurance, which at the date of this Agreement Seller carries, to be increased by such amount or amounts as Purchaser shall specify.

8.5 New Transactions. Seller shall not do, or agree to do, any of the following acts without the prior written consent of Purchaser:

(a) Enter into any contract, commitment or transaction not in the usual and ordinary course of its business, consistent with past practices;

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(b) Enter into any contract, commitment or transaction in the usual and ordinary course of business involving an amount exceeding five thousand dollars (\$5,000) individually, except for items on Schedule 8.5(b) hereof, or ten thousand dollars (\$10,000) in the aggregate;

(c) Make any capital expenditures in excess of five thousand dollars (\$5,000), except for items on Schedule 8.5(c) hereof, for any single item or in the aggregate, or enter into any leases of capital equipment or property under which the annual lease charge is in excess of one thousand five hundred dollars (\$1,500); or

(d) Sell or dispose of any capital assets with a net book value in excess of one thousand dollars (\$1,000) individually or two thousand dollars (\$2,000) in the aggregate.

8.6 Payment of Liabilities and Waiver of Claims. Seller shall not do, or agree to do, any of the following acts (i) pay any obligation or liability, fixed or contingent, other than current liabilities, (ii) waive or compromise any right or claim or (iii) cancel, without full payment, any note, loan or other obligation owing to Seller.

8.7 Existing Agreements. Seller shall not modify, amend, cancel or terminate any of its existing contracts or agreements, or agree to do any of those acts.

8.8 Representations and Warranties True at Closing. Seller's representations and warranties set forth in this Agreement or in any Exhibit, Schedule, letter, certificate, memorandum and in any other written document furnished by Seller or Controlling Party or on his, its or their behalf, in connection with this Agreement shall be true and correct as of the Closing Date as if made on that date and all conditions precedent to Closing shall have been met at Closing.

8.9 NMPRC Filings. The Seller shall cooperate fully with Purchaser in

preparing and filing such applications to the NMPRC as Purchaser may deem necessary or appropriate to obtain NMPRC approval of the transactions contemplated by this Agreement.

8.10 Maintenance of Inventories. Seller shall maintain normal quantities of materials and supplies determined in accordance with the practices of Seller in existence on December 31, 1999.

8.11 Employees and Compensation. Seller shall not do, or agree to do, any of the following: (i) grant any increase in salaries payable or to become payable to any officer or employee, or (ii) increase benefits payable or to become payable to any officer or employee, except for incentive compensation for professional certification awards by a governmental agency or salary increases in the ordinary course of business, consistent with past business practices and approved by Purchaser who shall not unreasonably withhold such approval.

8.12 Transfer of Real Property Interest. Purchaser shall be satisfied with respect to the Seller's ability to transfer merchantable title to Purchaser for all real property and/or easements described in Schedule 8.12 herein. Purchaser and Seller shall jointly prepare legal descriptions for

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all real property interest to be transferred from Seller to Purchaser ("Legal Descriptions"). Prior to the Closing, Purchaser and Seller shall amend Schedule 1.2 (b) contained in this Agreement to include the Legal Descriptions.

8.13 Easement Claims. Purchaser shall be satisfied with respect to the legal right of the easement claims contemplated herein. Purchaser and Seller shall jointly prepare legal descriptions for the purpose of claiming an interest ("Legal Descriptions for Claims"), by prescription or otherwise, for all easements described in Schedule 8.13. Prior to the Closing, Purchaser and Seller shall amend Schedule 1.2 (b) contained in this Agreement to include the Legal Descriptions for Claims.

8.14 Conveyance Documents. Seller shall convey the Assets to Purchaser by a Bill of Sale in the Form as set forth by Schedule 8.14(a) attached hereto. Seller shall convey the Operating Easements, to Purchaser by a Grant Deed in the Form as set forth by Schedule 8.14(b) attached hereto. Seller shall convey the Other Property to Purchaser by an Assignment of Property in the form of Schedule 8.14(c) attached hereto.

#### 9. PURCHASER'S OBLIGATIONS BEFORE CLOSING

9.1 NMPRC Authorization. Purchaser will use its best efforts to secure NMPRC authorization for the transactions contemplated under this Agreement. To this end, Purchaser agrees to prepare at its own expense and file promptly with the NMPRC an appropriate application for such authorization.

9.2 NMED Authorization. Purchaser will use its best efforts to secure NMED authorization for the transactions contemplated under this Agreement. To this end, Purchaser agrees to prepare at its own expense and file promptly with the NMED, an appropriate application for such authorization. The Seller shall cooperate fully with Purchaser in preparing and filing such applications to the NMED.

9.3 EPA Approval. Purchaser will use its best efforts to secure EPA approval for the transfer of Seller's National Pollution Discharge Elimination System ("NPDES") permit(s) from Seller to Purchaser. To this end, Purchaser agrees to prepare at its own expense and file promptly with the EPA an appropriate application for such transfer. The Seller shall cooperate fully with Purchaser in preparing and filing such applications to the EPA.

#### 10. CONDITIONS PRECEDENT TO PURCHASER'S PERFORMANCE

The obligations of Purchaser under this Agreement are subject to the satisfaction, at or before the Closing, of all the conditions set out below in this Article 10. Purchaser may waive any or all of these conditions, other than those set forth in Section 10.1 and 10.2 hereof, in accordance with Section 1.2 hereof; provided, however, that no such waiver of a condition shall constitute a waiver by Purchaser of any of its other rights or remedies, at law or in equity, if Seller or the Shareholders

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shall be in default of any of their representations, warranties, covenants or agreements under this Agreement.

10.1 Authorization of NMPRC. NMPRC authorization for Purchaser to acquire the Acquired Assets pursuant to the terms and conditions of this Agreement shall be in full force and effect on the Closing Date.

10.2 Authorization of NMED. NMED authorization for Purchaser to operate

Seller's Utility Systems shall be in full force and effect on the Closing Date.

10.3 Authorization of EPA. EPA authorization for Purchaser to assume Seller's NPDES permit(s) shall be in full force and effect on the Closing Date.

10.4 Approval by Purchaser's Board of Directors. Ratification and approval of this Agreement and the transactions contemplated hereunder by Purchaser's Board of Directors.

10.5 Accuracy of Seller's Representations and Warranties. The representations and warranties of Seller in this Agreement and in any Exhibit, Schedule, letter, certificate, memorandum and in any other written document furnished by Seller, in connection with this Agreement shall be true on and as of the Closing Date as though such representations and warranties were made on and as of that date.

10.6 Absence of Liens; Title Insurance. At or prior to the Closing, Purchaser shall have received a Uniform Commercial Code ("UCC") search report dated as of a date not more than five (5) days before the Closing Date issued by the New Mexico Secretary of State indicating that there are no filings under the UCC on file with such Secretary of State which name Seller as debtor or otherwise indicating any lien on the Acquired Assets. At the Closing, Purchaser shall receive a policy of title insurance insuring fee simple title to the Real Property, free of any lien or exception to title, other than exceptions acceptable to Purchaser.

10.7 Seller's Corporate Approval. Seller shall have received corporate authorization and approval for the execution and delivery of this Agreement and shall have taken all corporate action necessary or proper to fulfill its obligations to be performed under this Agreement on or before the Closing Date.

10.8 Seller's Performance. Seller shall have performed, satisfied and complied with all covenants, agreements and conditions required by this Agreement to be performed, satisfied or complied with on or before the Closing Date.

10.9 Certification by Seller. Seller shall have furnished Purchaser with a certificate, dated the Closing Date, signed by Seller certifying, in such detail as Purchaser and its counsel may reasonably request, that the conditions specified in Sections 10.5 and 10.6 hereof have been fulfilled. Certification is set forth in Schedule 10.9 attached hereto.

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10.10 Absence of Litigation. No action, suit or proceeding before any court or any governmental body or authority (other than the NMPRC authorization specified in Section 9.1, NMED authorization specified in Section 9.2 and EPA authorization specified in Section 9.3) pertaining to the transactions contemplated by this Agreement or to their consummation shall have been instituted or threatened on or before the Closing Date.

10.11 Consents. All necessary agreements, consents and approvals of any persons to the consummation of the transactions contemplated by this Agreement, or otherwise pertaining to the matters covered by it, shall have been obtained by Seller and delivered to Purchaser.

10.12 Approval of Documentation. The form and substance of all certificates, instruments, opinions and other documents delivered to Purchaser under this Agreement shall be satisfactory in all reasonable respects to Purchaser and its counsel.

10.13 Purchaser's Satisfaction with Inspections, Title, Survey, Water Quality. Purchaser shall be satisfied with all inspections and investigations concerning title to and surveys of the Real Property, Water Rights and other Acquired Assets, as provided in Article 4 hereof.

10.14 No Material Adverse Change. Prior to the Closing, there shall have been no material adverse change in the Acquired Assets or liabilities, the business or condition, financial or otherwise, the results of operations, or prospects of Seller as described in the Annual Report of Seller as of December 31, 1999 filed with the NMPRC, whether (without limitation) as a result of any legislative or regulatory change, revocation of any franchise or license, fire, accident, storm or other casualty or labor or civil disturbance or act of God.

#### 11. CONDITIONS PRECEDENT TO SELLER'S PERFORMANCE

The obligations of Seller under this Agreement are subject to the satisfaction, at or before the Closing, of all the conditions set out below in this Article 11. Seller may waive any or all of these conditions in accordance with Section 1.2 hereof; provided, however, that no such waiver of a condition shall constitute a waiver by it of any of its other rights or remedies, at law or in equity, if Purchaser shall be in default of any of its representations, warranties, covenants or agreements under this Agreement.

11.1 Accuracy of Purchaser's Representations and Warranties. The representations and warranties by Purchaser contained in this Agreement and in any Exhibit, Schedule, letter, certificate, memorandum and in any other written document furnished by Purchaser, or on its behalf, in connection with this Agreement shall be true on and as of the Closing Date as though such representations and warranties were made on and as of that date.

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11.2 Purchaser's Performance. Purchaser shall have performed, satisfied and complied with all covenants, agreements and conditions required by this Agreement to be performed, satisfied or complied with by Purchaser on or before the Closing Date.

11.3 Purchaser's Corporate Approval. Purchaser shall have received corporate authorization and approval for the execution and delivery of this Agreement and shall have taken all corporate action necessary or proper to fulfill its obligations to be performed under this Agreement on or before the Closing Date.

11.4 Certification by Purchaser. Purchaser shall have furnished Seller with a certificate, dated the Closing Date, signed by an officer of Purchaser, certifying, in such detail as they and their counsel may reasonably request, that the conditions specified in Sections 11.1, 11.2 and 11.3 hereof have been fulfilled. Certification by Purchaser is set forth in Schedule 11.4 attached hereto.

## 12. SELLER'S OBLIGATIONS AFTER THE CLOSING

12.1 Indemnification. Seller agrees to indemnify, defend and hold harmless Purchaser against any and all losses, claims, liabilities, damages, actions, costs or expenses, including attorney's fees and costs (the "Indemnified Losses") arising from, in connection with, or with respect to the following items:

(a) Any breach of any representation, warranty, covenant or agreement of Seller contained in this Agreement, or any agreement, certificate or document executed and delivered by them, or their affiliates pursuant hereto or in connection with any of the transactions contemplated in this agreement;

(b) Any failure by Seller to satisfy, perform or pay any liabilities relating to Seller, except those specifically assumed by Purchaser and identified in Schedule 2.1 contained in this Agreement.

(c) Any and all actions, suits, proceedings, claims or demands by third parties ("Third Party Claims") and losses, liabilities, expenses or judgments relating thereto, directly resulting from or arising from matters (i) relating to Seller, its business or the Acquired Assets which occurred or are alleged to have occurred prior to the Closing or (ii) matters relating to Seller, or liabilities of Seller other than those specifically assumed by Purchaser and identified in Schedule 2.1 contained in this Agreement.

Third Party Claims shall include, without limitation, any and all actions, suits, proceedings, claims or demands by governmental agencies or third parties made in connection with any Environmental Condition (as defined in this Subsection 12.1(d)) that (i) exists or is alleged to have existed on the Real Property on or prior to the Closing Date or (ii) that exists or is alleged to exist on

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other land due to activities on the Real Property as of or prior to the Closing Date. "Environmental Condition" means the presence of any "hazardous substance" as that term is defined in any federal, state, county or municipal statute, ordinance, regulation, rule, order, judgment or decree, including, without limitation, (i) the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended; the Resource Conservation and Recovery Act of 1976, as amended; the Clean Air Act; the Water Pollution Control Act (the Clean Water Act); the Toxic Substances Control Act; the Safe Drinking Water Act; and the Insecticide, Fungicide and Rodenticide Control Act, as amended; and any state counterpart of those laws; and (ii) any material or substance which is now listed in the United States Department of Transportation Hazardous Materials Table (49 CFR ss.172.101); and any contaminant, oil, petroleum product or by-product, radioactive material or by-product, any mining waste, toxic substance, hazardous waste or other material, the removal of which is required or the existence or management of which is prohibited, penalized or regulated by any federal, state or local government agency, authority or unit.

(d) If a Third Party Claim is made against Purchaser, Purchaser shall notify in writing, and in reasonable detail, of the Third Party Claim within 30 business days after it receives written notice thereof; provided, however, that failure to give such notice shall not affect the indemnification obligation provided hereunder except to the extent Seller shall



have been actually prejudiced as a result of such failure. Thereafter, Purchaser shall deliver to Seller, within five business days after Purchaser's receipt thereof, copies of all notices and documents (including court papers) received by Purchaser relating to Third Party Claim. Purchaser shall have the right to assume the defense of any Third Party Claim with counsel selected by it. Seller shall have the right to participate in the defense and to employ a counsel, at their expense, separate from the counsel employed by Purchaser. Counsel for Purchaser shall cooperate and share information with counsel for Seller if they participate in the defense of the Third Party Claim, but Purchaser shall control such defense at all times. Seller shall be liable to Purchaser for the reasonable fees and expenses of the counsel it employs to defend the Third Party Claim.

If Purchaser does not elect to assume the defense of a Third Party Claim, Seller shall be obligated to assume the defense thereof at their own expense. Purchaser shall be entitled to participate in the defense thereof with separate counsel employed at its own expense.

12.2 Duration of Indemnification; Statutory Limitation. Except as described in Schedule 12.2 hereof, the obligations agreed to by Seller in Sections 12.1 (a) through (d) shall survive the Closing Date for a period of four (4) years. If a court of competent jurisdiction determines that the provisions of Section 56-7-1, NMSA 1978, as amended, are applicable to this Agreement or any claim arising under this Agreement, then any agreement to indemnify contained in this Agreement shall not extend to liability, claims, damages, losses or expenses, including attorney fees, arising out of:

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(a) The preparation or approval of maps, drawings, opinions, reports, surveys, change orders, designs or specifications by the indemnitee, or the agents or employees of the indemnitee; or

(b) The giving of or the failure to give directions or instructions by the indemnitee, or the agents or employees of the indemnitee, where such giving or failure to give directions or instructions is the primary cause of bodily injury to persons or damages.

12.3 Access to Records. From and after the Closing, Seller shall allow Purchaser and its counsel, accountants, and other representatives such access to records which after the Closing are in the custody or control of Seller as Purchaser reasonably requests.

### 13. PURCHASER'S OBLIGATIONS AFTER THE CLOSING

13.1 Indemnification. Purchaser agrees to indemnify, defend and hold harmless Seller against any and all losses, claims, liabilities, damages, actions, costs or expenses, including attorney's fees and costs (the "Indemnified Losses") arising from, in connection with, or with respect to the following items:

(a) Any breach of any representation, warranty, covenant or agreement of Purchaser contained in this Agreement, or any agreement, certificate or document executed and delivered by them, or their affiliates pursuant hereto or in connection with any of the transactions contemplated in this agreement;

(b) Any and all actions, suits, proceedings, claims or demands by third parties, or assessments or judgments in their favor, directly resulting from or arising from matters relating to (i) the Acquired Assets which occurred or are alleged to have occurred after the Closing or (ii) liabilities assumed by Purchaser and identified in Schedule 2.1 contained in this Agreement.

13.2 Duration of Indemnification; Statutory Limitation. The obligations agreed to by Purchaser in Section 13.1 (a) and (b) shall survive the Closing Date for a period of six (6) years. If a court of competent jurisdiction determines that the provisions of Section 56-7-1, NMSA 1978, as amended, are applicable to this Agreement or any claim arising under this Agreement, then any agreement to indemnify contained in this Agreement shall not extend to liability, claims, damages, losses or expenses, including attorney fees, arising out of:

(a) The preparation or approval of maps, drawings, opinions, reports, surveys, change orders, designs or specifications by the indemnitee, or the agents or employees of the indemnitee; or

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(b) The giving of or the failure to give directions or instructions by the indemnitee, or the agents or employees of the indemnitee, where such giving or failure to give directions or instructions is the primary cause of bodily injury to persons or damages.

13.3 Seller's Facility Master Plan. Purchaser acknowledges Seller's facilities master plan and intends to integrate its goals and objectives into Purchaser's facility master plan, where such goals and objectives are applicable and compatible with Purchaser's own facilities master plan. The parties further understand that Purchaser must comply with NMPRC policies on system expansion, and Purchaser cannot invest in facilities that are not in the best interest of its customers and in compliance with NMPRC policy.

#### 14. COSTS

14.1 Finder's or Broker's Fees. Except for the obligation to Keith Hinds as set forth in Hinds' agreement with Purchaser, each of the parties represents and warrants that it has not dealt with any broker or finder in connection with any of the transactions contemplated by this Agreement, and, insofar as it knows, no broker or other person is entitled to any commission or finder's fee in connection with any of these transactions

14.2 Escrow and Title Expenses. Purchaser shall pay for all costs, fees and expenses incurred or to be incurred by it relating to title insurance. Seller shall pay the transfer tax associated with the transfer of all real property and easements by it to Purchaser.

14.3 Survey and Related Expenses. Seller shall pay for all costs, fees and expenses incurred or to be incurred by it relating to perfecting the transfer of certain real property interests to Purchaser described in Schedule 8.12.

14.4 All Other Expenses. Except for those expenses described in Sections 14.2 and 14.3, each of the parties shall pay all costs and expenses incurred or to be incurred by it in negotiating and preparing this Agreement and in closing and carrying out the transactions contemplated by this Agreement.

#### 15. FORM OF AGREEMENT

15.1 Headings. The subject headings of the Articles and Sections of this Agreement are included for purposes of convenience only, and shall not affect the construction or interpretation of any of its provisions.

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15.2 Entire Agreement; Modification; Waiver. This Agreement constitutes the entire agreement between the parties pertaining to the subject matter contained herein and supersedes all prior and contemporaneous agreements, representations and understandings of the parties. No supplement, modification or amendment of this Agreement shall be binding unless executed in writing by all the parties. No waiver of any of the provisions of this Agreement shall be deemed, or shall constitute, a waiver of any other provision, whether or not similar, nor shall any waiver constitute a continuing waiver. No waiver shall be binding unless executed in writing by the party making the waiver.

15.3 Counterparts. This Agreement may be executed simultaneously in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

#### 16. PARTIES

16.1 Parties in Interest. Nothing in this Agreement, whether express or implied, is intended to confer any rights or remedies under or by reason of this Agreement on any persons other than the parties to it and their respective successors and permitted assigns, nor is anything in this Agreement intended to relieve or discharge the obligation or liability of any third persons to any party to this Agreement, nor shall any provisions give any third persons any right of subrogation or action over against any party to this Agreement.

16.2 No Assignment. This Agreement may not be transferred, assigned, pledged or hypothecated by any party hereto, except by Purchaser to an affiliated company which is controlled by, controls, or under common control with it; provided, further, that Purchaser may assign (whether or not as collateral) Purchaser's rights to payments hereunder. This Agreement shall be binding on and shall inure to the benefit of the parties to it and their respective heirs, legal representatives, successors and permitted assigns.

#### 17. REMEDIES

17.1 Recovery of Litigation Costs. If any legal action or other proceeding is brought by either Seller or Purchaser for the enforcement of this Agreement, or because of an alleged dispute, breach, default or misrepresentation in connection with any of the provisions of this Agreement, the successful or prevailing party or parties shall be entitled to recover reasonable attorney's fees and other costs incurred in that action or proceeding, in addition to any other relief to which it or they may be entitled.

17.2 Non-Exclusivity of Remedies. The remedies provided for in this Section 17 are not intended, and shall not be deemed, to be exclusive or

restrictive of any other rights to which the parties are entitled by law or equity with respect to any breach or default of any representations, warranties, covenants or agreements under this Agreement.

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#### 18. NOTICES

All notices, requests, demands and other communications under this Agreement shall be in writing and shall be deemed to have been duly given on the date of service if served personally on the party to whom notice is to be given, or on the third day after mailing if mailed to the party to whom notice is to be given, by first class mail registered or certified, postage prepaid, and properly addressed as follows:

To Seller at: Rio Grande Utility Corporation  
P.O. Box 1179  
Belen, NM 87002  
Attention: Robert J. Davey

To Purchaser at: NEW MEXICO WATER SERVICE COMPANY  
1720 North First Street  
San Jose, CA 95112  
Attention: Peter C. Nelson

Any party may change its address for purposes of this Section 17 by giving the other party written notice of the new address in the manner set forth above.

#### 19. GOVERNING LAW

This agreement shall be construed in accordance with, and governed by, the laws of the State of New Mexico, without regard to, any contrary conflict of laws provision or rule.

#### 20. MISCELLANEOUS

20.1 Announcements. Seller will not make any announcements to the public or to agents of Seller concerning this Agreement or the transactions contemplated hereby without the prior approval of Purchaser, which will not be unreasonably withheld.

20.2 Knowledge. Where any representation or warranty contained in this Agreement is expressly qualified by reference to the knowledge of any party, such party confirms that it has made due and diligent inquiry as to the matters that are the subject of such representations and warranties.

20.3 Severability. If any provision in this Agreement shall be held invalid, illegal or unenforceable, the validity, legality or enforceability of the remaining provisions hereof will not in any way be affected or impaired thereby.

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20.4 References. Unless otherwise specified, references to Sections or Articles are to Sections or Articles in this Agreement. All references to this "Agreement" shall include its Exhibits and Schedules.

IN WITNESS WHEREOF, the parties to this Agreement have duly executed it as of the day and year first above written.

PURCHASER: NEW MEXICO WATER SERVICE COMPANY, a New Mexico corporation  
By: /s/ Peter C. Nelson  
PETER C. NELSON  
Chief Executive Officer

SELLER: RIO GRANDE UTILITY CORPORATION, a New Mexico corporation  
By: /s/ Dale Pipher  
DALE PIPHER  
President

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ASSUMPTION AGREEMENT

FOR VALUABLE CONSIDERATION, New Mexico Water Service Company, a New Mexico corporation ("Purchaser"), hereby assumes those obligations and liabilities of Rio Grande Utility Corporation, a New Mexico corporation ("Seller") described in Schedule 2.1 of the Asset And Real Property Purchase And Sale Agreement ("Agreement"), dated November 6, 2000, among Purchaser and Seller.

Pursuant to Section 2.1 of the Agreement, Purchaser is not assuming and will not assume or be obligated to satisfy or perform any liabilities, obligations or commitments of Seller, other than those described in Schedule 2.1 to the Agreement, whether fixed or contingent, or known or unknown.

IN WITNESS WHEREOF, Purchaser has caused this Assumption Agreement to be executed as of this 6th day of November 2000.

NEW MEXICO WATER SERVICE COMPANY  
A New Mexico Corporation

By /s/ Peter C. Nelson  
Peter C. Nelson  
Chief Executive Officer

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SCHEDULE 8.14(a)

BILL OF SALE

FOR GOOD AND VALUABLE CONSIDERATION, receipt of which is hereby acknowledged, Rio Grande Utility Corporation, a New Mexico corporation ("Seller"), hereby sells, grants, conveys, assigns, transfers and sets over to NEW MEXICO WATER SERVICE COMPANY, a New Mexico public utility water corporation ("Purchaser"), all improvements and personal property comprising the water production, storage and distribution facilities and all water rights, and assets of every kind comprising the Utility Systems owned and operated by Seller, in the area of Belen, Valencia County, New Mexico, including, without limiting the generality of the foregoing, the following:

1. All of the Improvements described in Schedule 1.2(a) attached hereto.

2. To the extent not described in Schedule 1.2(a) hereto, all wells, pumps, pumping plants and pumping equipment, tanks, mains, pipes, pipelines, hydrants, valves, connections, services, meters, meter boxes and associated facilities, buildings, structures, improvements and appurtenances thereto, and all property and assets of every kind comprising a part of or used in connection with the operation of Seller's potable Utility Systems.

3. All rights of any kind now held by Seller in and to any and all water, water rights and rights to receive distribution of water.

4. Seller warrants to Purchaser that Seller owns and has the right to convey all property conveyed by this Bill of Sale and that all property conveyed hereby is conveyed free and clear of all liens, encumbrances, claims and liabilities.

Executed on the 6th day of November, 2000.

RIO GRANDE UTILITY CORPORATION  
a New Mexico Corporation

By: /s/ Dale Pipher  
Dale Pipher  
President

By: /s/ Cynthia Geran  
Cynthia Geran  
Controller

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=====

CALIFORNIA WATER SERVICE COMPANY

THIRD SUPPLEMENT TO NOTE AGREEMENT

Dated as of May 1, 2002

Re: \$20,000,000 7.11% Series E Senior Notes  
Due May 1, 2032

=====

THIRD SUPPLEMENT TO NOTE AGREEMENT

Dated as of  
May 1, 2002

To the Purchasers named in  
Schedule A hereto

Ladies and Gentlemen:

This Third Supplement to Note Purchase Agreement (the "Third Supplement") is between California Water Service Company (the "Company") whose address is 1720 North First Street, San Jose, California 95112 and the institutional investors named on Schedule A attached hereto (the "Purchasers").

Reference is hereby made to that certain Note Agreement dated as of March 1, 1999 (the "Note Agreement") between the Company and the purchasers listed on Schedule I thereto. All capitalized terms not otherwise defined herein shall have the same meaning as specified in the Note Agreement. Reference is further made to Section 4.3 thereof which requires that, prior to the delivery of any Additional Notes, the Company and each Additional Purchaser shall execute and deliver a Supplement.

The Company hereby agrees with the Purchasers named on Schedule A hereto as follows:

1. The Company has authorized the issue and sale of \$20,000,000 aggregate principal amount of its 7.11% Series E Senior Notes due May 1, 2032 (the "Series E Notes"). The Series E Notes, together with the Series B Notes initially issued pursuant to the Note Agreement, the Series C Notes issued pursuant to the First Supplement to Note Agreement dated as of October 1, 2000, the Series D Notes issued pursuant to the Second Supplement to Note Agreement dated as of September 1, 2001 and each Series of Additional Notes which may from time to time be issued pursuant to the provisions of Section 1.4 of the Note Agreement, are collectively referred to as the "Notes" (such term shall also include any such notes issued in substitution therefor pursuant to Section 9.2 of the Note Agreement). The Series E Notes shall be substantially in the form set out in Exhibit 1 hereto with such changes therefrom, if any, as may be approved by the Purchasers and the Company.

2. Subject to the terms and conditions hereof and as set forth in the Note Agreement and on the basis of the representations and warranties hereinafter set forth, the Company agrees to issue and sell to each Purchaser, and each Purchaser agrees to purchase from the Company, Series E Notes in the principal amount set forth opposite such Purchaser's name on Schedule A hereto at a price of 100% of the principal amount thereof on the closing date hereafter mentioned.

3. Delivery of the \$20,000,000 in aggregate principal amount of the Series E Notes will be made at the offices of Chapman and Cutler, 111 West Monroe Street, Chicago, Illinois 60603-4080 against payment therefor in Federal Reserve or other funds current and immediately available at the principal office of Bank of America, ABA No. 121000358, Account No. 14879-00161, Account Name: California Water Service Company Security Sales, in the amount of the purchase

price at 11:00 A.M., San Francisco, California time, on May 23, 2002 or such later date (not later than May 31, 2002) as shall mutually be agreed upon by the Company and the Purchasers of the Series E Notes (the "Closing Date").

#### 4. Prepayment of Notes.

(a) Required Prepayments. No prepayments are required to be made with respect to the Series E Notes prior to the expressed maturity date thereof other than prepayments made in connection with an acceleration of the Series E Notes pursuant to the provisions of Section 6.3 of the Note Agreement.

(b) Optional Prepayment with Premium. Upon compliance with Section 4(d) below the Company shall have the privilege, at any time and from time to time, of prepaying the outstanding Notes of any Series, either in whole or in part (but if in part then in a minimum principal amount of \$100,000) by payment of the principal amount of the Notes of such Series, or portion thereof to be prepaid, and accrued interest thereon to the date of such prepayment, together with a premium equal to the Make-Whole Amount, determined as of five Business Days prior to the date of such prepayment pursuant to this Section 4(b).

(c) Optional Prepayment at Par in the Event of Condemnation. In the event a Material Condemnation shall have occurred with respect to any property of the Company or a Restricted Subsidiary, then upon compliance with Section 4(d) below the Company shall have the privilege of applying the proceeds of any condemnation award received in connection with such Material Condemnation to the prepayment of the principal amount of the Notes of any Series then outstanding, or any portion thereof to the extent of such proceeds, together with accrued interest thereon to the date of such prepayment. Any optional prepayment made pursuant to this Section 4(c) shall be without premium.

(d) Notice of Optional Prepayments. The Company will give notice of any prepayment of the Notes pursuant to Section 4(b) or 4(c) to each Holder of Notes to be prepaid not less than 30 days nor more than 60 days before the date fixed for such optional prepayment specifying (a) such date, (b) the Section of this Third Supplement under which the prepayment is to be made, (c) the principal amount of the Holder's Notes to be prepaid on such date, (d) whether a premium may be payable, (e) the date when the premium, if any, will be calculated, (f) the estimated premium, together with a reasonably detailed computation of such estimated premium, and (g) the accrued interest applicable to the prepayment. Such notice of prepayment shall also certify all facts, if any, which are conditions precedent to any such prepayment. Notice of prepayment having been so given, the aggregate principal amount of the Notes to be prepaid specified in such notice, together with accrued interest thereon and the premium, if any, payable with respect thereto shall become due and payable on the prepayment date specified in said notice. Not later than two Business Days prior to the prepayment date specified in such notice,

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the Company shall provide each Holder of a Note to be prepaid written notice of the premium, if any, payable in connection with such prepayment and, whether or not any premium is payable, a reasonably detailed computation of the Make-Whole Amount.

(e) Application of Prepayments. In the case of each partial prepayment of the Notes pursuant to the provisions of Section 4(b) or 4(c), the principal amount of the Notes of the Series to be prepaid shall be allocated among all of the Notes of such Series at the time outstanding in proportion, as nearly as practicable, to the respective unpaid principal amounts thereof.

(f) Direct Payment. Notwithstanding anything to the contrary contained in the Note Agreement, this Third Supplement or the Notes, in the case of any Note owned by any Holder that is a Purchaser, Additional Purchaser or any other Institutional Holder which has given written notice to the Company requesting that the provisions of this Section 4(f) shall apply, the Company will punctually pay when due the principal thereof, interest thereon and premium, if any, due with respect to said principal, without any presentment thereof, directly to such Holder at its address set forth herein or such other address as such Holder may from time to time designate in writing to the Company or, if a bank account with a United States bank is so designated for such Holder, the Company will make such payments in immediately available funds to such bank account, marked for attention as indicated, or in such other manner or to such other account in any United States bank as such Holder may from time to time direct in writing.

(g) Make Whole Amount. The term "Make-Whole Amount" shall mean with respect to the Series E Notes in connection with any prepayment or acceleration, the following: the excess, if any, of (a) the aggregate present value as of the date of such prepayment of each dollar of principal being prepaid and the amount of interest (exclusive of interest accrued to the date of prepayment) that would have been payable in respect of such dollar if such prepayment had not been made, determined by discounting such amounts at the Reinvestment Rate from the respective dates on which they would have been payable, over (b) 100% of the principal amount of the outstanding Series E Notes being prepaid. If the

Reinvestment Rate is equal to or higher than 7.11%, the Make-Whole Amount shall be zero. For purposes of any determination of the Make-Whole Amount for the Series E Notes, the following terms have the following meanings:

"Reinvestment Rate" shall mean (1) the sum of 0.50%, plus the yield reported on page "USD" of the Bloomberg Financial Markets Services Screen (or, if not available, any other nationally recognized trading screen reporting on-line intraday trading in the United States government Securities) at 10:00 A.M. (Chicago, Illinois time) for the United States government Securities have a maturity (rounded to the nearest month) corresponding to the Remaining Life to Maturity of the principal of the Notes being prepaid or (2) in the event that no nationally recognized trading screen reporting on-line intraday trading in the United States government Securities is available, Reinvestment Rate shall mean 0.50%, plus the arithmetic mean of the yields for the two columns under the heading "Week Ending" published in the Statistical Release under the caption "Treasury Constant Maturities" for the maturity (rounded to the nearest month) corresponding to the Remaining Life to Maturity of the principal being prepaid. If no maturity exactly corresponds to such Remaining Life to Maturity, yields for the published maturity

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next longer than the Remaining Life to Maturity and for the published maturity next shorter than the Remaining Life to Maturity shall be calculated pursuant to the immediately preceding sentence and the Reinvestment Rate shall be interpolated from such yields on a straight-line basis, rounding in each of such relevant periods to the nearest month. For the purposes of calculating the Reinvestment Rate, the most recent Statistical Release published prior to the date of determination of the Make-Whole Amount shall be used.

"Statistical Release" shall mean the then most recently published statistical release designated "H.15(519)" or any successor publication which is published weekly by the Federal Reserve System and which establishes yields on actively traded U.S. Government Securities adjusted to constant maturities or, if such statistical release is not published at the time of any determination hereunder, then such other reasonably comparable index which shall be designated by the Holders holding 66-2/3% in aggregate principal amount of the outstanding Series E Notes, subject to approval of the Company which approval will not be unreasonably withheld.

"Remaining Life to Maturity" of the principal amount of the Series E Notes being prepaid shall mean, as of the time of any determination thereof, the number of years (calculated to the nearest one-twelfth) which will elapse between the date of determination and the final maturity of the Series E Notes being prepaid.

#### 5. Closing Conditions.

(a) Conditions. The obligation of each Purchaser to purchase the Series E Notes on the Closing Date shall be subject to the performance by the Company of its agreements hereunder which by the terms hereof are to be performed at or prior to the time of delivery of the Series E Notes and to the following further conditions precedent:

(i) Closing Certificate. Such Purchaser shall have received a certificate dated the Closing Date, signed by the President or a Vice President of the Company, the truth and accuracy of which shall be a condition to such Purchaser's obligation to purchase the Series E Notes proposed to be sold to such Purchaser and to the effect that (1) the representations and warranties of the Company set forth in Exhibit 2 hereto are true and correct on and with respect to the Closing Date, (2) the Company has performed all of its obligations hereunder which are to be performed on or prior to the Closing Date, and (3) no Default or Event of Default has occurred and is continuing.

(ii) Compliance Certificate. Such Purchaser shall have received a certificate dated the Closing Date, signed by the Senior Financial Officer of the Company stating that such officer has reviewed the provisions of the Note Agreement and this Third Supplement and setting forth the information and computation (in sufficient detail) required in order to establish whether the Company is in compliance with Section 5.6 of the Note Agreement on the Closing Date.

(iii) Legal Opinions. Such Purchaser shall have received from McCutchen, Doyle, Brown & Enersen LLP, counsel for the Company, and Chapman and Cutler,

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special counsel for the Purchasers, their opinions dated the Closing Date, in form and substance satisfactory to such Purchasers, and covering the matters set forth respectively in Exhibits 3 and 4 hereto.

(iv) Regulatory Approval. Prior to the Closing Date, the issue and sale of the Series E Notes shall have been duly authorized or approved by appropriate order of the Public Utilities Commission of the State of California (the "Commission"). Such order shall be final and in full force and effect and not subject to any appeal, hearing, rehearing or contest. All conditions contained in any such order which are to be fulfilled on or prior to the issuance of the Series E Notes shall have been fulfilled. The Company shall have delivered to the Purchasers and their special counsel a certified copy of such order and the application therefor.

(v) Related Transactions. The Company shall have consummated the sale of the entire principal amount of the Series E Notes scheduled to be sold on the Closing Date pursuant to this Third Supplement.

(vi) Satisfactory Proceedings. All proceedings taken in connection with the transactions contemplated by this Third Supplement, and all documents necessary to the consummation thereof, shall be satisfactory in form and substance to such Purchaser and such Purchaser's special counsel, and such Purchaser shall have received a copy (executed or certified as may be appropriate) of all legal documents or proceedings taken in connection with the consummation of said transactions.

(vii) Purchase Permitted By Applicable Law. On the Closing Date, the purchase of Series E Notes shall (a) be permitted by the laws and regulations of each jurisdiction to which any Purchaser is subject, without recourse to provisions (such as Section 1405(a)(8) of the New York Insurance Law) permitting limited investments by insurance companies without restriction as to the character of the particular investment, (b) not violate any applicable law or regulation (including, without limitation, Regulation U, T or X of the Board of Governors of the Federal Reserve System) and (c) not subject any Purchaser to any tax, penalty or liability under or pursuant to any applicable law or regulation, which law or regulation was not in effect on the date hereof. If requested by any Purchaser, such Purchaser shall have received an Officer's Certificate certifying as to such matters of fact as such Purchaser may reasonably specify to enable such Purchaser to determine whether such purchase is so permitted.

(viii) Payment of Special Counsel Fees. The Company shall have paid, on or before the Closing Date, the fees, charges and disbursements of the Purchasers' special counsel referred to in (iii) above, to the extent reflected in a statement of such counsel rendered to the Company at least one Business Day prior to the Closing Date.

(ix) Private Placement Number. A Private Placement Number issued by Standard & Poor's CUSIP Service Bureau (in cooperation with the Securities Valuation Office of the National Association of Insurance Commissioners) shall have been obtained for the Series E Notes.

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(b) The obligation of the Company to deliver the Series E Notes hereunder is subject to the conditions that (i) the Commission shall have authorized the issuance and sale by the Company of the Series E Notes at the price herein provided and said authorization shall be in full force and effect and (ii) the entire principal amount of the Series E Notes scheduled to be sold on the Closing Date pursuant to this Third Supplement shall have been tendered by the Purchasers. If the condition specified in this Section 5(b) shall not have been fulfilled prior to or on the Closing Date, this Third Supplement and all the obligations of the Company hereunder, except as provided in Section 9.4 of the Note Agreement, may be cancelled by the Company.

(c) If on the Closing Date the Company fails to tender to any Purchaser the Series E Notes to be issued to any Purchaser on such date or if the conditions specified in Section 5(a) have not been fulfilled, such Purchaser may thereupon elect to be relieved of all further obligations under this Third Supplement. Without limiting the foregoing, if the conditions specified in Section 5(a) have not been fulfilled, such Purchaser may waive compliance by the Company with any such condition to such extent as such Purchaser may in its sole discretion determine. Nothing in this Section 5(c) shall operate to relieve the Company of any of its obligations hereunder or to waive any Purchaser's rights against the Company.

6. Each Purchaser represents and warrants that the representations and warranties set forth in Section 3.2 of the Note Agreement are true and correct on the date hereof with respect to the Series E Notes purchased by such Purchasers.



7. The Company and each Purchaser agree to be bound by and comply with the terms and provisions of the Note Agreement as if such Purchaser were an original signatory to the Note Agreement.

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California Water Service Company  
Third Supplement

The execution hereof shall constitute a contract between the Company and the Purchaser(s) for the uses and purposes hereinabove set forth, and this agreement may be executed in any number of counterparts, each executed counterpart constituting an original but all together only one agreement.

CALIFORNIA WATER SERVICE COMPANY

By \_\_\_\_\_  
Name: Peter C. Nelson  
Title: President and Chief Executive Officer

Accepted as of May \_\_\_\_, 2002

ALLSTATE LIFE INSURANCE COMPANY

By \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

ALLSTATE LIFE INSURANCE COMPANY OF NEW YORK

By \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

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California Water Service Company  
Third Supplement

Accepted as of May \_\_\_\_, 2002

NEW YORK LIFE INSURANCE COMPANY

By \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

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INFORMATION RELATING TO PURCHASERS

NAME AND ADDRESS OF PURCHASER	PRINCIPAL AMOUNT OF SERIES E NOTES TO BE PURCHASED
ALLSTATE LIFE INSURANCE COMPANY 3075 Sanders Road, STE G5D Northbrook, Illinois 60062-7127 Attention: Private Placements Department Telephone Number: (847) 402-8922 Telecopier Number: (847) 402-3092	\$8,000,000

Payments

All payments on or in respect of the Notes to be made by Fedwire transfer of immediately available funds (identifying each payment with name of the Issuer (and the Credit, if any), the Private Placement Number preceded by "DPP" and the payment as principal, interest or premium) in the exact format as follows:

- BBK = Harris Trust and Savings Bank  
ABA #071000288
- BNF = Allstate Life Insurance Company  
Collection Account #168-117-0

ORG = [Name of Issuer]  
OBI = DPP - [Insert Private Placement Number]--  
Payment Due Date (MM/DD/YY)--  
P \_\_\_\_\_ (enter "P" and the amount of principal being  
remitted, for example, P5000000.00)--  
I \_\_\_\_\_ (enter "I" and the amount of interest being  
remitted, for example, I225000.00)

#### Notices

All notices of scheduled payments and written confirmation of each such payment, to be addressed:

Allstate Insurance Company  
Investment Operations--Private Placements  
3075 Sanders Road, STE G4A  
Northbrook, Illinois 60062-7127  
Telephone: (847) 402-6672  
Telecopy: (847) 326-5040

All financial reports, compliance certificates and all other written communications, including notice of prepayments to be addressed as first provided above.

Name of Nominee in which Notes are to be issued: None

Taxpayer I.D. Number: 36-2554642

#### SCHEDULE A (to Supplement)

NAME AND ADDRESS OF PURCHASER	PRINCIPAL AMOUNT OF SERIES E NOTES TO BE PURCHASED
ALLSTATE LIFE INSURANCE COMPANY OF NEW YORK 3075 Sanders Road, STE G5D Northbrook, Illinois 60062-7127 Attention: Private Placements Department Telephone Number: (847) 402-4394 Telefacsimile Number: (847) 402-3092	\$2,000,000

#### Payments

All payments on or in respect of the Notes to be made by Fedwire transfer of immediately available funds (identifying each payment with name of the Issuer (and the Credit, if any), the Private Placement Number preceded by "DPP" and the payment as principal, interest or premium) in the exact format as follows:

BBK = Harris Trust and Savings Bank  
ABA #071000288  
BNF = Allstate Life Insurance Company of New York  
Collection Account #168-120-4  
ORG = [Name of Issuer]  
OBI = DPP - [Insert Private Placement Number]--  
Payment Due Date (MM/DD/YY)--  
P \_\_\_\_\_ (enter "P" and the amount of principal being  
remitted, for example, P5000000.00)--  
I \_\_\_\_\_ (enter "I" and the amount of interest being  
remitted, for example, I225000.00)

#### Notices

All notices of scheduled payments and written confirmation of each such payment, to be addressed:

Allstate Insurance Company  
Investment Operations--Private Placements  
3075 Sanders Road, STE G4A  
Northbrook, Illinois 60062-7127  
Telephone: (847) 402-6672  
Telecopy: (847) 326-5040

All financial reports, compliance certificates and all other written communications, including notice of prepayments to be addressed as first provided above.

Name of Nominee in which Notes are to be issued: None

Taxpayer I.D. Number: 36-2608394

NAME AND ADDRESS OF PURCHASER  
NEW YORK LIFE INSURANCE COMPANY  
c/o New York Life Investment Management LLC  
51 Madison Avenue  
New York, New York 10010  
Attention: Securities Investment Group, Private Finance, 2nd Floor  
Telefacsimile Number: (212) 447-4122

PRINCIPAL AMOUNT OF SERIES E  
NOTES TO BE PURCHASED  
\$10,000,000

Payments

All payments on or in respect of the Notes to be by wire or intrabank transfer of immediately available funds to:

Chase Manhattan Bank  
New York, New York 10019  
ABA #021-000-021  
Credit: New York Life Insurance Company  
General Account Number 008-9-00687

With sufficient information (including issuer, PPN number, interest rate, maturity and whether payment is of principal, premium, or interest) to identify the source and application of such funds.

Notices

All notices with respect to payments and written confirmation of each such payment, to be addressed:

New York Life Insurance Company  
c/o New York Investment Management LLC  
51 Madison Avenue  
New York, New York 10010-1603  
Attention: Financial Management and Operations Group  
Securities Operations, 2nd Floor  
Fax Number: (212) 447-4160

All other notices and communications to be addressed as first provided above, with a copy of any notices regarding defaults or Events of Default under the operative documents to: Office of the General Counsel, Investment Section, Room 1107, Fax Number (212) 576-8340

Name of Nominee in which Notes are to be issued: None

Taxpayer I.D. Number: 13-5582869

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[FORM OF SERIES E NOTE]

THIS NOTE HAS NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND ANY SALE, TRANSFER, PLEDGE OR OTHER DISPOSITION THEREOF MAY BE MADE ONLY (1) IN A TRANSACTION REGISTERED UNDER SAID ACT OR (2) IF AN EXEMPTION FROM REGISTRATION UNDER SAID ACT IS AVAILABLE.

CALIFORNIA WATER SERVICE COMPANY

7.11% Series E Senior Note  
Due May 1, 2032

PPN: 130789 M \* 8

No. May \_\_, 2002

\$

California Water Service Company, a California corporation (the "Company"), for value received, hereby promises to pay to

or registered assigns  
on the first day of May, 2032,  
the principal amount of

DOLLARS (\$\_\_\_\_\_)

and to pay interest (computed on the basis of a 360-day year of twelve 30-day months) on the principal amount from time to time remaining unpaid hereon at the rate of 7.11% per annum from the date hereof until maturity, payable

semiannually on the first day of each May and November in each year (commencing on the first of such dates after the date hereof) and at maturity. The Company agrees to pay interest on overdue principal (including any overdue required or optional prepayment of principal) and premium, if any, and (to the extent legally enforceable) on any overdue installment of interest, at the rate of 9.11% per annum after the due date, whether by acceleration or otherwise, until paid. Both the principal hereof and interest hereon are payable at the principal office of the Company in San Jose, California in coin or currency of the United States of America which at the time of payment shall be legal tender for the payment of public and private debts.

EXHIBIT 1  
(to Supplement)

This Note is one of a series of Notes (the "Notes") issued pursuant to a supplement to the Note Agreement dated as of March 1, 1999 (as from time to time amended and supplemented, the "Note Agreement"), between the Company, the Purchasers named therein and Additional Purchasers of Notes from time to time issued pursuant to any Supplement to the Note Agreement. This Note and the holder hereof are entitled equally and ratably with the holders of all other Notes of all Series from time to time outstanding under the Note Agreement to all the benefits provided for thereby or referred to therein. Each holder of this Note will be deemed, by its acceptance hereof, to have made the representation set forth in Section 3.2 of the Note Agreement, provided that such holder may (in reliance upon information provided by the Company, which shall not be unreasonably withheld) make a representation to the effect that the purchase by such holder of any Note will not constitute a non-exempt prohibited transaction under Section 406(a) of ERISA.

This Note and the other Notes outstanding under the Note Agreement may be declared due prior to their expressed maturity dates, all in the events, on the terms and in the manner and amounts as provided in the Note Agreement.

The Notes are not subject to prepayment or redemption at the option of the Company prior to their expressed maturity dates except on the terms and conditions and in the amounts and with the premium, if any, set forth in the Note Agreement.

This Note is registered on the books of the Company and is transferable only by surrender thereof at the principal office of the Company duly endorsed or accompanied by a written instrument of transfer duly executed by the registered holder of this Note or its attorney duly authorized in writing. Payment of or on account of principal, premium, if any, and interest on this Note shall be made only to or upon the order in writing of the registered holder.

This Note shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the law of the State of California excluding choice-of-law principles of the law of such State that would require the application of the laws of a jurisdiction other than such State.

CALIFORNIA WATER SERVICE COMPANY

By \_\_\_\_\_  
Name: \_\_\_\_\_  
Title: \_\_\_\_\_

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REPRESENTATIONS AND WARRANTIES

The Company represents and warrants to each Purchaser that:

1. Corporate Organization, Subsidiaries. The Company is duly organized and existing and in good standing under and by virtue of the laws of the State of California and is duly authorized and empowered to own and operate its properties and to carry on its business, all as and in the places where such properties are now owned and operated and such business is conducted. The Company has no Subsidiaries.

2. Corporate Authority. The Company has full corporate power and corporate authority to sell and issue the Series E Notes. The issuance and sale of the Series E Notes and the execution and delivery of the Third Supplement will have been duly authorized by the Board of Directors of the Company and by the Public Utilities Commission of the State of California (the "Commission") prior to the Closing Date, and no other action is required to be taken by, and no consents or approvals are required to be obtained from, the shareholders of the Company or any public body or bodies, and no other corporate action of the Company is requisite to such issue and sale.

3. Business and Property. Each Purchaser has heretofore been furnished

with a copy of the Company Information which generally sets forth the principal properties of the Company and the business conducted and proposed to be conducted by the Company.

4. Indebtedness. Annex A attached hereto correctly describes all Current Debt, Funded Debt and Capitalized Leases of the Company outstanding on March 31, 2002.

5. Financial Statements and Reports. The Company has furnished each Purchaser with a copy of its audited financial reports for 1999, 2000 and 2001 hereinafter called the "Company Reports," and a copy of Form 10-K filed by California Water Service Group ("CWSG") hereinafter called the "CWSG 10-K" with the Securities and Exchange Commission for 2001, together with all reports or documents required to be filed by CWSG pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, since the filing of the CWSG 10-K. The Company has also furnished each Purchaser with an unaudited quarterly financial statement for the Company for the fiscal quarter ended March 31, 2002, and Forms 10 Q for CWSG for the fiscal quarter ended March 31, 2002 (the "Quarterly Reports"). The financial statements contained in the foregoing Company Reports, the CWSG 10-K, the Quarterly Reports and such other reports and documents were prepared in accordance with generally accepted accounting principles upon a consistent basis and are complete and correct and the balance sheets included therein fairly present the financial condition of the Company or CWSG, as the case may be, as at the respective dates thereof and the Statements of Income, Common Shareholders' Equity and Cash Flows included therein fairly present the results of the operations of the Company for the periods covered thereby, subject in the case of unaudited statements to normal year-end adjustments.

6. Material Contracts. The Company has no contracts or commitments, whether contingent or other, which are material to the Company and which were not made in the ordinary

EXHIBIT 2  
(to Supplement)

course of business. Certain material contracts related to water supply are listed in Annex B hereto. The Company has no contracts or commitments, contingent or other, which materially and adversely affect or in the future may (so far as the Company can foresee) materially and adversely affect the Company or its business, property, assets, operations or condition, financial or other. As at December 31, 2001, there were no material liabilities of the Company (other than those under contracts entered into in the normal and ordinary course of business), actual, contingent or accrued, which were not reflected in the Company Reports and CWSG 10-K except for (i) liability in respect of uncompleted construction work under open contracts in connection with the Company's construction program and (ii) the obligations of the Company to contribute to a pension plan, an employees' savings plan and a health and welfare plan.

7. No Material Adverse Change. (a) There has been no change in the condition of the Company, financial or other, from that set forth or reflected in the Company Information, other than changes which may have occurred in the ordinary course of business or by reason of ordinary dividends paid or declared or outstanding First Mortgage Bonds redeemed by the Company in accordance with their terms, and no such changes in the ordinary course of business have been material adverse changes.

(b) Since December 31, 2001, neither the business, operations, properties nor assets of the Company have been adversely affected in any material way by any casualties such as fire, windstorm, riot, strike, explosion, accident, flood, earthquake, lockout, sabotage, activities of armed forces, act of God or the public enemy or condemnation of properties by the United States government or any municipal governmental agency, authority or body.

8. Title to Properties. The Company is engaged in the business of a public utility water company serving all or a portion of the California cities and communities listed in the 2001 Company Report and paragraph 9 hereof. The Company has good and merchantable title, subject only to the lien of the Mortgage Indenture and to current tax and assessment liens, rights-of-way, easements and certain minor liens, encumbrances, clouds or defects in title which do not materially affect the use thereof, to all the material water distribution facilities (including, without limitation, transmission and distribution mains, pump stations, wells, storage tanks and reservoirs) and other material units of property used in its business except as follows:

(a) some of the offices, but not its principal office, are in leased premises and some wells, well sites and other minor distribution facilities are rented; and

(b) several wells are located on property which the Company does not own but in which it has an easement for the location of such wells;

and except as to easements and rights-of-way and certain parcels of land (not

exceeding for said parcels of land an aggregate book value of \$1,000,000) with respect to which there is a possibility of reverter if the property ceases to be used for public utility purposes, and, except that the greater portion of its transmission and distribution systems is located in public highways and streets and in rights-of-way owned by the Company over lands of others, the Company's title thereto is fee simple. Except for parcels of land having an aggregate book value of not more than \$1,000,000, the Company has good and merchantable title to all its other property and assets

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subject only to the lien of the Mortgage Indenture and the lien of the Dominguez Mortgage Indenture and to current tax and assessment liens and minor liens and encumbrances which do not materially affect the use thereof. All of the properties of the Company are located in the State of California and substantially all of the properties of the Company used or useful in its public utility business are subject to the Mortgage Indenture. As used herein, the term "Dominguez Mortgage Indenture" means the Trust Indenture dated as of August 1, 1954, as supplemented from time to time, between the Company, as successor to Dominguez Water Company ("Dominguez") and U.S. Bank, as Trustee, which provides a lien on properties owned by Dominguez immediately prior to the merger described in paragraph 9 hereof which lien secures \$9,000,000 in aggregate principal amount of Dominguez bonds which were assumed by the Company upon the merger.

9. Franchises. The Company has, in its judgment, adequate franchises and permits without burdensome restrictions (other than those typically contained in franchises and permits of this type) to allow the Company to conduct the business in which it is engaged.

The Company has two classes of franchises to install and operate water pipes and mains under public streets and highways:

(a) so-called "constitutional" franchises obtained by virtue of the provisions of Article XI, Section 19, of the California Constitution, as in effect prior to 1911; and

(b) franchises granted pursuant to statutory authority.

The Company believes, based on the advice of counsel (which is itself based upon the assumption of the accuracy of information obtained by the Company from sources believed to be reliable that the following cities served by the Company were all incorporated prior to 1911:

Bakersfield	Marysville	South San Francisco
Chico	Oroville	Stockton
Dixon	Redondo Beach	Visalia
Hermosa Beach	Salinas	Willows
King City	San Mateo	
Livermore	Selma	

that water distribution systems were constructed and service furnished to the inhabitants of each by various predecessors of the Company prior to 1911, and that there were no public water works owned or controlled by the municipality in any of them prior to 1911), that the Company has a "constitutional" franchise in each of the above cities and under such constitutional franchise has a perpetual right which was not repealed by the repeal of Article XI, Section 19, of the California Constitution to continue to occupy public streets of each of said cities with its pipes and mains and to lay down additional pipes and mains in said streets for the supplying of water, subject to reasonable regulation by the respective municipalities. The Company also believes, based on the advice of counsel, that this right is not limited to streets in which pipes or mains were laid prior to 1911 but extends at least to all streets in the said municipalities as they existed at the date of repeal of the constitutional provision in 1911 and probably also extends to

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territory incorporated into each respective city after such repeal, although this latter question remains somewhat in doubt in the absence of a final decision of the courts thereon. The Company holds either by assignment or as original grantee franchises granted under statutory authority by the Counties of Kern, Los Angeles, San Joaquin, Santa Clara and Monterey, the Cities of Montebello, Torrance, Cupertino, Sunnyvale, Los Altos, Mountain View, Bakersfield, Commerce, San Carlos, Rolling Hills Estates and Thousand Oaks, and the Towns of Los Altos Hills and Atherton. Following incorporation of the City of Rancho Palos Verdes in 1973, the Company made franchise payments to the City and the City accepted the same as successor in interest to the grantor's rights under the Company's former franchise from the County of Los Angeles; the City has agreed that the Company may exercise its rights in the City under its current County franchise until the expiration of that franchise in 2012. The Company's franchises from the Cities of Palos Verdes Estates, Menlo Park and Woodside terminated in 1977, 1993 and 1994, respectively. While none of the

Cities and the Company have executed a new franchise agreement, the Company has made and will continue to make franchise payments to each of the Cities in accordance with the provisions of the prior franchise. In other areas where the Company has no franchise, the Company or its predecessors have distributed water for many years and, to the Company's knowledge, no question has ever been raised as to the right to make such distribution and to maintain all pipes and mains necessary therefor.

On May 25, 2000, Dominguez Service Corporation was merged into the Company and subsequently Dominguez and its subsidiaries were also merged into the Company (collectively, the "merger"). The Company acquired in the Dominguez merger operations in the following cities, counties, townships or localities that Dominguez previously served:

Bodfish	Kern County	Los Angeles County
Carson	Kernville	Lucerne
Compton	Lake Hughes	Mountain Shadows
Duncans Mills	Lakeland	Onyx
Fremont Valley	Lancaster	Squirrel Valley
Guerneville	Leona Valley	Torrance
Harbor City	Long Beach	Wofford Heights

Water distribution systems were constructed and service furnished to the inhabitants of the localities currently known as Carson, Compton, Harbor City, Long Beach and Torrance by various predecessors of the Company prior to 1911 and the Company believes that it has a prior right to operate in these locations which right was not extinguished by the incorporation of these cities subsequent to 1911. Except as noted below, Dominguez has no franchises from these cities and has made no franchise payments to them and, to the Company's knowledge, no question has ever been raised as to the right to make water distribution and to maintain all pipes and mains necessary therefor.

As to the remaining localities, Dominguez has received written franchise agreements which are in full force and effect and has paid all franchise fees to date, with the exception of Compton and the City of Carson Redevelopment Project #2, as to which the franchises expired without renewal in, respectively, 1994 and 1998. Dominguez continued to provide water services to Compton and the City of Carson Redevelopment Project #2 subsequent to the

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expiration of the respective franchises, and to pay franchise fees, and to the Company's knowledge no question has ever been raised as to the right to make such distribution and to maintain all pipes and mains necessary therefor.

10. Condition of Assets. The physical assets of the Company are in sound operating condition, there are no material arrears in the maintenance of any such physical assets and the Company believes that its sources of water are adequate to meet its requirements for the foreseeable future.

11. Pending Litigation, Proceedings. (a) There are no actions, suits or proceedings pending at law or in equity or before or by any federal, state, municipal or other governmental department, commission, board, bureau, agency or instrumentality, domestic or foreign, or, to the knowledge of the Company, threatened against or affecting the Company not adequately covered by insurance or for which reserves adequate in the Company's judgment have not been established which involve, in the opinion of the Company, a reasonable possibility of judgments or liabilities exceeding \$500,000 in the aggregate net of insurance, or which may, in the opinion of the Company result in any material adverse change in the business or properties or in the condition, financial or other, of the Company, or the ability of the Company to perform its obligations under the Third Supplement or the Series E Notes.

(b) There are no proceedings pending or, to the knowledge of the Company, threatened against the Company before or by any federal, state or municipal commission, board or other administrative agency, which materially and adversely affect the water rates of the Company presently in effect.

(c) The Company is not in default with respect to any order, writ, injunction or decree of any court, or any federal, state or municipal commission, board or other administrative agency and the Company has complied with all applicable statutes and regulations of the United States of America and of any state, municipality or agency of any thereof, in respect of the conduct of its business known or believed by the Company to be applicable thereto, the failure to comply with which could reasonably be expected to have a material adverse effect on the Company or its properties.

12. No Condemnation Proceedings. Since January 1, 1995, no elections have been held or other actions taken authorizing the commencement of proceedings for condemnation of any of the properties of the Company. However, from time to time there are expressions of interest made by public bodies, elected or appointed municipal officials, persons seeking political position or citizens groups urging acquisition of the Company's facilities in one or more of the communities served by the Company. The Company does not believe that any

acquisition by a city or municipality of its properties by condemnation or threat thereof would be adverse to the holders of the Series E Notes.

13. No Burdensome Restrictions. The Company is not subject to any burdensome corporate restrictions in its Articles of Incorporation, By-Laws or otherwise, which materially and adversely affect or in the future may (so far as the Company can foresee) materially and

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adversely affect the Company or its business, property, assets, operations or condition, financial or other.

14. Regulatory Status, Approval. (a) The Company is not a registered holding company or a subsidiary of a registered holding company and the Company is not required to register under the Public Utility Holding Company Act of 1935, as amended. The Company is subject to the jurisdiction of the Commission.

(b) No consent of, approval or authorization by, filing or registration with, or notice to any governmental or public authority or agency is required for the issuance, sale or delivery of the Series E Notes or the execution, delivery or performance of the Third Supplement, other than the authorization of the Commission, which authorization has been duly obtained, is in full force and effect and is not subject to any appeal, hearing, rehearing or contest. All conditions contained in any such authorization which were to be fulfilled on or prior to the issuance of the Series E Notes have been fulfilled. The Company has furnished to your special counsel true, correct and complete copies of said authorization and all applications heretofore filed with or submitted to the Commission in connection with its action to obtain said authorization.

15. No Defaults, Compliance with Other Instruments. The Company is not in default under any outstanding indentures, contracts or agreements which are material to the Company including, without limitation, the Mortgage Indenture; and on the Closing Date there will not exist any condition which would be a default under any such indenture, contract or agreement. The execution and delivery of the Third Supplement, the consummation of the transactions therein provided for and compliance with the provisions of the Third Supplement and the Series E Notes by the Company will not violate or result in any breach of the terms, conditions or provisions of, or constitute a default under, its Articles of Incorporation, By-Laws or any indenture, mortgage, deed of trust, bank loan or credit agreement, or other material agreement or instrument to which the Company is a party or by which the Company may be bound, nor will such acts result in the violation of any applicable law, rule, regulation or order applicable to the Company of any court or governmental authority having jurisdiction in the premises or in the creation or imposition of any lien, charge or encumbrance of any nature whatsoever, upon any property or assets of the Company.

16. Leases. The Company has the right to, and does, enjoy peaceful and undisturbed possession under all material leases to which it is a party or under which it is operating. All such leases are valid, subsisting and in full force and effect, and the Company is not in default under any thereof and no event has occurred and is continuing, and no condition exists that, after notice or passage of time or both could become a material default under any such Lease.

17. Use of Proceeds. The Company will use the gross proceeds derived from the sale of the Series E Notes under the Third Supplement to refinance existing Indebtedness and to finance a portion of the Company's general construction program. None of the transactions contemplated in the Third Supplement (including, without limitation thereof, the use of the proceeds from the sale of the Series E Notes) will violate or result in a violation of Section 7 of the Securities Exchange Act of 1934, as amended, or any regulations issued pursuant thereto, including without limitation, Regulations U, T and X of the Board of Governors of the Federal

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Reserve System, 12 C.F.R., Chapter II. The Company does not own or intend to carry or purchase any "margin stock" within the meaning of said Regulation U, including margin stock originally issued by it. None of the proceeds from the sale of the Series E Notes will be used to purchase or carry (or refinance any borrowing the proceeds of which were used to purchase or carry) any margin stock.

18. ERISA. (a) The fair market value of all assets under all "employee pension benefit plans" (as such term is defined in Section 3(2) of ERISA), maintained by the Company, as from time to time in effect, exceeded as of December 31, 2001, the last annual valuation date, the actuarial present value of all benefits vested under the Plans by more than \$10,409,000.

(b) Neither any of the Plans nor any of the trusts created thereunder, nor any trustee or administrator thereof, has engaged in a "prohibited transaction," as such term is defined in Section 4975 of the Code which could



subject the Plans or any of them, any such trust, or any trustee or administrator thereof, or any disqualified person with respect to the Plans to the tax or penalty on prohibited transactions imposed by said Section 4975, except that, with respect to any actions or omissions of administrators, trustees, other fiduciaries, parties in interest or disqualified persons of or in respect to the Plans (other than employees of the Company), the Company has no knowledge that any of such persons has committed a prohibited transaction, nor has the Company participated knowingly in or knowingly undertaken to conceal a prohibited transaction with or by any of such persons nor enabled any of them to commit a prohibited transaction.

(c) Neither any of the Plans subject to Title IV of ERISA nor any trusts related to such plans have been terminated, nor have there been any Reportable Events, as that term is defined in Section 4043 of ERISA (as modified by the regulations thereunder), in respect of those plans since the effective date of ERISA.

(d) Neither any of the Plans which are subject to Section 302 of ERISA nor any trusts related to such plans have incurred any "accumulated funding deficiency," as such term is defined in said Section 302 (whether or not waived), since the effective date of ERISA.

(e) The consummation of the transactions provided for in the Third Supplement and compliance by the Company with the provisions thereof and the Series E Notes issued thereunder will not involve any prohibited transaction within the meaning of ERISA or Section 4975 of the Code.

19. Taxes. All Federal, state and local taxes and assessments due from the Company have been (a) fully paid or adequately provided for on the books of the Company in accordance with generally accepted accounting principles or (b) are being contested in good faith by the Company. There has been no examination of the Federal income tax returns of the Company by the Internal Revenue Service subsequent to the examinations of the returns for tax years 1984-1991.

20. Compliance with Laws. To the best of the Company's knowledge, after due inquiry, the Company is in compliance with all applicable Federal, state, or local laws, statutes, rules,

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regulations or ordinances relating to public health, safety or the environment, including, without limitation, relating to releases, discharges, emissions or disposals to air, water, land or ground water, to the withdrawal or use of ground water, to the use, handling or disposal of polychlorinated biphenyls (PCB's), asbestos or urea formaldehyde, to the treatment, storage, disposal or management of hazardous substances (including, without limitation, petroleum, its derivatives, by-products or other hydrocarbons), and to exposure to hazardous substances, the failure to comply with which could reasonably be expected to have a material adverse effect on the Company or its properties. Except as disclosed in the CWSG 10-K, the Company does not know of any liability of the Company under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended by the Superfund Amendments and Reauthorization Act of 1986 (42 U.S.C. Section 9601 et seq.) with respect to any property now or heretofore owned or leased by the Company.

21. Full Disclosure. The financial statements referred to in the Third Supplement do not, nor does the Third Supplement, the Company Information or any written statement (including without limitation the 2001 Company Report and the 2001 CWSG Report) furnished by the Company to you in connection with the negotiation of the sale of the Series E Notes, contain any untrue statement of a material fact or, taken together, omit a material fact necessary to make the statements contained therein or herein not misleading. There is no fact which the Company has not disclosed to you in writing which materially affects adversely nor, so far as the Company can now foresee, will materially affect adversely the properties, business, prospects, profits or condition (financial or otherwise) of the Company or the ability of the Company to perform its obligations under the Note Agreement, the Third Supplement or the Series E Notes.

22. Private Offering. Neither the Company, directly or indirectly, nor any agent on its behalf has offered or will offer the Series E Notes or any similar Security or has solicited or will solicit an offer to acquire the Series E Notes or any similar Security from or has otherwise approached or negotiated or will approach or negotiate in respect of the Series E Notes or any similar Security with any Person other than the Purchasers and not more than five (5) other institutional investors, each of whom was offered a portion of the Series E Notes at private sale for investment. Neither the Company, directly or indirectly, nor any agent on its behalf has offered or will offer the Series E Notes or any similar Security or has solicited or will solicit an offer to acquire the Series E Notes or any similar Security from any Person so as to cause the issuance and sale of the Series E Notes not to be exempt from the provisions of Section 5 of the Securities Act of 1933, as amended.

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CURRENT DEBT, FUNDED DEBT AND CAPITALIZED LEASES  
AS OF MARCH 31, 2002

1. Current Debt  

\$29,500,000 borrowed under the Company's bank line of credit with Bank of America.
2. Funded Debt  

\$111,865,000 outstanding under the Company's various series of First Mortgage Bonds with due dates ranging from 2002 to 2023.

\$20,000,000 Series A Senior Notes due November 1, 2025.

\$20,000,000 Series B Senior Notes due November 1, 2028.

\$20,000,000 Series C Senior Notes due November 1, 2030.

\$20,000,000 Series D Series Notes due November 1, 2031.

\$4,000,000 First Mortgage Bonds, Series J due 2023 (formerly Dominguez Water Company)

\$5,000,000 First Mortgage Bonds, Series K due 2012 (formerly Dominguez Water Company)

\$2,866,000 California Department of Water Resources Loans maturing 2011 to 2032.

\$519,000 obligations due on water system acquisitions.
3. Capitalized Leases  

None.

ANNEX A  
(to Exhibit 2)

MATERIAL WATER SUPPLY CONTRACTS

1. Water Supply Contract between the Company and the County of Butte relating to the Company's Oroville District.
2. Water Supply Contract between the Company and Kern County Water Agency relating to the Company's Bakersfield District.
3. Water Supply Contract between the Company and Stockton East Water District relating to the Company's Stockton District.
4. Amended Contract between the Company and Stockton East Water District relating to the Company's Stockton District.
5. Settlement Agreement and Master Water Sales Contract between the City and County of San Francisco and Certain Suburban Purchasers.
6. Supplement to Settlement Agreement and Master Water Sales Contract between the Company and the City and County of San Francisco relating to the Company's Bear Gulch District.
7. Supplement to Settlement Agreement and Master Water Sales Contract between the Company and the City and County of San Francisco relating to the Company's San Carlos District.
8. Supplement to Settlement Agreement and Master Water Sales Contract between the Company and the City and County of San Francisco relating to the Company's San Mateo District.
9. Supplement to Settlement Agreement and Master Water Sales Contract between the Company and the City and County of San Francisco relating to the Company's South San Francisco District.
10. Water Supply Contract between the Company and Santa Clara Valley Water District relating to the Company's Los Altos District.
11. Water Supply Contract between the Company and Pacific Gas and Electric Company related to the Company's Oroville District.
12. Water Supply Contract between the Company and Alameda County Flood Control and Water Conservation District related to the Company's Livermore District.

13. Water Supply Contract between the Company, ARCO Products Company and West Basin Municipal Water District relating to recycled water.

ANNEX B  
(to Exhibit 2)

DESCRIPTION OF CLOSING OPINION  
OF COUNSEL TO THE COMPANY

The closing opinion of McCutchen, Doyle, Brown & Enersen LLP, counsel for the Company, which is called for by Section 5(a)(iii) of the Third Supplement, shall be dated the Closing Date and addressed to the Purchasers, shall be satisfactory in scope and form to the Purchasers and shall be to the effect that:

1. The Company is a corporation, duly incorporated, validly existing and in good standing under the laws of the State of California, has the corporate power and the corporate authority to execute and perform the Third Supplement and to issue the Series E Notes and has the full corporate power and the corporate authority to conduct the activities in which it is now engaged.

2. The Note Agreement and the Third Supplement have been duly authorized by all necessary corporate action on the part of the Company, have been duly executed and delivered by the Company and constitute the legal, valid and binding contract of the Company enforceable in accordance with its terms, subject to bankruptcy, insolvency, fraudulent conveyance and similar laws affecting creditors' rights generally, and general principles of equity (regardless of whether the application of such principles is considered in a proceeding in equity or at law).

3. The Series E Notes have been duly authorized by all necessary corporate action on the part of the Company, have been duly executed and delivered by the Company and constitute the legal, valid and binding obligations of the Company enforceable in accordance with their terms, subject to bankruptcy, insolvency, fraudulent conveyance and similar laws affecting creditors' rights generally, and general principles of equity (regardless of whether the application of such principles is considered in a proceeding in equity or at law).

4. No approval, consent or withholding of objection on the part of, or filing, registration or qualification with, any governmental body, Federal or state, is necessary in connection with the execution and delivery of the Third Supplement or the Series E Notes other than the authorization of the Commission, which authorization has been duly obtained, and is in full force and effect.

5. The issuance and sale of the Series E Notes and the execution, delivery and performance by the Company of the Third Supplement do not violate or result in any breach of any of the provisions of or constitute a default under or result in the creation or imposition of any Lien upon any of the property of the Company pursuant to the provisions of the Articles of Incorporation or By-laws of the Company or any agreement or other instrument listed as a material contract in the Company's most recent Annual Report.

EXHIBIT 3  
(to Supplement)

6. Based upon the representations set forth in Section 6 of the Third Supplement, the issuance, sale and delivery of the Series E Notes under the circumstances contemplated by the Third Supplement do not, under existing law, require the registration of the Series E Notes under the Securities Act of 1933, as amended, or the qualification of the Third Supplement or an indenture under the Trust Indenture Act of 1939, as amended.

7. Based upon the assumption of the accuracy of information obtained by the Company from sources believed to be reliable that the following cities served by the Company were all incorporated prior to 1911:

Bakersfield	Marysville	South San Francisco
Chico	Oroville	Stockton
Dixon	Redondo Beach	Visalia
Hermosa Beach	Salinas	Willows
King City	San Mateo	
Livermore	Selma	

that water distribution systems were constructed and service furnished to the inhabitants of each by various predecessors of the Company prior

to 1911, and that there were no public water works owned or controlled by the municipality in any of them prior to 1911, in the opinion of such counsel, the Company has a "constitutional" franchise in each of the above cities and under such constitutional franchise has a perpetual right which was not repealed by the repeal of Article XI, Section 19, of the California Constitution to continue to occupy public streets of each of said cities with its pipes and mains and to lay down additional pipes and mains in said streets for the supplying of water, subject to reasonable regulation by the respective municipalities as they existed at the date of repeal of the constitutional provision in 1911 and probably also extends to territory incorporated into each respective city after such repeal, although this latter question remains somewhat in doubt in the absence of a final decision of the courts thereon.

On May 25, 2000, Dominguez Service Corporation was merged into the Company and subsequently Dominguez and its subsidiaries were also merged into the Company (collectively, the "Merger"). The Company acquired in the Dominguez merger operations in the following cities, counties, townships or localities that Dominguez previously served:

Bodfish	Kern County	Los Angeles County
Carson	Kernville	Lucerne
Compton	Lake Hughes	Mountain Shadows
Duncans Mills	Lakeland	Onyx
Fremont Valley	Lancaster	Squirrel Valley
Guerneville	Leona Valley	Torrance
Harbor City	Long Beach	Wofford Heights

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Water distribution systems were constructed and service furnished to the inhabitants of the localities currently known as Carson, Compton, Harbor City, Long Beach and Torrance by various predecessors of the Company prior to 1911 and the Company believes that it has a prior right to operate in these locations which right was not extinguished by the incorporation of these cities subsequent to 1911. Except as noted below, Dominguez has no franchises from these cities and has made no franchise payments to them and, to the Company's knowledge, no question has ever been raised as to the right to make water distribution and to maintain all pipes and mains necessary therefor.

As to the remaining localities, Dominguez has received written franchise agreements which are in full force and effect and has paid all franchise fees to date, with the exception of Compton and the City of Carson Redevelopment Project #2, as to which the franchises expired without renewal in, respectively, 1994 and 1998. Dominguez continued to provide water services to Compton and the City of Carson Redevelopment Project #2 subsequent to the expiration of the respective franchises, and to pay franchise fees, and to the Company's knowledge no question has ever been raised as to the right to make such distribution and to maintain all pipes and mains necessary therefor.

The opinion of McCutchen, Doyle, Brown & Enersen LLP shall cover such other matters relating to the sale of the Series E Notes as the Purchasers may reasonably request. With respect to matters of fact on which such opinion is based, such counsel shall be entitled to rely on appropriate certificates of public officials and officers of the Company.

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#### DESCRIPTION OF SPECIAL COUNSEL'S CLOSING OPINION

The closing opinion of Chapman and Cutler, special counsel to the Purchasers, called for by Section 5(a)(iii) of the Third Supplement, shall be dated the Closing Date and addressed to the Purchasers, shall be satisfactory in form and substance to the Purchasers and shall be to the effect that:

1. The Company is a corporation, validly existing and in good standing under the laws of the State of California and has the corporate power and the corporate authority to execute and deliver the Third Supplement and to issue the Series E Notes.

2. The Note Agreement and the Third Supplement have been duly authorized by all necessary corporate action on the part of the Company, have been duly executed and delivered by the Company and constitute the legal, valid and binding contract of the Company enforceable in accordance with its terms, subject to bankruptcy, insolvency, fraudulent conveyance and similar laws affecting creditors' rights generally, and general principles of equity (regardless of whether the application of such principles is considered in a proceeding in equity or at law).

3. The Series E Notes have been duly authorized by all necessary corporate action on the part of the Company, have been duly

executed and delivered by the Company and constitute the legal, valid and binding obligations of the Company enforceable in accordance with their terms, subject to bankruptcy, insolvency, fraudulent conveyance and similar laws affecting creditors' rights generally, and general principles of equity (regardless of whether the application of such principles is considered in a proceeding in equity or at law).

4. The issuance, sale and delivery of the Series E Notes under the circumstances contemplated by the Third Supplement do not, under existing law, require the registration of the Series E Notes under the Securities Act of 1933, as amended, or the qualification of an indenture under the Trust Indenture Act of 1939, as amended.

The opinion of Chapman and Cutler may rely upon the opinion of McCutchen, Doyle, Brown & Enersen LLP, as to matters of California law. The opinion of Chapman and Cutler shall also state that the opinion of McCutchen, Doyle, Brown & Enersen LLP, is satisfactory in scope and form to Chapman and Cutler and that, in their opinion, the Purchasers are justified in relying thereon.

In rendering the opinion set forth in paragraph 1 above, Chapman and Cutler may rely, as to matters referred to in paragraph 1, solely upon an examination of the Articles of Incorporation certified by, and a certificate of good standing of the Company from, the Secretary of State of the State of California, the By-laws of the Company and the general business corporation law of the State of California.

With respect to matters of fact upon which such opinion is based, Chapman and Cutler may rely on appropriate certificates of public officials and officers of the Company and upon

EXHIBIT 4  
(to Supplement)

representations of the Company and the Purchasers delivered in connection with the issuance and sale of the Series E Notes.

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of California Water Service Group ("Company") on form 10-Q for the period ending June 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Peter C. Nelson, President and Chief Executive Office of the Company, certify, pursuant to 18 U.S.C.ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) 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 results of operations of the Company.

/s/ Peter C. Nelson

-----  
Peter C. Nelson  
President and Chief Executive Officer  
August 2, 2002

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of California Water Service Group ("Company") on form 10-Q for the period ending June 30, 2002 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Gerald F. Feeney, Vice President, Chief Financial Officer and Treasurer of the Company, certify, pursuant to 18 U.S.C.ss. 1350, as adopted pursuant to ss. 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) 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 results of operations of the Company.

/s/ Gerald F. Feeney

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Gerald F. Feeney  
Vice President  
Chief Financial Officer and Treasurer  
August 2, 2002