

AQUA AMERICA INC  
Form 10-K  
February 25, 2011

**Table of Contents**

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

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2010**

**OR**

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

**Commission File number 1-6659**

**AQUA AMERICA, INC.**

(a Pennsylvania corporation)

762 W. Lancaster Avenue

Bryn Mawr, Pennsylvania 19010-3489

(610) 527-8000

I.R.S. Employer Identification Number 23-1702594

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

Title of each class	Name of each exchange on which registered
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Common stock, par value \$.50 per share	New York Stock Exchange, Inc.
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Securities registered pursuant to Section 12(g) of the Act: None.

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

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Small reporting company   
(do not check if smaller reporting company)

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of June 30, 2010: \$2,405,487,848

For purposes of determining this amount only, registrant has defined affiliates as including (a) the executive officers named in Part I of this 10-K report, (b) all directors of registrant, and (c) each shareholder that has informed registrant by June 30, 2010, that it has sole or shared voting power of 5% or more of the outstanding common stock of registrant.

The number of shares outstanding of the registrant's common stock as of February 11, 2011: 137,968,188

**DOCUMENTS INCORPORATED BY REFERENCE**

(1) Portions of registrant's 2010 Annual Report to Shareholders have been incorporated by reference into Parts I and II of this Form 10-K.

(2) Portions of the definitive Proxy Statement, relative to the May 12, 2011 annual meeting of shareholders of registrant, to be filed within 120 days after the end of the fiscal year covered by this Form 10-K, have been incorporated by reference into Part III of this Form 10-K.

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TABLE OF CONTENTS

	Page
<u>Part I</u>	
<u>Item 1. Business</u>	4
<u>Item 1A. Risk Factors</u>	15
<u>Item 1B. Unresolved Staff Comments</u>	20
<u>Item 2. Properties</u>	21
<u>Item 3. Legal Proceedings</u>	21
<u>Item 4. (Removed and Reserved)</u>	23
<u>Part II</u>	
<u>Item 5. Market for the Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	23
<u>Item 6. Selected Financial Data</u>	24
<u>Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 7A. Quantitative and Qualitative Disclosures About Market Risk</u>	25
<u>Item 8. Financial Statements and Supplementary Data</u>	25
<u>Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	25
<u>Item 9A. Controls and Procedures</u>	25
<u>Item 9B. Other Information</u>	26
<u>Part III</u>	
<u>Item 10. Directors, Executive Officers and Corporate Governance</u>	28
<u>Item 11. Executive Compensation</u>	30
<u>Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	30
<u>Item 13. Certain Relationships and Related Transactions, and Director Independence</u>	30
<u>Item 14. Principal Accountant Fees and Services</u>	31

Part IV

<u>Item 15. Exhibits and Financial Statement Schedules</u>	31
<u>Signatures</u>	32
<u>Exhibit Index</u>	34
<u>Exhibit 4.34</u>	
<u>Exhibit 4.35</u>	
<u>Exhibit 10.22</u>	
<u>Exhibit 10.42</u>	
<u>Exhibit 10.51</u>	
<u>Exhibit 13.1</u>	
<u>Exhibit 21.1</u>	
<u>Exhibit 23.1</u>	
<u>Exhibit 31.1</u>	
<u>Exhibit 31.2</u>	
<u>Exhibit 32.1</u>	
<u>Exhibit 32.2</u>	
<u>EX-101 INSTANCE DOCUMENT</u>	
<u>EX-101 SCHEMA DOCUMENT</u>	
<u>EX-101 CALCULATION LINKBASE DOCUMENT</u>	
<u>EX-101 LABELS LINKBASE DOCUMENT</u>	
<u>EX-101 PRESENTATION LINKBASE DOCUMENT</u>	
<u>EX-101 DEFINITION LINKBASE DOCUMENT</u>	

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**Table of Contents**

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain statements in this Annual Report on Form 10-K ( 10-K ), or incorporated by reference into this 10-K, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 that are made based upon, among other things, our current assumptions, expectations, plans, and beliefs concerning future events and their potential effect on us. These forward-looking statements involve risks, uncertainties and other factors, many of which are outside our control, that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by these forward-looking statements. In some cases you can identify forward-looking statements where statements are preceded by, followed by or include the words believes, expects, anticipates, plans, future, potential, probably, predictions, continue or the negative of such terms or similar expressions. Forward-looking statements in this 10-K, or incorporated by reference into this 10-K, include, but are not limited to, statements regarding:

- projected capital expenditures and related funding requirements;
- the availability and cost of capital;
- developments, trends and consolidation in the water and wastewater utility industries;
- dividend payment projections;
- opportunities for future acquisitions, the success of pending acquisitions and the impact of future acquisitions;
- the capacity of our water supplies, water facilities and wastewater facilities;
- the impact of geographic diversity on our exposure to unusual weather;
- the impact of conservation awareness of customers and more efficient plumbing fixtures and appliances on water usage per customer;
- our capability to pursue timely rate increase requests;
- our authority to carry on our business without unduly burdensome restrictions;
- our ability to obtain fair market value for condemned assets;
- the impact of fines and penalties;
- the impact of changes in governmental laws, regulations and policies, including those dealing with taxation, the environment, health and water quality, and public utility regulation;
- the impact of decisions of governmental and regulatory bodies, including decisions to raise or lower rates;
- the development of new services and technologies by us or our competitors;
- the availability of qualified personnel;
- the condition of our assets;
- the impact of legal proceedings;
- general economic conditions;
- acquisition-related costs and synergies; and
- the forward-looking statements contained under the heading *Forward-Looking Statements* in the section entitled *Management's Discussion and Analysis of Financial Condition and Results of Operations* from the portion of our 2010 Annual Report to Shareholders incorporated by reference herein and made a part hereof.

**Table of Contents**

Because forward-looking statements involve risks and uncertainties, there are important factors that could cause actual results to differ materially from those expressed or implied by these forward-looking statements, including but not limited to:

- changes in general economic, business, credit and financial market conditions;
- changes in governmental laws, regulations and policies, including those dealing with taxation, the environment, health and water quality, and public utility regulation;
- changes in environmental conditions, including those that result in water use restrictions;
- abnormal weather conditions;
- changes in, or unanticipated, capital requirements;
- changes in our credit rating or the market price of our common stock;
- our ability to integrate businesses, technologies or services which we may acquire;
- our ability to manage the expansion of our business;
- the extent to which we are able to develop and market new and improved services;
- the effect of the loss of major customers;
- our ability to retain the services of key personnel and to hire qualified personnel as we expand;
- labor disputes;
- increasing difficulties in obtaining insurance and increased cost of insurance;
- cost overruns relating to improvements or the expansion of our operations;
- increases in the costs of goods and services;
- civil disturbance or terroristic threats or acts; and
- changes in accounting pronouncements.

Given these risks and uncertainties, you should not place undue reliance on any forward-looking statements. You should read this 10-K and the documents that we incorporate by reference into this 10-K completely and with the understanding that our actual future results, performance and achievements may be materially different from what we expect. These forward-looking statements represent assumptions, expectations, plans, and beliefs only as of the date of this 10-K. Except for our ongoing obligations to disclose certain information under the federal securities laws, we are not obligated, and assume no obligation, to update these forward-looking statements, even though our situation may change in the future. For further information or other factors which could affect our financial results and such forward-looking statements, see Risk Factors. We qualify all of our forward-looking statements by these cautionary statements.

**Table of Contents**

**PART I**

**Item 1. Business**

**The Company**

Aqua America, Inc. (referred to as Aqua America, the Company, we, or us) is the holding company for regulated utilities providing water or wastewater services to what we estimate to be approximately 3 million people in Pennsylvania, Texas, North Carolina, Ohio, Illinois, New Jersey, New York, Florida, Indiana, Virginia, Maine, Missouri, and Georgia. Our largest operating subsidiary, Aqua Pennsylvania, Inc., accounted for approximately 53% of our operating revenues for 2010 and as of December 31, 2010, provided water or wastewater services to approximately one-half of the total number of people we serve, and is located in the suburban areas in counties north and west of the City of Philadelphia and in 25 other counties in Pennsylvania. Our other subsidiaries provide similar services in 12 other states. In September 2010, we entered into a definitive agreement to sell our wastewater operation in South Carolina, which served approximately 400 customers. The sale of our utility operation in South Carolina closed in December 2010, concluding our utility operations in South Carolina. In addition, in December 2010, we entered into a definitive agreement to sell our regulated water and wastewater operations in Missouri, which serves approximately 3,900 customers. This sale is conditioned, among other things, on the receipt of regulatory approval, and is expected to close by the third quarter of 2011. The completion of this transaction will conclude our regulated utility operations in Missouri. In addition, we provide water and wastewater services through operating and maintenance contracts with municipal authorities and other parties close to our utility companies' service territories as well as sludge hauling, septage and grease services, backflow prevention services, and certain other non-regulated water and wastewater services.

Aqua America, which prior to its name change in 2004 was known as Philadelphia Suburban Corporation, was formed in 1968 as a holding company for its primary subsidiary, Aqua Pennsylvania, Inc., formerly known as Philadelphia Suburban Water Company. In the early 1990s we embarked on a growth through acquisition strategy focused on water and wastewater operations. Our most significant transactions to date have been the merger with Consumers Water Company in 1999, the acquisition of the regulated water and wastewater operations of AquaSource, Inc. in 2003, the acquisition of Heater Utilities, Inc. in 2004, and the acquisition of New York Water Service Corporation in 2007. Since the early 1990s, our business strategy has been primarily directed toward the regulated water and wastewater utility industry and has extended our regulated operations from southeastern Pennsylvania to include operations in 12 other states. In 2009, we began operations in Georgia through the acquisition of a wastewater utility business that is currently not subject to economic regulation by the Georgia Public Service Commission, but is included within our Regulated segment as it provides services similar to our regulated utility subsidiaries.

**Table of Contents**

The following table reports our operating revenues by principal state for the Regulated segment and Other for the year ended December 31, 2010:

	Operating Revenues (000 \$)	Operating Revenues (%)
Pennsylvania	\$ 382,802	52.7%
Texas	56,816	7.8%
North Carolina	45,631	6.3%
Ohio	44,468	6.1%
Illinois	42,539	5.9%
Other states*	142,251	19.6%
Regulated segment total	714,507	98.4%
Other	11,565	1.6%
Consolidated	\$ 726,072	100.0%

\* Includes our operating subsidiaries in the following states: New Jersey, New York, Indiana, Florida, Virginia, Maine, Missouri, South Carolina, and Georgia. In December 2010, the sale of our South Carolina utility operation closed.

Information concerning revenues, net income, identifiable assets and related financial information of the Regulated segment and Other for 2010, 2009, and 2008 is set forth in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 17 Segment Information in the Notes to Consolidated Financial Statements from the portions of our 2010 Annual Report to Shareholders filed as Exhibit 13.1 to this Form 10-K. The information from these sections of our 2010 Annual Report to Shareholders is incorporated by reference herein.

The following table summarizes our operating revenues, by utility customer class, for the Regulated segment and Other for the year ended December 31, 2010:

	Operating Revenues (000 \$)	Operating Revenues (%)
Residential water	\$ 431,178	59.4%
Commercial water	105,294	14.5%
Fire protection	30,381	4.2%
Industrial water	21,550	3.0%
Other water	40,047	5.5%
Water	628,450	86.6%
Wastewater	73,939	10.2%
Other utility	12,118	1.6%
Regulated segment total	714,507	98.4%
Other	11,565	1.6%
Consolidated	\$ 726,072	100.0%



**Table of Contents**

Our utility customer base is diversified among residential water, commercial water, fire protection, industrial water, other water, wastewater customers and other utility customers (consisting of certain operating contracts that are closely associated with the utility operations). Residential customers make up the largest component of our utility customer base, with these customers representing approximately 70% of our water and wastewater revenues. Substantially all of our water customers are metered, which allows us to measure and bill for our customers' water consumption. Water consumption per customer is affected by local weather conditions during the year, especially during the late spring and summer in our northern U.S. service territories. In general, during these seasons, an extended period of dry weather increases consumption, while above average rainfall decreases consumption. Also, an increase in the average temperature generally causes an increase in water consumption. On occasion, abnormally dry weather in our service areas can result in governmental authorities declaring drought warnings and water use restrictions in the affected areas, which could reduce water consumption. See **Water Supplies, Water Facilities and Wastewater Facilities** for a discussion of water use restrictions that may impact water consumption during abnormally dry weather. The geographic diversity of our utility customer base reduces the effect of our exposure to extreme or unusual weather conditions in any one area of our service territory. Water usage is also affected by changing consumption patterns by our customers, resulting from such causes as increased water conservation and the installation of water saving devices and appliances that can result in decreased water usage.

Our growth in revenues over the past five years is primarily a result of increases in water and wastewater rates and in our utility customer base. See **Economic Regulation** for a discussion of water and wastewater rates. The majority of the increase in our utility customer base has been due to customers added through acquisitions. In 2006, the utility customer growth rate was 7.2%, including 44,792 customers associated with the New York Water Service Corporation acquisition, which was completed on January 1, 2007. In 2010, 2009, 2008, and 2007, the utility customer growth rate due to acquisitions and other growth ventures was 1.0%, 1.0%, 2.0%, and 2.6%, respectively. In 2008, our net customer count declined by 3,838 customers, or 0.4%, due to the sale or relinquishment of two utility systems, pursuant to our plan to evaluate and dispose of underperforming utility operations and one system that was turned over to the local city through condemnation. Overall, for the five-year period of 2006 through 2010, our utility customer base increased at an annual compound rate of 2.2%. If the number of customers associated with utility system dispositions during the past five years was excluded from the January 1, 2006 utility customer base, the annual compound growth rate would have been 2.7% for that same period.

**Acquisitions and Water Sale Agreements**

According to the U.S. Environmental Protection Agency (EPA), approximately 85% of the U.S. population obtained its water from community water systems, and 15% of the U.S. population obtained its water from private wells. With approximately 52,000 community water systems in the U.S. (83% of which serve less than 3,300 customers), the water industry is the most fragmented of the major utility industries (telephone, natural gas, electric, water and wastewater). The majority of these community water systems are government-owned, and the balance of the systems are privately-owned (or investor-owned). The nation's water systems range in size from large government-owned systems, such as the New York City water system which serves approximately 9 million people, to small systems, where a few customers share a common well. In the states where we operate, we believe there are approximately 23,000 community water systems of widely-varying size, with the majority of the population being served by government-owned water systems.

Although not as fragmented as the water industry, the wastewater industry in the U.S. also presents opportunities for consolidation. According to the EPA most recent survey of wastewater treatment facilities (which includes both government-owned and privately-owned facilities) in 2008, there are approximately 15,000 such facilities in the nation serving approximately 74% of the U.S. population. The remaining population represents individual homeowners with their own treatment facilities; for example, community on-lot disposal systems and septic tank systems. The vast majority of wastewater facilities are government-owned rather than privately-owned. The EPA survey also indicated that there are approximately 9,600 wastewater facilities in operation or planned in the 13 states where we operate.



## **Table of Contents**

Because of the fragmented nature of the water and wastewater utility industries, we believe that there are many potential water and wastewater system acquisition candidates throughout the U.S. We believe the factors driving consolidation of these systems are:

- the benefits of economies of scale;
- increasingly stringent environmental regulations;
- the monetizing of public assets to support the financial condition of municipalities;
- the need for substantial capital investment;
- limited access to cost-effective financing; and
- the need for technological and managerial expertise.

We are actively exploring opportunities to expand our utility operations through acquisitions or other growth ventures. During the five-year period ended December 31, 2010, we completed 104 acquisitions or other growth ventures.

We believe that acquisitions will continue to be an important source of customer growth for us. We intend to continue to pursue acquisitions of government-owned and privately-owned water and wastewater systems that provide services in areas near our existing service territories or in new service areas. We engage in continuing activities with respect to potential acquisitions, including calling on prospective sellers, performing analyses and investigations of acquisition candidates, making preliminary acquisition proposals and negotiating the terms of potential acquisitions.

### **Water Supplies, Water Facilities and Wastewater Facilities**

Our water utility operations obtain their water supplies from surface water sources such as reservoirs, lakes, ponds, rivers and streams, in addition to obtaining water from wells and purchasing water from other water suppliers. Approximately 9% of our water sales are purchased from other suppliers. It is our policy to obtain and maintain the permits necessary to obtain the water we distribute. The water supplies for the service areas in the principal states in which we operate in are as follows:

**Pennsylvania** The principal supply of water is surface water from streams, rivers and reservoirs. Wells and interconnections with adjacent municipal authorities supplement these surface supplies. We operate 12 surface water treatment plants.

**Texas** Water supply in more than 300 water systems is obtained principally from wells, supplemented in some cases by purchased water from adjacent water systems.

**North Carolina** Water supply in more than 700 systems is obtained principally from wells. Several systems purchase water from neighboring municipal systems.

**Ohio** Water supply is obtained for customers in Lake County from Lake Erie. Customers in Mahoning County obtain their water from man-made lakes. Water supply is obtained for customers in Stark, Williams, Richland and Summit counties from wells supplemented with purchased water from an adjacent municipal system in Stark and Summit counties.

**Illinois** Water supply is obtained for customers in the Kankakee system from the Kankakee River. Three small separate systems in Kankakee County are supplied from wells. Customers in Danville (Vermilion County) are supplied from Lake Vermilion. One small separate system in Vermilion County is supplied from wells. In Will, Boone, Lake, and Knox counties, customers are served from wells. Water supplied to two small systems is purchased from neighboring systems.

We believe that the capacities of our sources of supply, and our water treatment, pumping and distribution facilities, are generally sufficient to meet the present requirements of our customers under normal conditions. We plan system improvements and additions to capacity in response to changing regulatory standards, changing patterns of consumption and increased demand from customer growth. The various state public utility commissions have generally recognized the operating and capital costs associated with these improvements in setting water rates.

**Table of Contents**

On occasion, drought warnings and water use restrictions are issued by governmental authorities for portions of our service territories in response to extended periods of dry weather conditions. The timing and duration of the warnings and restrictions can have an impact on our water revenues and net income. In general, water consumption in the summer months is more affected by drought warnings and restrictions because discretionary and recreational use of water is at its highest during the summer months. At other times of the year, warnings and restrictions generally have less of an effect on water consumption.

We believe that our wastewater treatment facilities are generally adequate to meet the present requirements of our customers under normal conditions. In addition, we own several sewer collection systems where the wastewater is treated at a municipally-owned facility. Changes in regulatory requirements can be reflected in revised permit limits and conditions when National Pollution Discharge Elimination System ( NPDES ) permits are renewed, typically on a five-year cycle, or when treatment capacity is expanded. Capital improvements are planned and budgeted to meet anticipated changes in regulations and needs for increased capacity related to projected growth, and to correct inflow and infiltration to collection systems. The various state public utility commissions have generally recognized the operating and capital costs associated with these improvements in setting wastewater rates for current customers and capacity charges for new customers.

**Economic Regulation**

Most of our water and wastewater utility operations are subject to regulation by their respective state regulatory commissions, which have broad administrative power and authority to regulate rates and charges, determine franchise areas and conditions of service, approve acquisitions and authorize the issuance of securities. The regulatory commissions also establish uniform systems of accounts and approve the terms of contracts with affiliates and customers, business combinations with other utility systems, loans and other financings, and the franchise areas that we serve. A small number of our operations are subject to rate regulation by county or city governments. The profitability of our utility operations is influenced to a great extent by the timeliness and adequacy of rate allowances we are granted by the respective regulatory commissions or authorities in the various states in which we operate. Accordingly, we maintain a rate case management capability, the objective of which is to provide that the tariffs of our utility operations reflect, to the extent practicable, the timely recovery of increases in costs of operations, capital, taxes, energy, materials and compliance with environmental regulations. We file rate increase requests to recover and earn a return on the capital investments that we make in improving or replacing our facilities and to recover expenses. In the states in which we operate, we are primarily subject to economic regulation by the following state regulatory commissions:

State	Regulatory Commission
Pennsylvania	Pennsylvania Public Utility Commission
Ohio	The Public Utilities Commission of Ohio
North Carolina	North Carolina Utilities Commission
Illinois	Illinois Commerce Commission
Texas	Texas Commission on Environmental Quality
New Jersey	New Jersey Board of Public Utilities
New York	New York Public Service Commission
Florida	Florida Public Service Commission
Indiana	Indiana Utility Regulatory Commission
Virginia	Virginia State Corporation Commission
Maine	Maine Public Utilities Commission
Missouri	Missouri Public Service Commission

**Table of Contents**

Our water and wastewater operations are comprised of 129 rate divisions, each of which requires a separate rate filing for the evaluation of the cost of service, including the recovery of investments, in connection with the establishment of tariff rates for that rate division. When feasible and beneficial to our utility customers, we will seek approval to consolidate rate divisions to achieve a more even distribution of costs over a larger customer base. Eight of the states in which we operate permit some form of consolidated rates in varying degrees for the rate divisions in that state, and two states currently permit us to fully consolidate state-wide rate filings within either our water or wastewater operations. Due to the length of time since the last rate increase for some of our systems and the large amount of capital improvements relative to the number of customers in some smaller systems, the proposed rate increase in some of these systems may be substantial. Also, as a result of the condition of some of the systems acquired and capital investments required to maintain compliance, some divisions are experiencing longer periods of regulatory lag. We can provide no assurance that the rate increases will be granted in a timely or sufficient manner to cover the investments and expenses for which we initially sought the rate increases.

In some regulatory jurisdictions, we may seek authorization to bill our utility customers in accordance with a rate filing that is pending before the respective regulatory commission. Furthermore, some regulatory commissions authorize the use of expense deferrals and amortization in order to provide for an impact on our operating income by an amount that approximates the requested amount in a rate request. The additional revenue billed and collected prior to the final regulatory commission ruling is subject to refund based on the outcome of the ruling. The revenue recognized and the expenses deferred by us reflect an estimate as to the final outcome of the ruling. If the request is denied completely or in part, we could be required to refund some or all of the revenue billed to date, and write-off some or all of the deferred expenses.

Six states in which we operate water utilities, and two states in which we operate wastewater utilities, permit us to add a surcharge to water or wastewater bills to offset the additional depreciation and capital costs associated with certain capital expenditures related to replacing and rehabilitating infrastructure systems. Without a surcharge mechanism, a water and wastewater utility absorbs all of the depreciation and capital costs of these projects between base rate increases without the benefit of additional revenues. The gap between the time that a capital project is completed and the recovery of its costs in rates is known as regulatory lag. The infrastructure rehabilitation surcharge mechanism is intended to substantially reduce regulatory lag, which often acted as a disincentive to water and wastewater utilities to rehabilitate their infrastructure. In addition, our subsidiaries in certain states use a surcharge or credit on their bills to reflect changes in certain costs, such as changes in state tax rates, other taxes and purchased water, until such time as the costs are incorporated into base rates.

Currently, Pennsylvania, Illinois, Ohio, New York, Indiana, and Missouri allow for the use of infrastructure rehabilitation surcharges. These mechanisms typically adjust periodically based on additional qualified capital expenditures completed or anticipated in a future period. The infrastructure rehabilitation surcharge is capped at a percentage of base rates, generally at 5% to 9% of base rates, and is reset to zero when new base rates that reflect the costs of those additions become effective in final rates or when a utility's earnings exceed a regulatory benchmark. Infrastructure rehabilitation surcharges provided revenues of \$14,207,000 in 2010, \$16,900,000 in 2009, and \$11,771,000 in 2008.

In general, we believe that Aqua America, Inc. and its subsidiaries have valid authority, free from unduly burdensome restrictions, to enable us to carry on our business as presently conducted in the franchised or contracted areas we now serve. The rights to provide water or wastewater service to a particular franchised service territory are generally non-exclusive, although the applicable regulatory commissions usually allow only one regulated utility to provide service to a given area. In some instances, another water utility provides service to a separate area within the same political subdivision served by one of our subsidiaries. Therefore, as a regulated utility, there is little or no competition for the daily water and wastewater service we provide to our customers. Water and wastewater utilities may compete for new customers in new service territories. Competition for new territory generally comes from nearby utilities, either investor-owned or municipal-owned. There is also often competition for the acquisition of other utilities. Competition for the acquisition of other water or wastewater utilities may come from other investor-owned utilities, nearby municipally-owned utilities and sometimes from strategic or financial purchasers seeking to enter or expand in the water and wastewater industry. The addition of new service territory and the acquisition of other utilities by

regulated utilities such as us are generally subject to review and approval by the applicable state regulatory commissions.

**Table of Contents**

In the states where our subsidiaries operate, it is possible that portions of our subsidiaries' operations could be acquired by municipal governments by one or more of the following methods:

eminent domain;

the right of purchase given or reserved by a municipality or political subdivision when the original franchise was granted; and

the right of purchase given or reserved under the law of the state in which the subsidiary was incorporated or from which it received its permit.

The price to be paid upon such an acquisition by the municipal government is usually determined in accordance with applicable law governing the taking of lands and other property under eminent domain. In other instances, the price may be negotiated, fixed by appraisers selected by the parties or computed in accordance with a formula prescribed in the law of the state or in the particular franchise or charter. We believe that our operating subsidiaries will be entitled to fair market value for any assets that are condemned, and we believe the fair market value will be in excess of the book value for such assets.

In a limited number of instances, in our southern states, where there are municipally-owned water or wastewater systems near our operating divisions, the municipally-owned system may either have water distribution or wastewater collection mains that are located adjacent to our division's mains or may construct new mains that parallel our mains. In these circumstances, on occasion, the municipally-owned system may attempt to take over the customers who are connected to our mains, resulting in our mains becoming surplus or underutilized without compensation.

The City of Fort Wayne, Indiana (the "City") has authorized the acquisition by eminent domain of the northern portion of the utility system of one of the operating subsidiaries that we acquired in connection with the AquaSource acquisition in 2003. We had challenged whether the City was following the correct legal procedures in connection with the City's attempted condemnation, but the Indiana Supreme Court, in an opinion issued in June 2007, supported the City's position. In October 2007, the City's Board of Public Works approved proceeding with its process to condemn the northern portion of our utility system at a preliminary price based on the City's valuation. We filed an appeal with the Allen County Circuit Court challenging the Board of Public Works' valuation on several bases. In November 2007, the City Council authorized the taking of the northern portion of the Company's system and the payment of \$16,910,500 based on the City's valuation of this portion of the system. In January 2008, we reached a settlement agreement with the City to transition the northern portion of the system in February 2008 upon receipt of the City's initial valuation payment of \$16,910,500. The settlement agreement specifically stated that the final valuation of the northern portion of the Company's system will be determined through a continuation of the legal proceedings that were filed challenging the City's valuation. On February 12, 2008, we turned over the northern portion of the system to the City upon receipt of the initial valuation payment. The Indiana Utility Regulatory Commission also reviewed and acknowledged the transfer of the Certificate of Territorial Authority for the northern portion of the system to the City. The proceeds received by the Company are in excess of the book value of the assets relinquished. No gain has been recognized due to the contingency over the final valuation of the assets. The net book value of the assets relinquished has been removed from the consolidated balance sheet and the difference between the net book value and the initial payment received has been deferred and is recorded in other accrued liabilities on the Company's consolidated balance sheet. Once the contingency is resolved and the asset valuation is finalized, through the finalization of the litigation between the Company and the City of Fort Wayne, the amounts deferred will be recognized in the Company's consolidated income statement. On March 16, 2009, oral argument was held on certain procedural aspects with respect to the valuation evidence that may be presented and whether the Company is entitled to a jury trial. On October 12, 2010, the Wells County Indiana Circuit Court ruled that the Company is not entitled to a jury trial, and that the Wells County judge should review the City of Fort Wayne Board of Public Works' assessment based upon a "capricious, arbitrary or an abuse of discretion" standard. The Company disagrees with the Court's decision and as such on November 11, 2010, requested that the Wells County Indiana Circuit Court certify those issues for an interim appeal. The Wells County Indiana Circuit Court has granted that request and on January 14, 2011, the Company filed a request with the Indiana Court of Appeals to review the decision of those issues on appeal. The Company continues to evaluate its legal options with respect to this decision. Depending upon the ultimate outcome of all of the legal proceeding, the Company may be required to refund a portion of the initial valuation payment, or may

receive additional proceeds. The northern portion of the utility system relinquished represents approximately 0.50% of Aqua America's total assets.

**Table of Contents**

Despite the condemnation referred to above, our primary strategy continues to be to acquire additional water and wastewater systems, to maintain our existing systems where there is a business or a strategic benefit, and to actively oppose unilateral efforts by municipal governments to acquire any of our operations, particularly for less than the fair market value of our operations or where the municipal government seeks to acquire more than it is entitled to under the applicable law or agreement. On occasion, we may voluntarily agree to sell systems or portions of systems in order to help focus our efforts in areas where we have more critical mass and economies of scale.

**Environmental, Health and Safety Regulation**

Provision of water and wastewater services is subject to regulation under the federal Safe Drinking Water Act, the Clean Water Act and related state laws, and under federal and state regulations issued under these laws. These laws and regulations establish criteria and standards for drinking water and for wastewater discharges. In addition, we are subject to federal and state laws and other regulations relating to solid waste disposal, dam safety and other aspects of our operations. Capital expenditures and operating costs required as a result of water quality standards and environmental requirements have been traditionally recognized by state public utility commissions as appropriate for inclusion in establishing rates.

From time to time, Aqua America has acquired, and may acquire, systems that have environmental compliance issues. Environmental compliance issues also arise in the course of normal operations or as a result of regulatory changes. Aqua America attempts to align capital budgeting and expenditures to address these issues in a timely manner. We believe that the capital expenditures required to address outstanding compliance issues have been budgeted in our capital program and represent less than 10% of our expected total capital expenditures over the next five years. We are parties to agreements with regulatory agencies in Pennsylvania, Texas, Florida, Indiana, and Virginia under which we have committed to make certain improvements for environmental compliance. These agreements are intended to provide the regulators with assurance that problems covered by these agreements will be addressed, and the agreements generally provide protection from fines, penalties and other actions while corrective measures are being implemented. We are actively working directly with state environmental officials to implement or amend these agreements as necessary.

**Safe Drinking Water Act** The Safe Drinking Water Act establishes criteria and procedures for the U.S. Environmental Protection Agency (the EPA ) to develop national quality standards for drinking water. Regulations issued pursuant to the Safe Drinking Water Act and its amendments set standards on the amount of certain microbial and chemical contaminants and radionuclides allowable in drinking water. Current requirements under the Safe Drinking Water Act are not expected to have a material impact on our business, financial condition, or results of operations as we have made and are making investments to meet existing water quality standards. We may, in the future, be required to change our method of treating drinking water at certain sources of supply and make additional capital investments if additional regulations become effective.

In order to remove or inactivate microbial organisms, rules were issued by the EPA to improve disinfection and filtration of potable water and reduce consumers' exposure to disinfectants and by-products of the disinfection process. Our subsidiary in Maine installed filtration for its one unfiltered surface water supply in 2010. The project was completed in 2010 at a cost of less than \$7,000,000.

**Table of Contents**

The EPA promulgated the Long Term 2 Enhanced Surface Water Treatment Rule and a Stage 2 Disinfection/Disinfection By-product Rule in January 2006. These rules resulted in additional one-time special monitoring costs of approximately \$600,000 over a five-year period from 2007 to 2011. Monitoring for all but the smallest systems has been completed, and none of the results have exceeded levels that would require modification of treatment.

The federal Groundwater Rule became effective December 1, 2009. This rule requires additional testing of water from well sources, and under certain circumstances requires demonstration and maintenance of effective disinfection. States throughout the country are taking a variety of approaches to implementation of the Groundwater Rule. Pennsylvania has taken a position that all wells will be required to demonstrate and maintain effective disinfection. We estimate that the capital cost of compliance with this regulation in Pennsylvania will be about \$5,000,000 over the next five years. The rule is also expected to require modifications to a few wells or well stations in Texas, North Carolina, and New York. In North Carolina, the rule is being coupled with an existing requirement for visitation of well stations or installation of monitoring equipment. The capital cost of compliance with these requirements in North Carolina is estimated to be about \$4,600,000 over the next five years. In aggregate, the costs of compliance with the requirements of the Ground Water Rule in all of our operating states is estimated at less than 1% of our planned capital program over the next five years.

A rule lowering the limit on arsenic was promulgated in 2001 by the EPA and became effective in January 2006, with a provision for further time extensions for small systems. One system in Texas was equipped with treatment in 2009. Construction was completed in 2010 for treatment of one well in Pennsylvania acquired in 2008. No additional capital expenditures for arsenic treatment are anticipated at this time. If treatment is required in the future for an acquired system, the anticipated cost of treatment will be considered in our analysis of the system within the first two years of acquisition.

The Safe Drinking Water Act provides for the regulation of radionuclides other than radon, such as radium and uranium. Revisions to the Radionuclides Rule that became effective in 2003 changed the monitoring protocols and added a maximum contaminant level for uranium. Under the revised rule, some of our groundwater facilities exceeded one or more of the radionuclide standards and required treatment. Treatment has been installed at all wells that remain in service and that had been identified as needing treatment in the initial round of testing. Ongoing testing continues on quarterly, annual, 3-year or 9-year cycles, and occasionally test results for an individual well trigger requirements for public notification and/or treatment. The future capital cost of compliance over the next five years is expected to be less than 1% of our planned capital budget over that time.

**Clean Water Act** The Clean Water Act regulates discharges from drinking water and wastewater treatment facilities into lakes, rivers, streams, and groundwater. It is our policy to obtain and maintain all required permits and approvals for the discharges from our water and wastewater facilities, and to comply with all conditions of those permits and other regulatory requirements. A program is in place to monitor facilities for compliance with permitting, monitoring and reporting for wastewater discharges. From time to time, discharge violations may occur which may result in fines. These fines and penalties, if any, are not expected to have a material impact on our business, financial condition, or results of operations. We are also parties to compliance agreements with regulatory agencies in several states where we operate while improvements are being made to address wastewater discharge compliance issues. The required costs to comply with the agreements previously cited are included in our capital program, are expected to be less than 1% of our planned five-year capital budget, and are expected to be recoverable in rates.

**Solid Waste Disposal** The handling and disposal of residuals and solid waste generated from water and wastewater treatment facilities is governed by federal and state laws and regulations. A program is in place to monitor our facilities for compliance with regulatory requirements, and we are not aware of any significant environmental remediation costs necessary from our handling and disposal of waste material from our water and wastewater operations. However, we do anticipate capital expenditures of less than \$2,000,000, that have been included within our five-year capital budget, related to the expansion and/or replacement of some of our current waste disposal facilities in Pennsylvania and Ohio, to support our large surface water treatment facilities in these states. Our capital budget also includes funds for capital projects intended to reduce waste volume and extend the life of our disposal facilities.



**Table of Contents**

**Dam Safety** Our subsidiaries own eighteen major dams that are subject to the requirements of the federal and state regulations related to dam safety. All major dams undergo an annual engineering inspection. We believe that all eighteen dams are structurally sound and well-maintained.

We performed studies of our dams that identified two dams in Pennsylvania and three dams in Ohio requiring capital improvements resulting from the adoption by the Department of Environmental Protection in Pennsylvania, and by the Department of Natural Resources in Ohio, of revised formulas for determining the magnitude of a probable maximum flood. Capital improvements remain to be performed on one dam in Pennsylvania totaling approximately \$14,000,000 planned during the three-year period from 2011 to 2013. Expenditures in the aggregate during the five-year period from 2011 to 2015 are expected to be approximately 1% of our planned capital program over the next five years. We continue to study alternatives for these remaining dams which may change the cost estimates of these capital improvements.

**Safety Standards** Our facilities and operations may be subject to inspections by representatives of the Occupational Safety and Health Administration from time to time. We maintain safety policies and procedures to comply with the Occupational Safety and Health Administration's rules and regulations, but violations may occur from time to time, which may result in fines and penalties, which are not expected to be material. We endeavor to correct such violations promptly when they come to our attention.

**Security**

We maintain security measures at our facilities, and collaborate with federal, state and local authorities and industry trade associations regarding information on possible threats and security measures for water utility operations. In the event of an increase in the cost of security, including capital expenditures, the costs incurred are expected to be recoverable in water rates and are not expected to have a material impact on our business, financial condition, or results of operations.

**Employee Relations**

As of December 31, 2010, we employed a total of 1,632 full-time employees. Our subsidiaries are parties to 11 labor agreements with labor unions covering 510 employees. The labor agreements expire at various times between March 2011 and December 2014.

**Available Information**

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (SEC). You may read and copy any document we file with the SEC at the SEC's public reference room at 100 F Street, NE, Washington, DC 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. You may also obtain our SEC filings from the SEC's Web site at [www.sec.gov](http://www.sec.gov).

Our Internet Web site address is [www.aquaamerica.com](http://www.aquaamerica.com). We make available free of charge through our Web site's Investor Relations page all of our filings with the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other information. These reports and information are available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

**Table of Contents**

In addition, you may request a copy of the foregoing filings, at no cost by writing or telephoning us at the following address or telephone number:

Investor Relations Department

Aqua America, Inc.

762 W. Lancaster Avenue

Bryn Mawr, PA 19010-3489

Telephone: 610-527-8000

Our Board of Directors has various committees including an audit committee, an executive compensation committee and a corporate governance committee. Each of these committees has a formal charter. We also have Corporate Governance Guidelines and a Code of Ethical Business Conduct. Copies of these charters, guidelines, and codes can be obtained free of charge from our Web site, [www.aquaamerica.com](http://www.aquaamerica.com). In the event we change or waive any portion of the Code of Ethical Business Conduct that applies to any of our directors, executive officers, or senior financial officers, we will post that information on our Web site.

The references to our Web site and the SEC's Web site are intended to be inactive textual references only, and the contents of those Web sites are not incorporated by reference herein and should not be considered part of this or any other report that we file with or furnish to the SEC.

**Table of Contents****Item 1A. Risk Factors**

In addition to the other information included or incorporated by reference in this 10-K, the following factors should be considered in evaluating our business and future prospects. Any of the following risks, either alone or taken together, could materially and adversely affect our business, financial position or results of operations. If one or more of these or other risks or uncertainties materialize, or if our underlying assumptions prove to be incorrect, our actual results may vary materially from what we projected.

***The rates we charge our customers are subject to regulation. If we are unable to obtain government approval of our requests for rate increases, or if approved rate increases are untimely or inadequate to recover and earn a return on our capital investments, to recover expenses, or to take into account changes in water usage, our profitability may suffer.***

The rates we charge our customers are subject to approval by public utility commissions or similar regulatory bodies in the states in which we operate. We file rate increase requests, from time to time, to recover our investments in utility plant and expenses. Our ability to maintain and meet our financial objectives is dependent upon the recovery of and return on our capital investments and expenses through the rates we charge our customers. Once a rate increase petition is filed with a public utility commission, the ensuing administrative and hearing process may be lengthy and costly, and the cost to the Company may not always be fully recoverable. The timing of our rate increase requests are therefore partially dependent upon the estimated cost of the administrative process in relation to the investments and expenses that we hope to recover through the rate increase to the extent approved. In addition, the amount of rate increases may be decreased as a result of changes in income tax laws regarding tax-basis depreciation as it applies to our capital expenditures. We can provide no assurances that any future rate increase request will be approved by the appropriate state public utility commission; and, if approved, we cannot guarantee that these rate increases will be granted in a timely or sufficient manner to cover the investments, expenses, and return for which we initially sought the rate increase.

In some regulatory jurisdictions, we may seek authorization to bill our utility customers in accordance with a rate filing that is pending before the respective regulatory commission. Furthermore, some regulatory commissions authorize the use of expense deferrals and amortization in order to provide for an impact on our operating income by an amount that approximates the requested amount in a rate request. The additional revenue billed and collected prior to the final ruling is subject to refund based on the outcome of the ruling. The revenue recognized and the expenses deferred by us reflect an estimate as to the final outcome of the ruling. If the request is denied completely or in part, we could be required to refund some or all of the revenue billed to date, and write-off some or all of the deferred expenses.

***Our business requires significant capital expenditures that are dependent on our ability to secure appropriate funding. Disruptions in the capital and credit markets may limit our access to capital. If we are unable to obtain sufficient capital, or if the cost of borrowing increases, it may materially and adversely affect our business, financial condition, and results of operations.***

Our business is capital intensive. In addition to the capital required to fund our growth through acquisition strategy, on an annual basis, we spend significant sums for additions to or replacement of property, plant and equipment. We obtain funds for our capital expenditures from operations, contributions, and advances by developers and others, equity issuances and debt issuances. Our ability to maintain and meet our financial objectives is dependent upon the availability of adequate capital, and we may not be able to access the debt and equity markets on favorable terms or at all. The U.S. credit and liquidity crisis that started in 2008 caused substantial volatility in capital markets, including credit markets and the banking industry, and generally reduced the availability of credit from financing sources, which may re-occur in the future. If in the future, our credit facilities are not renewed or our short-term borrowings are called for repayment, we would have to seek alternative financing sources; however, there can be no assurance that these alternative financing sources would be available on terms acceptable to us or at all. In the event we are unable to obtain sufficient capital, we may need to reduce our capital expenditures and our ability to pursue acquisitions that we may rely on for future growth could be impaired. The reduction in capital expenditures may result in reduced potential earnings growth, affect our ability to meet environmental laws and regulations, and limit our ability to improve or expand our utility systems to the level we believe appropriate. There is no guarantee that we will be able to obtain

sufficient capital in the future on reasonable terms and conditions for expansion, construction and maintenance. In addition, delays in completing major capital projects could delay the recovery of the capital expenditures associated with such projects through rates. If the cost of borrowing increases, we might not be able to recover increases in our cost of capital through rates. The inability to recover higher borrowing costs through rates, or the regulatory lag associated with the time that it takes to begin recovery, may adversely affect our business, financial condition, or results of operations.

**Table of Contents**

***Our inability to comply with debt covenants under our credit facilities could result in prepayment obligations.***

We are obligated to comply with debt covenants under some of our loan and debt agreements. Failure to comply with covenants under our credit facilities could result in an event of default, which if not cured or waived, could result in us being required to repay or finance these borrowings before their due date, limit future borrowings, cause cross default issues, and increase borrowing costs. If we are forced to repay or refinance (on less favorable terms) these borrowings our business, financial condition, and results of operations could be adversely affected by increased costs and rates.

***General economic conditions may affect our financial condition and results of operations.***

A general economic downturn may lead to a number of impacts on our business that may affect our financial condition and results of operations. Such impacts may include: a reduction in discretionary and recreational water use by our residential water customers, particularly during the summer months when such discretionary usage is normally at its highest; a decline in usage by industrial and commercial customers as a result of decreased business activity; an increased incidence of customers inability to pay or delays in paying their utility bills, or an increase in customer bankruptcies, which may lead to higher bad debt expense and reduced cash flow; a lower natural customer growth rate due to a decline in new housing starts; and a decline in the number of active customers due to housing vacancies or abandonments. General economic turmoil may also lead to an investment market downturn, which may result in our pension plans asset market values suffering a decline and significant volatility. A decline in our pension plans asset market values could increase our required cash contributions to these plans and pension expense in subsequent years.

***Federal and state environmental laws and regulations impose substantial compliance requirements on our operations. Our operating costs could be significantly increased in order to comply with new or stricter regulatory standards imposed by federal and state environmental agencies.***

Our water and wastewater services are governed by various federal and state environmental protection and health and safety laws and regulations, including the federal Safe Drinking Water Act, the Clean Water Act and similar state laws, and federal and state regulations issued under these laws by the U.S. Environmental Protection Agency and state environmental regulatory agencies. These laws and regulations establish, among other things, criteria and standards for drinking water and for discharges into the waters of the U.S. and states. Pursuant to these laws, we are required to obtain various environmental permits from environmental regulatory agencies for our operations. We cannot assure you that we will be at all times in total compliance with these laws, regulations and permits. If we violate or fail to comply with these laws, regulations or permits, we could be fined or otherwise sanctioned by regulators.

Environmental laws and regulations are complex and change frequently. These laws, and the enforcement thereof, have tended to become more stringent over time. While we have budgeted for future capital and operating expenditures to comply with these laws and our permits, it is possible that new or stricter standards could be imposed that will require additional capital expenditures or raise our operating costs. Although these expenditures and costs may be recovered in the form of higher rates, there can be no assurance that the various state public utility commissions or similar regulatory bodies that govern our business would approve rate increases to enable us to recover such expenditures and costs. In summary, we cannot assure you that our costs of complying with, or discharging liability under, current and future environmental and health and safety laws will not adversely affect our business, financial condition, or results of operations.

**Table of Contents**

*Our business is impacted by weather conditions and is subject to seasonal fluctuations, which could adversely affect demand for our water service and our revenues and earnings.*

Demand for our water during the warmer months is generally greater than during cooler months due primarily to addi