

AQUA AMERICA INC  
Form DEF 14A  
March 25, 2013

SCHEDULE 14A

(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the  
Securities Exchange Act of 1934 (Amendment No. )

Filed by the Registrant [X]

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]

Check the appropriate box:

- Preliminary Proxy Statement  Soliciting Material Under Rule 14a-12
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- Definitive Proxy Statement
- Definitive Additional Materials

Aqua America, Inc.  
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

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**AQUA AMERICA, INC.**  
762 W. Lancaster Avenue  
Bryn Mawr, Pennsylvania 19010

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS**

**To Be Held May 8, 2013**

TO THE SHAREHOLDERS OF  
AQUA AMERICA, INC.:

Notice is hereby given that the Annual Meeting of Shareholders of AQUA AMERICA, INC. (the Company) will be held at **Drexelbrook Banquet Facility & Corporate Events Center, 4700 Drexelbrook Drive, Drexel Hill, PA 19026** at **8:30 A.M.**, local time, on **Wednesday, May 8, 2013**, for the following purposes:

1. To consider and take action on the election of six directors for terms expiring at the 2014 Annual Meeting;
2. To consider and take action on the ratification of the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm for the Company for the 2013 fiscal year;
3. To consider and take action on an advisory vote on the Company's executive compensation programs as disclosed in this Proxy Statement;
4. To consider and take action on a shareholder proposal requesting that the Board of Directors create a comprehensive policy articulating the Company's respect for and commitment to the human right to water, if properly presented at the meeting; and
5. To transact such other business as may properly come before the meeting or any adjournments or postponements thereof.

Only shareholders of record at the close of business on March 11, 2013 will be entitled to notice of, and to vote at, the meeting and at any adjournments or postponements thereof.

By Order of the Board of Directors,

CHRISTOPHER P. LUNING  
*Secretary*

March 25, 2013

**Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting To Be Held On May 8, 2013.** We are mailing to many of our shareholders a notice of availability on the Internet of our proxy materials, rather than mailing a full paper set of the materials. The notice of availability contains instructions on how to access our proxy materials on the Internet, as well as instructions on how to obtain a paper copy if a shareholder elects to do so. All shareholders who do not receive such a notice of availability, including shareholders who have previously requested to receive a paper copy of the materials, will receive a full set of paper proxy materials by U.S. mail. This process will reduce our costs to print and distribute our proxy materials.

**REGARDLESS OF WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, AS A SHAREHOLDER YOU ARE URGED TO COMPLETE, SIGN AND RETURN THE ENCLOSED PROXY CARD IN THE ENVELOPE PROVIDED, WHICH REQUIRES NO POSTAGE IF MAILED IN THE UNITED STATES, OR VOTE ELECTRONICALLY, THROUGH THE INTERNET OR BY TELEPHONE, BY FOLLOWING THE INSTRUCTIONS SET OUT ON THE PROXY CARD. BY USING THE INTERNET OR TELEPHONE YOU HELP THE COMPANY REDUCE POSTAGE AND PROXY TABULATION COSTS.**

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**IMPORTANT NOTICE REGARDING THE AVAILABILITY OF PROXY  
MATERIALS FOR THE ANNUAL MEETING OF SHAREHOLDERS TO BE HELD ON  
MAY 8, 2013**

**The Notice of Annual Meeting, Proxy Statement and 2012 Annual Report to Shareholders are  
available at: <http://ir.aquaamerica.com/>**

**AQUA AMERICA, INC.  
762 W. Lancaster Avenue  
Bryn Mawr, Pennsylvania 19010**

**PROXY STATEMENT**

This proxy statement is furnished in connection with the solicitation of proxies by the Board of Directors (the Board of Directors or the Board ) of Aqua America, Inc. ( Aqua America or the Company ) to be used at the Annual Meeting of Shareholders to be held Wednesday, May 8, 2013 and at any adjournments or postponements thereof ( 2013 Annual Meeting or the meeting ).

The cost of soliciting proxies will be paid by the Company, which has arranged for reimbursement, at the rate suggested by the New York Stock Exchange, of brokerage houses, nominees, custodians and fiduciaries for the forwarding of proxy materials to the beneficial owners of shares held of record. In addition, the Company has retained Alliance Advisors LLC to assist in the solicitation of proxies from (i) brokers, bank nominees and other institutional holders, and (ii) individual holders of record. The fee paid to Alliance Advisors LLC for normal proxy solicitation is an amount not to exceed \$8,000 plus expenses, which will be paid by the Company. Directors, officers and regular employees of the Company may solicit proxies, although no compensation will be paid by the Company for such efforts.

Under rules adopted by the U.S. Securities and Exchange Commission ( SEC ), the Company is now furnishing proxy materials to many of its shareholders on the Internet, rather than mailing printed copies of those materials to each shareholder. If you received a notice of availability over the Internet of the proxy materials ( Notice ) by mail, you will not receive a printed copy of the proxy materials unless you request one. Instead, the Notice will instruct you as to how you may access and review the proxy materials on the Internet. If you received a Notice by mail and would like to receive a printed copy of our proxy materials, please follow the instructions included in the Notice. The Notice was first sent to shareholders of record as of March 11, 2013, and proxy materials, which include the Notice of Annual Meeting of Shareholders, this proxy statement and Annual Report to Shareholders for the year ended December 31, 2012, including financial statements and other information with respect to the Company and its subsidiaries (the Annual Report ), are first being made available to shareholders of record as of March 11, 2013, on or about March 25, 2013. Additional copies of the Annual Report may be obtained by writing to the Company at the address and in the manner set forth under Additional Information on page 66.

**PURPOSE OF THE MEETING**

As the meeting is the Annual Meeting of Shareholders, the shareholders of the Company will be requested to:

- consider and take action on the election of six directors for terms expiring at the 2014 Annual Meeting;
  - consider and take action on the ratification of the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm for the Company for the 2013 fiscal year;
  - consider and take action on a non-binding advisory vote on the Company's executive compensation programs;
-

- consider and take action on a shareholder proposal requesting that the Board of Directors create a comprehensive policy articulating the Company's respect for and commitment to the human right to water, if properly presented at the meeting (the Shareholder Proposal); and
- transact such other business as may properly come before the meeting or any adjournments or postponements thereof.

## VOTING AT THE MEETING

### General

Holders of shares of the Company's Common Stock of record at the close of business on March 11, 2013 are entitled to vote at the meeting. As of that date, there were 140,163,766 shares of Common Stock outstanding and entitled to be voted at the meeting. Each shareholder entitled to vote shall have the right to one vote on each matter presented at the meeting for each share of Common Stock outstanding in such shareholder's name.

The Company's charter and bylaws provide that the affirmative vote of a majority of the votes cast by those shareholders present in person or represented by proxy at the meeting is required to take action with respect to any matter properly brought before the meeting on the recommendation of a vote of a majority of the entire Board of Directors. The Company's bylaws also provide that the affirmative vote of at least three quarters of the votes which all voting shareholders, voting as a single class, are entitled to cast is required to take action with respect to any other matter properly brought before the meeting.

### Manner of Voting

Shares cannot be voted at the meeting unless the holder of record is present in person or by proxy. The proxy card is a means by which a shareholder may authorize the voting of his or her shares at the meeting if he or she is unable to attend in person. Alternatively, you may vote electronically, over the Internet or by telephone, following the instructions set out on the proxy card (as outlined in the notice of availability over the Internet of the proxy materials). The shares of Common Stock represented by each properly executed proxy card or electronic proxy will be voted at the meeting in accordance with each shareholder's direction. Shareholders are urged to specify their choices by marking the appropriate boxes on the proxy card or electronic proxy. If the proxy card or electronic proxy is signed, but no choice has been specified, the shares will be voted as recommended by the Board of Directors. If any other matters are properly presented at the meeting or any adjournment or postponement thereof for action, the proxy holders will vote the proxies (which confer discretionary authority to vote on such matters) in accordance with their judgment.

Execution of the accompanying proxy or voting electronically or by telephone will not affect a shareholder's right to attend the meeting and vote in person. Any shareholder giving a proxy or voting electronically or by telephone has the right to revoke the proxy or the electronic or telephonic vote by giving written notice of revocation to the Secretary of the Company at any time before the proxy is voted, by executing a proxy bearing a later date, by making a later-dated vote electronically or by telephone, or by attending the meeting and voting in person. Attendance at the meeting will not, by itself, revoke a previously granted proxy.

### Quorum

A quorum of shareholders is necessary to hold a valid meeting for the transaction of business. The holders of a majority of the shares entitled to vote, present in person or represented by proxy at the meeting, constitute a quorum. Abstentions and broker non-votes are counted as present and entitled to vote for purposes of determining a quorum.

### Broker Non-Votes

A broker non-vote occurs when a bank, broker or other holder of record holding shares for a beneficial owner does not vote on a particular proposal because that holder does not have discretionary voting power under New York Stock Exchange (NYSE) rules for that particular item and has not received instructions from the beneficial owner. If you are a beneficial owner, your bank, broker or other holder of record is permitted under NYSE rules to vote your shares on the ratification of PricewaterhouseCoopers LLP as our independent registered public accounting firm for



the 2013 fiscal year, even if the record holder does not receive voting instructions from you. The record holder may not vote on the election of directors, the Company's executive compensation program or the Shareholder Proposal without instructions from you. Without your voting instructions on these matters, a broker non-vote will occur.

**Proposal No. 1 Election of Directors**

Under the Company's charter and bylaws, directors are elected by a plurality of the votes cast at the meeting. A plurality means that the six director nominees receiving the most votes FOR election to a director position will be elected as directors. Votes may be cast FOR or WITHHOLD for each nominee. WITHHOLD votes and broker non-votes will be excluded entirely from the vote to elect directors and will have no effect, other than for purposes of determining the presence of a quorum. Thus, the six director nominees with the most FOR votes will be elected at the meeting. Because the shareholders at the 2012 Annual Meeting approved the amendment to the Company's Articles of Incorporation providing for a transition to the annual election of directors, the six directors elected at the 2013 Annual Meeting will be elected for terms expiring at the 2014 Annual Meeting and three directors who were elected at the 2011 Annual Meeting for terms expiring at the 2014 Annual Meeting will continue to serve in accordance with their prior election.

In 2011, the Board of Directors adopted a majority voting policy for the election of directors in uncontested elections. Under this policy, any incumbent director who is nominated for re-election and who receives a greater number of WITHHOLD votes than FOR votes for the director's election shall promptly tender his or her resignation to the Board of Directors, which shall evaluate the relevant facts and circumstances in connection with such director's resignation, giving due consideration to the best interests of the Company and its shareholders. Within 90 days after the election, the independent directors shall make a decision on whether to accept or reject the tendered resignation, or whether other action should be taken. The Board of Directors will promptly disclose publicly its decision and the reasons for its decision. The Board of Directors believes that this process enhances accountability to shareholders and responsiveness to shareholder votes, while allowing the Board of Directors appropriate discretion in considering whether a particular director's resignation would be in the best interests of the Company and its shareholders. The Board of Directors' policy on the majority election of directors is set forth in the Company's Corporate Governance Guidelines. Copies of the Corporate Governance Guidelines can be obtained free of charge from the Corporate Governance portion of the Investor Relations section of the Company's website [www.aquaamerica.com](http://www.aquaamerica.com).

**Proposal No. 2 Ratification of the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm for the Company for the 2013 fiscal year**

Under the Company's charter and bylaws, the affirmative vote of a majority of the votes cast by those shareholders present in person or by proxy at the meeting is required to ratify the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm for the Company for the 2013 fiscal year. Abstentions will not be considered votes cast on this proposal and, therefore, will have no effect, other than for purposes of determining the presence of a quorum.

**Proposal No. 3 Advisory Vote on Executive Compensation**

Because the vote is advisory, it will not be binding upon the Company, the Board of Directors or the Executive Compensation Committee. The Board of Directors and the Executive Compensation Committee, which is comprised of independent directors, value the opinions of the Company's shareholders and expect to take into account the outcome of the vote when considering future executive compensation decisions to the extent they can determine the cause or causes of any significant negative voting results. Abstentions and broker non-votes will not be considered votes cast on this proposal and, therefore, will have no effect, other than for purposes of determining the presence of a quorum.



**Proposal No. 4 Shareholder Proposal**

Under the Company's charter and bylaws, the affirmative vote of at least three quarters of the votes which all voting shareholders, voting as a single class, are entitled to cast is required to approve this proposal because it is not being brought before the meeting on the recommendation of a majority of the Board of Directors. Abstentions and broker non-votes will not be considered votes cast on this proposal and, therefore, will have no effect, other than for purposes of determining the presence of a quorum.

Since the Shareholder Proposal is presented in the form of a request to the Board of Directors, approval of the Shareholder Proposal will not have the effect of requiring the Board of Directors to prepare a comprehensive report on the human right to water, but will represent simply an expression of the wishes of the shareholders on that subject. The Board of Directors would still be required by statute to decide whether it would be in the best interests of the Company to prepare such a report and could decide in the exercise of its business judgment not to have the Company prepare such a report as requested in the Shareholder Proposal.

**Your proxy vote is important. Accordingly, you are asked to complete, sign and return the accompanying proxy card or vote electronically or telephonically regardless of whether or not you plan to attend the meeting.**

**(PROPOSAL NO. 1)**

**ELECTION OF DIRECTORS**

The Board of Directors was previously divided into three classes with one class elected each year to hold office for a three-year term. At the 2012 Annual Meeting of Shareholders, the shareholders approved an Amendment to the Company's Articles of Incorporation (the Amendment) that provides for the transition to the annual election of the members of the Board of Directors. The directors elected at the 2012 Annual Meeting were elected for a one-year term expiring at the 2013 Annual Meeting, and until their successors are duly elected and qualified. The directors previously elected at the 2010 and 2011 Annual Meetings have terms expiring at the 2013 and 2014 Annual Meetings, respectively. Thus, the directors elected at the 2010 and 2012 Annual Meetings with terms expiring at the 2013 Annual Meeting and who are nominated for re-election and elected will be elected for a one-year terms expiring at the 2014 Annual Meeting, and until their successors are duly elected and qualified. The directors previously elected at the 2011 Annual Meeting for terms expiring at the 2014 Annual Meeting will continue to serve in accordance with their prior election.

In accordance with the Company's Corporate Governance Guidelines, the Chairman of the Corporate Governance Committee reported to the Corporate Governance Committee that Nicholas DeBenedictis, Richard H. Glanton, Lon R. Greenberg, Wendell F. Holland, William P. Hankowsky and Andrew J. Sordoni, III, the six directors with terms expiring at the 2013 Annual Meeting would be willing to serve on the Board of Directors if re-elected. The Corporate Governance Committee reviewed the qualifications of the six directors in relation to the criteria for candidates for nomination for election to the Board of Directors under the Company's Corporate Governance Guidelines. The Corporate Governance Committee voted to recommend to the Board of Directors, and the Board of Directors approved, the nomination of Mr. DeBenedictis, Mr. Glanton, Mr. Greenberg, Mr. Holland, Mr. Hankowsky and Mr. Sordoni for election to the class of directors to be elected at the 2013 Annual Meeting, with Mr. Glanton abstaining on the vote by the Corporate Governance Committee with respect to his nomination and each other nominee abstaining from the vote by the Board of Directors with respect to his nomination.

In June 2012, Ms. Mary C. Carroll reached the retirement age of 72 under the Company's Corporate Governance Guidelines. Ms. Carroll, who was elected at the 2011 Annual Meeting for a term expiring at the 2014 Annual Meeting, submitted her resignation effective on her 72<sup>nd</sup> birthday to the Board on May 10, 2012. The Board of Directors requested, and Ms. Carroll agreed, that she remain on the Board of Directors until the 2013 Annual Meeting. In February 2013, the Board requested, and Ms. Carroll agreed, that she remain on the Board of Directors until the end of 2013.

Therefore, six directors, Mr. DeBenedictis, Mr. Glanton, Mr. Greenberg, Mr. Holland, Mr. Hankowsky and Mr. Sordoni will stand for election by a plurality of the votes cast at the 2013 Annual Meeting, and three directors having terms ending at the 2014 Annual Meeting will continue to serve on the Board of Directors in accordance with their prior election. At the 2013 Annual Meeting, proxies in the accompanying form, properly executed, will be voted for the election of the six nominees listed below, unless authority to do so has been withheld in the manner specified in the instructions on the proxy card or the record holder does not have discretionary voting power under the NYSE rules (see "Voting At The Meeting - Broker Non-Votes" on pages 2 and 3). Discretionary authority is reserved to cast votes for the election of a substitute should any nominee be unable or unwilling to serve as a director. Each nominee has stated his willingness to serve and the Company believes that the nominees will be available to serve.

**The Board of Directors unanimously recommends that the shareholders vote FOR the election of Mr. DeBenedictis, Mr. Glanton, Mr. Greenberg, Mr. Holland, Mr. Hankowsky and Mr. Sordoni as directors.**

**INFORMATION REGARDING NOMINEES AND DIRECTORS**

For each of the six nominees for election as directors at the 2013 Annual Meeting and the three directors whose term of office is to expire at the 2014 Annual Meeting, set forth below is information as to the positions and offices with the Company held by each, the principal occupation of each during the past five years, the directorships of public companies and other organizations held by each and the experience, qualifications, attributes or skills that, in the opinions of the Corporate Governance Committee and the Board of Directors make the individual qualified to serve as a director of the Company.

**NOMINEES FOR ELECTION AT THE 2013 ANNUAL MEETING**

Nicholas DeBenedictis  
Ardmore, PA  
Director since 1992

**Biography:** Mr. DeBenedictis has served as Chief Executive Officer of the Company since July 1992 and Chairman of the Board since May 1993. He also serves as Chairman and Chief Executive Officer of the Company's principal subsidiaries, including Aqua Pennsylvania, Inc. Between April 1989 and June 1992, he served as Senior Vice President for Corporate Affairs of PECO Energy Company (now known as Exelon). From December 1986 to April 1989, he served as President of the Greater Philadelphia Chamber of Commerce and from 1983 to 1986 he served as the Secretary of the Pennsylvania Department of Environmental Resources. Mr. DeBenedictis is a director of Exelon Corporation and P.H. Glatfelter Company. He also serves on the Boards of Pennsylvania area non-profit, civic and business organizations. Age: 67.

**Qualifications:** In addition to his knowledge and experience as the Company's Chief Executive Officer since 1992 and his prior experience as a senior executive of a major electric utility, Mr. DeBenedictis has experience as the head of Pennsylvania's environmental regulatory agency. He serves as a director of two other public companies, including as a member of the corporate governance, finance and compensation committees of those companies. Mr. DeBenedictis has also held leadership positions with various, educational, civic and charitable institutions. The Board of Directors views Mr. DeBenedictis experience with various aspects of the utility industry and his demonstrated leadership roles in business and community activities as important qualifications, skills and experience for the Board of Directors conclusion that Mr. DeBenedictis should serve as a director of the Company.

Richard H. Glanton  
Philadelphia, PA  
Director since 1995

**Biography:** Mr. Glanton is Chairman of the Philadelphia Television Network, a privately-held media company and Managing Member of ElectedFace LLC, an on-line service that connects people with their elected officials. Mr. Glanton was Senior Vice President of Corporate Development at Exelon Corporation from 2003 to 2008. From 1983 to 2003 he was a partner at the law firms of Wolf Block LLP (1983 to 1986) and Reed Smith LLP (1986 to 2003). Mr. Glanton is a director of The GEO Group, Inc. and Mistras Group, Inc. Age: 66.

**NOMINEES FOR ELECTION AT THE 2013 ANNUAL MEETING**

**Qualifications:** Mr. Glanton has more than 25 years of legal experience in law firms and 13 years of executive experience as President of The Barnes Foundation for more than eight years from 1990 to 1998 and at Exelon. Mr. Glanton has approximately 29 years of continuous experience serving on boards of publicly-traded companies. He has served as a director on boards of five publicly-traded companies, four of which are traded on the NYSE and one, CGU, is traded on the United Kingdom Stock Exchange. He served as a Director of CGU of North America, a British-based Insurance Company, from 1983 to 2003 when it was sold to White Mountain Group of Exeter, New Hampshire and Berkshire Hathaway. He was a member of both its Executive and Audit Committees during his 20-year tenure on that board. From 1990 until 2003, he served as Director of PECO Energy and Exelon Corporation Boards until he resigned to assume a senior management position within the Company at the request of its Chairman. He served on the Executive, Audit and Governance Committees of PECO/Exelon. He has been a director of the GEO Group since 1998, where he serves on its three member Executive Committee, and as Chairman of the Audit and Finance Committee and a Member of its Governance and Compensation Committees. He has served as Chairman of Aqua America's Corporate Governance Committee since 2005. The Board has determined that Mr. Glanton is an independent director. The Board of Directors views Mr. Glanton's independence, his experience in utility acquisitions, his experience as a director of other publicly-traded companies and his demonstrated leadership roles in other business activities as important qualifications, skills and experience for the Board of Directors' conclusion that Mr. Glanton should serve as a director of the company.

Lon R. Greenberg  
Wyndmoor, PA  
Director since 2005

**Biography:** Mr. Greenberg has been Chairman of the Board of Directors of UGI Corporation since August 1996 and Chief Executive Officer since August 1995. He was formerly President (July 1994 to August 2005), Vice Chairman of the Board (1995 to 1996) and Senior Vice President - Legal and Corporate Development (1989 to 1994) of UGI Corporation. Mr. Greenberg is a member of the Board of Trustees of Temple University and the Temple University Health System. Mr. Greenberg also serves as a director of Ameriprise Financial, Inc., UGI Utilities, Inc. and AmeriGas Propane, Inc. Age: 62.

**NOMINEES FOR ELECTION AT THE 2013 ANNUAL MEETING**

**Qualifications:** Mr. Greenberg has over 20 years of experience in various executive, legal and corporate development roles with a major gas utility company and international distributor of propane. He is also Chairman of the nation's largest retail propane marketer and he serves as a director for a NYSE-listed financial planning, products and services company. He is a member of the Board of Trustees of a major university in Philadelphia and the university's health system. Mr. Greenberg has served as a member of the Company's Executive Compensation Committee since 2005 and a member of the Company's Audit Committee since 2009. Mr. Greenberg has also held leadership positions with various civic and charitable institutions. The Board of Directors has determined that Mr. Greenberg is an independent director, financially literate and an audit committee financial expert within the meaning of applicable U.S. Securities and Exchange Commission (SEC) rules. The Board of Directors views Mr. Greenberg's independence, his experience with various aspects of the utility industry, his experience as an executive of a non-utility business and his demonstrated leadership roles in business and community activities as important qualifications, skills and experience for the Board of Directors' conclusion that Mr. Greenberg should serve as a director of the Company.

William P. Hankowsky  
Philadelphia, PA  
Director since 2004

**Biography:** Mr. Hankowsky has been Chairman, President and Chief Executive Officer of Liberty Property Trust, a fully integrated real estate firm, since 2003. Mr. Hankowsky joined Liberty in 2001 as Executive Vice President and Chief Investment Officer. Prior to joining Liberty, he served for 11 years as President of the Philadelphia Industrial Development Corporation. Prior to that, he was Commerce Director for the City of Philadelphia. Mr. Hankowsky serves on the Board of Directors of Citizens Financial Group and on various charitable and civic boards, including the Philadelphia Convention and Visitors Bureau and the Kimmel Regional Performing Arts Center. Age: 62.

**Qualifications:** Mr. Hankowsky has over 35 years of experience managing public, private and non-profit organizations, including eight years as Chairman and Chief Executive Officer of Liberty Property Trust, a publicly-traded Real Estate Investment Trust which owns 80 million square feet of office and industrial space in over 20 markets throughout the United States and the United Kingdom. He has experience in financing, acquisitions and real estate matters across the United States. Mr. Hankowsky has also held leadership positions with various cultural and civic institutions in the greater Philadelphia region. Mr. Hankowsky has served as Chairman of the Company's Executive Compensation Committee since 2005. The Board of Directors has determined that Mr. Hankowsky is an independent director, financially literate and an audit committee financial expert within the meaning of applicable SEC rules. The Board of Directors views Hankowsky's independence, his experience with real estate, financing and acquisitions and his demonstrated leadership roles in business and community activities as important qualifications, skills and experience supporting the Board of Directors' conclusion that Mr. Hankowsky should serve as a director of the Company.

**NOMINEES FOR ELECTION AT THE 2013 ANNUAL MEETING**

Wendell F. Holland  
Bryn Mawr, PA  
Director since 2011

**Biography:** Mr. Holland is a partner in the law firm of Saul Ewing, LLP. Mr. Holland served as Chairman of the Pennsylvania Public Commission from 2004 to 2008 and as a Commissioner from 1990 to 1993 and 2003 to 2004. Mr. Holland was Of Counsel to the law firm of Obermayer Rebman from 1999 to 2003, Vice President of American Water Works Company from 1996 to 1999 and a partner at the law firm of LeBoeuf Lamb Greene and McRae from 1993 to 1995. He has served as Treasurer of the National Association of Utility Regulatory Commissioners (NARUC) and also served on NARUC's Executive Committee, Board of Directors, and as Chairman of its Audit and Investment Committees. He is a member of the Board of Bryn Mawr Trust Bank and was a member of the Allegheny Energy Board of Directors from 1994 to 2003. Age: 60.

**Qualifications:** Mr. Holland has extensive knowledge and experience in the regulation of public utilities, especially water utilities. His experience as Chairman of the Public Utility Commission in Pennsylvania for four years and a Commissioner for four years enables him to provide valuable insight into the regulatory process. His service as a member of the Board of Directors of a large, publicly-trade energy company also enables him to play a meaningful role on the Company's Board of Directors. As outside counsel to, and an executive at, other public utility companies, he has a valuable perspective on the various issues facing public utility companies. The Board of Directors has determined that Mr. Holland is an independent director. The Board of Directors views Mr. Holland's independence, his experience with utility regulation and utility operations, his reputation in the utility industry and his leadership roles in business and community activities as important qualifications, skills and experience for the Board of Directors' conclusion that Mr. Holland should serve as a director of the Company.

Andrew J. Sordoni, III  
Forty Fort, PA  
Director since 2006

**Biography:** Mr. Sordoni is Chairman of Sordoni Construction Services, Inc., a building construction and management services company and has been an officer of that company since 1967. Mr. Sordoni was Chairman or President of C-TEC Corporation, a diversified telecommunications company from 1979 to 1993. Since 1974 he has headed Sordoni Foundation, Inc. and has served as a director of various business and charitable organizations. He is also a director of Harsco Corporation. Age: 69.

**NOMINEES FOR ELECTION AT THE 2013 ANNUAL MEETING**

**Qualifications:** Mr. Sordoni has experience as a director and executive of various public and private companies throughout the course of his career, including experience in construction, finance, administration and acquisitions. He was Chairman and President of a regulated public utility company in Pennsylvania. He has been a director of another publicly-traded company since 1988 and is a member of that company's nominating committee and compensation committee. Mr. Sordoni has lived and worked in northeast Pennsylvania, an important area of the Company's operations, for over 50 years. Mr. Sordoni has served as a member of the Company's Audit Committee since 2006. The Board of Directors has determined that Mr. Sordoni is an independent director, financially literate and an audit committee financial expert within the meaning of applicable SEC rules. The Board of Directors views Mr. Sordoni's independence, his experience as an executive of a public utility company in Pennsylvania, his experience in construction, finance and acquisitions, his knowledge of northeast Pennsylvania, his experience as a director of another publicly-traded company and his demonstrated leadership roles in business and community activities as important qualifications, skills and experience supporting the Board of Directors conclusion that Mr. Sordoni should serve as a director of the Company.

**DIRECTORS CONTINUING IN OFFICE WITH TERMS EXPIRING IN 2014**

Mary C. Carroll  
Bryn Mawr, PA  
Director since 1981

**Biography:** Ms. Carroll is a retired consultant and an advisor to non-profit corporations, businesses and government agencies and is a well-recognized civic volunteer. She is the Honorary Consul of Nepal and Chairman of the Nepal Foundation. She is a founder, director or trustee of various civic and charitable organizations, including the YMCA of Philadelphia and Vicinity and the Friends of Patan Hospital. Age: 72.

**DIRECTORS CONTINUING IN OFFICE WITH TERMS EXPIRING IN 2014**

**Qualifications:** As the Company's longest serving director, Ms. Carroll has knowledge of the Company's history and culture. She has been a community leader for over 35 years, having served as an officer or member of the board of directors of over 30 local, regional and national non-profit organizations. She has established advisory boards which consulted and worked with the federal government. She has served as founder, President and CEO of organizations involved in economic development, conservation and self-help in Philadelphia and in Nepal, Russia and South Korea. Ms. Carroll has both a unique community-oriented and world perspective. Ms. Carroll has been a member of the Company's Corporate Governance Committee since 1981. The Board of Directors has determined that Ms. Carroll is an independent director. The Board of Directors views Ms. Carroll's independence, her knowledge of the company's history and culture and her demonstrated leadership roles in community activities as important qualifications, skills and experience for the Board of Directors' conclusion that Ms. Carroll should serve as a director of the Company.

Mario Mele  
Ft. Washington, PA  
Director since 2009

**Biography:** Mr. Mele is President of Fidelio Insurance Company, a health insurance company specializing in underwriting group dental insurance, and President of Dental Delivery Systems, Inc., a dental HMO with over 50,000 enrollees in Pennsylvania, New Jersey and New York. Mr. Mele served as Chairman of the Montgomery County, Pennsylvania Board of Commissioners from 1992 to 2000. He has also been a member of the Board of Directors of the Southeastern Pennsylvania Transportation Authority from 1997 to 2001 and a member of the Board of the Pennsylvania Liquor Control Board from 1980 to 1987. Age: 71.

**Qualifications:** Mr. Mele has 35 years of experience as the president of a health insurance company and over 20 years of experience in various state and local governmental organizations. He has held leadership roles in various cultural and civic organizations. He also has B.A and M.A. degrees in physics. The Board of Directors has determined that Mr. Mele is an independent director. The Board of Directors views Mr. Mele's independence, his experience with health insurance issues and state and local government, his science education and his demonstrated leadership roles in business and community activities as important qualifications, skills and experience for the Board of Directors' conclusion that Mr. Mele should serve as a director of the Company.



**DIRECTORS CONTINUING IN OFFICE WITH TERMS EXPIRING IN 2014**

Ellen T. Ruff  
Charlotte, NC  
Director since 2006

**Biography:** Ms. Ruff was President, Office of Nuclear Development, for Duke Energy Corporation, from December 2008 until her retirement in January 2011. Duke Energy Corporation is a leading energy company focused on electric power and gas distribution operations and other energy services in the Americas. From April 2006 through December 2008, Ms. Ruff was President of Duke Energy Carolinas, an electric utility that provides electricity and other services to customers in North Carolina and South Carolina. Ms. Ruff joined the Duke Energy organization in 1978 and during her career held a number of key positions, including: Vice President and General Counsel of Corporate, Gas and Electric Operations; Senior Vice President and General Counsel for Duke Energy; Senior Vice President of Asset Management for Duke Power; Senior Vice President of Power Policy and Planning; Group Vice President of Power Policy and Planning; and Group Vice President of Planning and External Affairs. Ms. Ruff is a director of Mistras Group, Inc. Age: 64.

**Qualifications:** Ms. Ruff has over 30 years of experience with a major utility company in various management, operations, legal, planning and public affairs positions. Ms. Ruff has lived and worked in North Carolina, an important area of the Company's operations, for many years. Ms. Ruff has served as a member of the Company's Executive Compensation Committee since 2006. The Board of Directors has determined that Ms. Ruff is an independent director. The Board of Directors views Ms. Ruff's independence, her experience with various aspects of the utility industry, her knowledge of North Carolina and her demonstrated leadership roles in business and community activities as important qualifications, skills and experience for the Board of Directors' conclusion that Ms. Ruff should serve as a director of the Company.

## CORPORATE GOVERNANCE

The Board of Directors operates pursuant to a set of written Corporate Governance Guidelines. Copies of these Guidelines can be obtained free of charge from the Corporate Governance portion of the Investor Relations section of the Company's website [www.aquaamerica.com](http://www.aquaamerica.com).

Our website is not part of this Proxy Statement; references to our website address in this Proxy Statement are intended to be inactive textual references only.

### DIRECTOR INDEPENDENCE

The Board of Directors is, among other things, responsible for determining whether each of the directors is independent in light of any relationship such director may have with the Company. The Board has adopted Corporate Governance Guidelines that contain categorical standards of director independence that are consistent with the listing standards of the NYSE. Under the Company's Corporate Governance Guidelines, a director will not be deemed independent if:

- the director is, or has been within the last three years, an employee of the Company, or an immediate family member is, or has been within the last three years an executive officer of the Company;
- (A) the director or an immediate family member is a current partner of a firm that is the Company's internal or external auditor, (B) the director is a current employee of such a firm, (C) the director has an immediate family member who is a current employee of such a firm and personally works on the Company's audit, or (D) the director or an immediate family member was within the last three years (but is no longer) a partner or employee of such firm and personally worked on the Company's audit within that time;
- the director or an immediate family member is, or has been within the last three years, employed as an executive officer of another company where any of the Company's present executive officers at the same time serves or served on that company's compensation committee;
- the director has received, or has an immediate family member who has received, during any twelve-month period within the last three years, more than \$120,000 in direct compensation from the Company, other than director and committee fees and pension or other forms of deferred compensation for prior service (provided such compensation is not contingent in any way on continued service) and, in the case of an immediate family member who is not an executive officer, other than compensation for service as an employee of the Company;
- the director is an executive officer or employee, or someone in her/his immediate family is an executive officer, of another company that, during any of the other company's past three fiscal years made payments to, or received payments from, the Company for property or services in an amount which, in any single fiscal year of the other company, exceeded the greater of \$1 million or 2% of the other company's consolidated gross revenues; or
- the director serves as an executive officer of a charitable organization and, during any of the charitable organization's past three fiscal years, the Company made charitable contributions to the charitable organization in any single fiscal year of the charitable organization that exceeded the greater of \$1 million or two percent of the charitable organization's consolidated gross revenues.

For purposes of the categorical standards set forth above, (a) a person's immediate family includes a person's spouse, parents, children, siblings, mothers- and fathers-in-law, sons- and daughters-in-law, and brothers- and sisters-in-law and anyone (other than domestic employees) who shares such person's home, and (b) the term "executive officer" has the same meaning specified for the term "officer" in Rule 16a-1(f) under the Securities Exchange Act of 1934.

In addition to these categorical standards, no director will be considered independent unless the Board of Directors affirmatively determines that the director has no material relationship with the Company (either directly, or as a partner, stockholder, director or officer, of an organization that has a relationship with the Company). When making independence determinations, the Board of Directors broadly considers all relevant facts and circumstances surrounding any relationship between a director or nominee and the Company. Transactions, relationships and arrangements between directors or members of their immediate family and the Company that are not addressed by the categorical standards may be material depending on the relevant facts and circumstances of such transactions, relationships and arrangements. The Board of Directors considered the following transactions, relationships and arrangements in connection with making the independence determinations:

1. The Company made contributions to charitable or civic organizations for which the following directors serve as directors, trustees or executive officers: Ms. Carroll, Mr. Glanton, Mr. Greenberg, Mr. Hankowsky, Mr. Mele and Mr. Sordoni. None of the Company's contributions exceeded the greater of \$1 million or 2% of the recipient organization's consolidated gross revenues.
2. The Company purchases energy at normal tariff rates from Duke Energy Corporation and UGI Corporation or their affiliates for which Ms. Ruff and Mr. Greenberg, respectively, serve or served as executive officers. The amounts paid by the Company to these other entities are not material to these other entities.
3. The Company provides water service at normal tariff rates to Liberty Property Trust and UGI Corporation or their affiliates for which Mr. Hankowsky and Mr. Greenberg, respectively, serve as executive officers. The amounts paid to the Company by these other entities are not material to these other entities.
4. Mr. DeBenedictis serves on the board of directors of civic or charitable organizations with Mr. Greenberg, Mr. Hankowsky and Mr. Sordoni.
5. The Company has banking arrangements with Citizens Financial Group or its affiliates, and Mr. Hankowsky is a member of the Board of Directors of Citizens Financial Group. The amounts paid by the Company to these other entities are not material to these entities.
6. The Company has had a relationship with the law firm at which Mr. Holland is a partner prior to Mr. Holland joining that firm. The legal services provided by the law firm to the Company were rendered by attorneys other than Mr. Holland. The Company paid \$599,455 in fees for legal services to this firm in 2012.

Based on a review applying the categorical standards set forth in the Company's Corporate Governance Guidelines and considering the relevant facts and circumstances of the transactions, relationships and arrangements between the directors and the Company described above, the Board of Directors has affirmatively determined that each nominee for director and each of the Company's other directors, other than Mr. DeBenedictis, the Company's Chief Executive Officer, is independent.

In 2005, the Board of Directors approved share ownership guidelines for each director to own shares of Company common stock having a value equal to five times the annual cash retainer for directors. Directors have up to five years to attain this guideline share ownership level. As of December 31, 2012, each director owned sufficient shares to comply with these guidelines except Mr. Holland, who has until 2016, five years following his appointment to the Board of Directors, to meet the guidelines.

#### **BOARD OF DIRECTORS LEADERSHIP STRUCTURE**

The Board of Director's current policy is that the positions of Chairman and Chief Executive Officer be held by the same person. The Board of Directors believes that this leadership structure has served the Company well over the years by providing unified leadership and direction and, in combination with the Company's other corporate governance policies and procedures, is in the best interests of the Company's shareholders. The Board of Directors may separate these positions in the future should circumstances change, such as in connection with a transition in leadership.

The Board of Directors annually elects a lead independent director to coordinate the activities of the other independent directors and enhance the role of the independent directors in the overall corporate governance of the Company. Unless otherwise determined by the Board, the director elected annually to serve as the Chair of the Corporate Governance Committee will also serve as the lead independent director. The duties and powers of the lead independent director include:

- presiding at all meetings of the Board at which the Chairman of the Board is not present, including executive sessions of the independent directors;
- serving as liaison between the independent directors and the Chairman of the Board;
- consulting with the Chairman of the Board on meeting agendas and information provided to the Board for meetings, including the authority to add items to the agendas for any such meeting;
- reviewing and approving meeting schedules to assure that there is sufficient time for discussion of all agenda items;
- having the authority to call executive sessions of the independent directors and to prepare the agendas for such executive sessions;
- serving as the Board's liaison for consultation and communications with shareholders on behalf of the independent directors;
- serving as a member of the Executive Committee;
- in the event of the death or incapacity of the Chairman and Chief Executive Officer, becoming the acting Chairman of the Board until a new Chairman is selected; and
- having the authority (on behalf of the independent directors) to engage such legal, financial or other advisors as the independent directors shall deem appropriate at the expense of the Company and without consultation or the need to obtain approval of any officer of the Company.

#### **OVERSIGHT OF RISK MANAGEMENT**

The Board oversees management's risk management activities through a combination of processes.

- Management has developed a Company-wide Enterprise Risk Management process intended to identify, prioritize and monitor key risks that may affect the Company. At least annually, the Board reviews this Enterprise Risk Management process and management presents to the Board a report on the status of the risks and the metrics used to monitor those risks. Each risk that is tracked as part of the Enterprise Risk Management process has a member of the Company's management who serves as the owner and monitor for that risk. The risk owners and monitors report on the status of their respective risks at the quarterly meeting of management's Compliance Committee. The information discussed at the Compliance Committee meeting is then reviewed by the Disclosure Committee composed of the Company's Chief Executive Officer, Chief Financial Officer, General Counsel, Chief Accounting Officer and Director of Internal Audit. The results of the Disclosure Committee meetings are presented to the Audit Committee each quarter.
- The Audit Committee, in consultation with management, the independent registered public accountants and the internal auditors, discusses the Company's policies and guidelines regarding risk assessment and risk management as well as the Company's significant financial risk exposures and the steps management has taken to monitor, control and report such exposures. The Audit Committee meets in executive session with the Director of Internal Audit and with the independent registered public accountants at the end of each Audit Committee meeting. The Company's General Counsel reports to the Audit Committee quarterly regarding any significant litigation involving the Company and his opinion of the adequacy of the Company's reserves for such litigation.

- The Executive Compensation Committee considers the risks that may be presented by the structure of the Company's compensation programs and the metrics used to determine individual compensation under that program. In addition, two members of the Audit Committee are also members of the Executive Compensation Committee, which allows for the sharing of information concerning the risk assessment and risk management reviewed by the Audit Committee with the Executive Compensation Committee in its consideration of the Company's compensation policies and practices.
- The Corporate Governance Committee leads an annual discussion by the Board of Directors regarding the Company's strategic plans and management's performance with respect to such plans.
- The Board believes that the present leadership structure of having the same person serve as the Chairman and Chief Executive Officer of the Company, along with the important risk oversight functions performed by the Audit Committee, the Executive Compensation Committee and the full Board, permits the Board to effectively perform its role in the risk oversight of the Company.
- Management briefs the Board of Directors on acquisitions valued in excess of \$2 million and the Board approves every acquisition valued in excess of \$10 million or which involves the issuance of the Company's common stock as part of the acquisition.
- In addition to updates at each Board meeting by operating management regarding any significant operational or environmental matters, management provides the Board with an annual update on environmental matters by the Company's Chief Environmental Compliance Officer in connection with a presentation by the Company's Senior Vice President of Engineering on the Company's proposed capital spending plans.

## CODE OF ETHICS

The Company maintains a Code of Ethical Business Conduct for its directors, officers and employees, including the Company's Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, as defined by the rules adopted by the SEC pursuant to Section 406(a) of the Sarbanes-Oxley Act of 2002. The Code of Ethical Business Conduct covers a number of important subjects, including: conflicts of interest; corporate opportunities; fair dealing; confidentiality; protection and proper use of Company assets; compliance with laws, rules and regulations (including insider trading laws); and encouraging the reporting of illegal or unethical behavior. Copies of the Company's Code of Ethical Business Conduct can be obtained free of charge from the Corporate Governance portion of the Investor Relations section of the Company's website, [www.aquaamerica.com](http://www.aquaamerica.com). The Company intends to post amendments to or waivers from the Code of Ethical Business Conduct (to the extent applicable to the Company's executive officers, senior financial officers or directors) on its website.

## POLICIES AND PROCEDURES FOR APPROVAL OF RELATED PERSON TRANSACTIONS

The Board has a written policy with respect to Related Person Transactions to document procedures pursuant to which such transactions are reviewed, approved or ratified. The policy applies to any transaction in which (1) the Company is a participant, (2) any related person has a direct or indirect material interest and (3) the amount involved exceeds \$120,000, but excludes certain types of transactions in which the related person is deemed not to have a material interest.

Under this policy, a related person means: (a) any person who is, or at any time since the beginning of the Company's last fiscal year was, a director, an executive officer or a director nominee; (b) any person known to be the beneficial owner of more than 5% of any class of the Company's voting securities; (c) any immediate family member of a person identified in items (a) or (b) above, meaning such person's spouse, parent, stepparent, child, stepchild, sibling, mother- or father-in-law, son- or daughter-in-law, brother- or sister-in-law or any other individual (other than a tenant or employee) who shares the person's household; or (d) any entity that employs any person identified in (a), (b) or (c) or in which any person identified in (a), (b) or (c) directly or indirectly owns or otherwise has a material interest.

The Corporate Governance Committee, with assistance from the Company's General Counsel, is responsible for reviewing, approving and ratifying any related person transaction. In its review and approval or ratification of related person transactions (including its determination as to whether the related person has a material interest in a transaction), the Corporate Governance Committee will consider, among other factors:

- the nature of the related person's interest in the transaction;
- the material terms of the transaction, including, without limitation;
- the amount and type of transaction;
- the importance of the transaction to the related person;
- the importance of the transaction to the Company;
- whether the transaction would impair the judgment of a director or executive officer to act in the best interests of the Company; and
- any other matters the Corporate Governance Committee deems appropriate.

The Corporate Governance Committee intends to approve only those related person transactions that are in, or are not inconsistent with, the best interests of the Company and its shareholders.

As noted under Director Independence on page 14, the Company had a pre-existing relationship with the law firm that Mr. Holland joined as a partner in 2008 prior to Mr. Holland joining the firm. Most of the legal services provided by that law firm to the Company relate to regulatory matters for the Company's New Jersey subsidiaries and do not involve services by Mr. Holland. Because the legal services provided to the Company exceed \$120,000, the relationship between the Company and the law firm constitutes a related person transaction. Prior to nominating Mr. Holland for appointment to the Board of Directors, the Corporate Governance Committee reviewed the relationship between the Company and the law firm pursuant to the Company's Related Person Transaction Policy and concluded that the relationship was in the best interests of the Company since the attorneys performing most of that work had been handling regulatory matters for the Corporation's New Jersey subsidiary for several years prior to Mr. Holland joining the firm.

## **BOARD AND BOARD COMMITTEES**

The Board of Directors held seven meetings in 2012. The Company's Bylaws provide that the Board of Directors, by resolution adopted by a majority of the whole Board, may designate an Executive Committee and one or more other committees, with each such committee to consist of two or more directors. The Board of Directors annually elects from its members the Executive, Audit, Executive Compensation and Corporate Governance Committees. The Board may also from time to time appoint an ad hoc Finance Committee to approve the terms of the Company's financings. The Retirement and Employee Benefits Committee, which is comprised of senior management of the Company, reports periodically to the Board of Directors. Ms. Carroll and Mr. Holland serve as advisors to the Retirement and Employee Benefits Committee. Each director attended at least 75% of the aggregate of all meetings of the Board and the Committees on which each such director served in 2012. The Board of Directors encourages all directors to attend the Company's Annual Meeting of Shareholders. All the directors were in attendance at the 2012 Annual Meeting of Shareholders.

Each of the standing Committees of the Board of Directors operates pursuant to a written Committee Charter. Copies of these Charters can be obtained free of charge from the Corporate Governance portion of the Investor Relations section of the Company's website, [www.aquaamerica.com](http://www.aquaamerica.com).

The current members of the standing Committees of the Board of Directors are as follows:

**Executive Committee**

Nicholas DeBenedictis\*  
Richard H. Glanton  
William P. Hankowsky  
Lon R. Greenberg

**Executive Compensation Committee**

William P. Hankowsky\*  
Lon R. Greenberg  
Ellen T. Ruff

**Audit Committee**

Lon R. Greenberg\*  
William P. Hankowsky  
Andrew J. Sordoni, III

**Corporate Governance Committee**

Richard H. Glanton\*  
Mary C. Carroll  
Mario Mele

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\* Chairman

**Executive Committee**

The Company's Bylaws provide that the Executive Committee shall have and exercise all of the authority of the Board in the management of the business and affairs of the Company, with certain specified exceptions. The Executive Committee is intended to serve in the event that action by the Board of Directors is necessary or desirable between regular meetings of the Board, or at a time when convening a meeting of the entire Board is not practical, and to make recommendations to the entire Board with respect to various matters. The Executive Committee did not meet in 2012. The Executive Committee currently has four members, and the Chairman of the Board of Directors serves as Chairman of the Executive Committee.

**Audit Committee**

The Audit Committee is composed of three directors, whom the Board of Directors has affirmatively determined meet the standards of independence required of audit committee members by the NYSE listing requirements and applicable SEC rules. Based on a review of the background and experience of the members of the Audit Committee, the Board of Directors has determined that all members of the Audit Committee are financially literate and are audit committee financial experts within the meaning of applicable SEC rules. The Audit Committee was required to meet at least four times during the year and met five times during 2012. The Audit Committee operates pursuant to a Board-approved charter which states its duties and responsibilities. The primary responsibilities of the Audit Committee are to monitor the integrity of the Company's financial reporting process and systems of internal controls, including the review of the Company's annual audited financial statements, and to monitor the independence of the Company's independent registered public accounting firm. The Audit Committee has the exclusive authority to select, evaluate and, where appropriate, replace the Company's independent registered public accounting firm.

The Audit Committee has considered the extent and scope of non-audit services provided to the Company by its independent registered public accounting firm and has determined that such services are compatible with the independent registered public accounting firm maintaining its independence. For more information, see the Audit Committee Report on page 57.

**Executive Compensation Committee**

The Executive Compensation Committee is composed of three directors, whom the Board of Directors has affirmatively determined are independent directors as defined by the NYSE listing requirements. The Executive Compensation Committee operates pursuant to a Board-approved charter which states its duties and responsibilities. The Executive Compensation Committee has the power to, among other things, administer and make awards under the Company's equity compensation plans. The Executive Compensation Committee reviews the recommendations of the Company's Chief Executive Officer as to appropriate compensation of the Company's executive officers (other than the Chief Executive Officer) and determines the compensation of such executive officers. The Committee reviews and recommends to the Board of Directors the compensation for the Company's Chief Executive Officer, which is subject to final approval by the Board of Directors. The Executive Compensation Committee held four meetings in 2012.

## Corporate Governance Committee

The Corporate Governance Committee is composed of three directors, whom the Board of Directors has affirmatively determined are independent directors as defined by the NYSE listing requirements. The Corporate Governance Committee operates pursuant to a Board-approved charter which states its duties and responsibilities, which include identifying and considering qualified nominees for directors, developing and periodically reviewing the Corporate Governance Guidelines by which the Board of Directors is organized and executes its responsibilities. The Corporate Governance Committee advises the Board of Directors on executive selections and succession, including ensuring that there is a succession plan for the Chief Executive Officer and such other senior executives as determined by the Corporate Governance Committee. In addition, the Chairman of the Corporate Governance Committee, as lead independent director, conducts corporate governance discussions in executive sessions with the Board of Directors. The Corporate Governance Committee also reviews and approves, ratifies or rejects related person transactions under the Company's written policy with respect to related person transactions. The Corporate Governance Committee met two times during 2012.

## OWNERSHIP OF COMMON STOCK

The following table sets forth certain information as of March 11, 2013 with respect to shares of Common Stock of the Company beneficially owned by: (1) each person known to the Company to be the beneficial owner of more than 5% of the Common Stock of the Company; (2) each director, nominee for director and executive officer named in the Summary Compensation Table; and (3) all directors, nominees and executive officers of the Company as a group. This information has been provided by each of the directors, executive officers and nominees at the request of the Company or derived from statements filed with the SEC pursuant to Section 13(d) or 13(g) of the Exchange Act. Beneficial ownership of securities as shown below has been determined in accordance with applicable guidelines issued by the SEC. Beneficial ownership includes the possession, directly or indirectly, through any formal or informal arrangement, either individually or in a group, of voting power (which includes the power to vote, or to direct the voting of, such security) and/or investment power (which includes the power to dispose of, or to direct the disposition of, such security).

Name and Address of Beneficial Owner	Sole voting and sole investment power (1)	Shared voting and shared investment power	Amount and Nature of Beneficial Ownership	Percent of Class (2)
<b>1) Certain beneficial owners:</b>				
BlackRock, Inc. (3) 40 East 52 <sup>nd</sup> Street New York, NY 10022	8,895,504		8,895,504	6.33%
State Street Corporation (4) One Lincoln Street Boston, MA 02111	0	7,973,276	7,973,276	5.67%
The Vanguard Group (5) 100 Vanguard Blvd. Malvern, PA 19355	7,717,695	95,352	7,813,047	5.56%
<b>2) Directors (including nominees) and named executive officers:</b>				
Mary C. Carroll	22,479	3,891 (6)	26,370	*
Nicholas DeBenedictis	933,678	252,754 (7)	1,186,431	*
Christopher H. Franklin	105,261		105,261	*
Richard H. Glanton	10,950		10,950	*
Lon R. Greenberg	10,000	8,400 (8)	18,400	*
William P. Hankowsky	15,060		15,060	*
Wendell F. Holland	2,200		2,200	*
Karl M. Kyriss	86,061	21,885 (9)	107,947	*
Christopher P. Luning	28,923		28,923	*
Mario Mele	13,200	15,582 (10)	28,782	*
Ellen T. Ruff	11,200		11,200	*
David P. Smeltzer	143,602	33,916 (11)	177,518	*



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Andrew J. Sordoni	54,886	12,536 (12)	67,422	*
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Name and Address of Beneficial Owner	Sole voting and sole investment power (1)	Shared voting and shared investment power	Amount and Nature of Beneficial Ownership	Percent of Class (2)
<b>3) All directors, nominees and executive officers as a group (15 persons)</b>				
	1,587,500 (13)	372,164 (14)	1,959,664	1.39%

\* Less than 1%

- (1) Includes shares held under the Company's 401(k) Plan as applicable. Also includes the following number of shares issuable upon exercise of outstanding stock options exercisable on or before May 11, 2013: 404,364 shares issuable to Mr. DeBenedictis; 105,577 shares issuable to Mr. Smeltzer; 75,332 shares issuable to Mr. Franklin; 83,747 shares issuable to Mr. Kyriss; and 25,000 shares issuable to Mr. Luning.
- (2) Percentage of ownership for each person or group is based on 140,613,766 shares of Common Stock outstanding as of March 11, 2013. For each beneficial owner, the shares include all shares issuable to such person or group upon exercise of outstanding stock options exercisable within 60 days of that date.
- (3) The information for BlackRock, Inc. was obtained from the Schedule 13G/A filed by BlackRock, Inc. with the SEC on February 6, 2013.
- (4) The information for State Street Corporation was obtained from the Schedule 13G filed by State Street Corporation with the SEC on February 12, 2013.
- (5) The information for The Vanguard Group was obtained from the Schedule 13 G/A filed by The Vanguard Group with the SEC on February 22, 2013.
- (6) The shareholdings indicated are owned of record by Ms. Carroll's husband.
- (7) The shareholdings indicated also include 252,754 shares owned by Mr. DeBenedictis' wife, including 185,160 shares in a trust for which his wife is trustee.
- (8) The shareholdings indicated are owned jointly with Mr. Greenberg's wife.
- (9) The shareholdings indicated are owned jointly with Mr. Kyriss' wife.
- (10) The shareholdings indicated include: 3,666 shares owned by the Fidelio Foundation, for which Mr. Mele is trustee; 7,916 shares owned by Dental Delivery Systems, Inc., of which Mr. Mele is President; and 4,000 shares owned by Mele Brothers Realty, of which Mr. Mele is partner.
- (11) The shareholdings indicated are owned jointly with Mr. Smeltzer's wife.
- (12) The shareholdings indicated include 2,000 shares owned of record by Mr. Sordoni's wife and 10,536 shares owned by a trust for the benefit of Mr. Sordoni's children and with respect to which Mr. Sordoni's wife is trustee.
- (13) The shareholdings indicated include 803,352 shares issuable to such group upon exercise of outstanding stock options exercisable on or before May 31, 2013.
- (14) The shareholdings indicated include 372,164 shares (i) held in joint ownership with spouses, (ii) held as custodian for minor children, (iii) owned by family members or (iv) in trusts for adult children.

## EXECUTIVE COMPENSATION

### COMPENSATION DISCUSSION AND ANALYSIS

In this Compensation Discussion and Analysis ( CD&A ), we address the compensation paid or awarded to our executive officers listed in the Summary Compensation Table that immediately follows this discussion. We refer to these executive officers as our named executive officers. As used in this CD&A, the total of base salary and annual cash incentive compensation is referred to as total cash compensation and the total of base salary, annual cash incentive compensation and equity incentive compensation is referred to as total direct compensation. The purpose of the CD&A is to explain: the elements of compensation; why our Compensation Committee selects these elements; and how the Compensation Committee determines the relative size of each element of compensation.

#### Executive Summary

##### *2012 Company Overview*

In 2012, the Company delivered positive results for our customers, our shareholders and our employees. A few of the highlights for the year include:

- Revenues increased 10.3% from \$687.3 million to \$757.8 million;
- Net income rose 38.8% from \$143.1 million to \$196.6 million;
- Earnings per share increased from \$1.03 to \$1.40;
- The Board of Directors approved a 6.1% increase to the quarterly dividend for the December 1, 2012 dividend;
- We invested a record \$348 million in our water and wastewater systems to improve our distribution network and enhance water quality and reliability for our customers;
- We maintained an A+ rating from Standard & Poors for our largest subsidiary, Aqua Pennsylvania; and
- Our stock price increased 15.3% for 2012 versus a 13.4% increase for the S&P 500.

##### *Executive Compensation Program Overview*

Our executive compensation program is intended to attract, retain and motivate a talented management team and appropriately reward them for their accomplishments in fulfilling our objectives with respect to our various stakeholders. Our program consists of a combination of short-term and long-term compensation vehicles and a substantial portion of the named executive officers' total direct compensation comes from incentive compensation as shown in the table below. Based on input from the Executive Compensation Committee's (the Compensation Committee) compensation consultant, we believe that the types of compensation vehicles we use and the relative proportion of the named executive officers' total compensation represented by these vehicles is consistent with current competitive compensation practices. We measure the competitiveness of our program for our executive officers against the median compensation for comparable positions at other companies in our benchmark market composed of other investor-owned utilities. Since compensation levels are typically aligned with a company's revenues, we adjust the Company's revenues in the manner described below to align with the companies in the benchmark market and size-adjust the market data using regression analysis to determine the market rates for our named executive officer positions. Our goal is to provide total direct compensation that is competitive with the market rates for each named executive officer. The total target direct compensation for each of our named executive officers was at or below the median of the benchmark market for each of their positions at the beginning of 2013.

Our executive compensation program is designed to balance a number of objectives, as detailed in this CD&A. The following is a summary of some of the compensation practices and policies that are part of our executive compensation program:

- a substantial portion of our executives' compensation is performance-based;
- a majority of the long-term equity incentives for our executives are performance-based;



- there are stock ownership guidelines for the named executive officers;
- the Company has ceased the practice of providing tax gross-ups in any new change-in-control agreements;
- the Company uses multiple metrics in its long-term equity incentives;
- the Company has an incentive compensation clawback policy for awards under its annual cash incentive plan; and
- there is no stock pledging or hedging by the Company's named executive officers.

The table below shows the portion of each named executive officer's 2012 total direct compensation that is considered performance-based (i.e., annual cash incentives and performance-based equity incentives).

Name	2012 Cash		2012	2012	2012	Total Percentage
	2012 Salary	Incentive Paid in 2013	Performance Units	Restricted Stock Units	Performance-based Restricted Stock Units	Performance-based Compensation
N. DeBenedictis	25%	36%	26%		12%	75%
D. Smeltzer	39%	28%	22%	10%		50%
C. Franklin	38%	30%	21%	10%		51%
K. Kyriss	38%	29%	22%	10%		51%
C. Luning	48%	25%	18%	9%		43%

Note: The information in the table above differs from the information in the Summary Compensation Table on page 37 in that it excludes amounts from the Changes in Pension Value and Non-qualified Deferred Compensation Earnings and All Other Compensation because these amounts are not considered in establishing the named executive officers' annual total cash compensation and total direct compensation and some of the amounts in those columns in the Summary Compensation Table can vary significantly from year to year.

With respect to the annual equity incentive awards, 100% of the 2012 equity incentive awards for the CEO and at least 66% of the 2012 equity incentive awards for the other named executive officers, based on grant date values, are performance-based.

Finally, it should be noted that the Total Compensation in the Summary Compensation Table on page 37 for Mr. DeBenedictis, the Company's Chief Executive Officer, who reached aged 65 in September 2010, includes in 2010 a one-time grant of 57,000 shares of restricted stock in 2010 in connection with Mr. DeBenedictis' entry into an Employment Agreement to continue to serve as Chief Executive Officer beyond his normal retirement date through January 2013 and includes in 2011 a one-time grant of 50,000 shares of restricted stock made in 2011 in connection with the Company's request that Mr. DeBenedictis further extend the term of his Employment Agreement to June 30, 2015.

#### Objectives of Aqua America's Compensation Program

Our executive compensation program is designed to motivate our executives to achieve our goals of providing our customers with quality, cost-effective and reliable water and wastewater services and providing our shareholders with a long-term, positive return on their investment.

Toward that end, our compensation program is designed to meet the following objectives:

- provide compensation levels that are competitive with those provided by other companies with which we may compete for executive talent;
- motivate executives to achieve annual customer service-oriented objectives and strategic business initiatives and reward them for their performance in achieving these objectives and initiatives;
- create a strong link between the compensation of our executives and our financial performance and shareholder value; and
- retain executives of significant abilities.



### **Elements of Aqua America's Compensation Program**

Our executive compensation program is composed of the following six elements, which we believe are important components of a well-designed, balanced and competitive compensation program:

- Base Salary
- Annual Cash Incentive Awards (referred to as Non-Equity Incentive Plan Compensation in the Summary Compensation Table on page 37)
- Equity Incentives and stock ownership guidelines
- Retirement Benefits
- Non-Qualified Deferred Compensation Plans
- Change-in-Control Agreements

We utilize these six elements to achieve the objectives of our compensation program as follows.

- Competitively benchmarked base salaries are designed to attract and retain executives consistent with their talent and experience; market-based salary increases are designed to recognize the executives performance of their duties and responsibilities; and promotions and related salary increases are designed to encourage executives to assume increased job duties and responsibilities.
- Annual cash incentive awards are intended to reward executives and other employees for: improving the quality of service to our customers; controlling the cost of service to our customers by managing expenses and improving performance; achieving economies of scale by the acquisition of additional water and wastewater systems that can benefit from our resources and expertise; disposing of under-performing systems where appropriate; and enhancing our financial viability and performance by the achievement of annual objectives.
- Stock ownership guidelines are designed to focus executives on the long-term performance of the Company and align the interests of our executives with our shareholders by encouraging executives to maintain a significant ownership interest in the Company. Equity incentives are designed to reward executives and other employees for (1) enhancing our financial health, which also benefits our customers, (2) improving our long-term performance through both revenue increases and cost control, and (3) achieving increases in the Company's equity and in absolute shareholder value and shareholder value relative to peer companies as well as helping to retain executives due to the longer term nature of these incentives;
- Retirement benefits are intended to assist executives and other employees to provide income for their retirement.
- Our non-qualified deferred compensation plan is designed to allow eligible executives to manage their financial and tax planning and defer current income until a later date, including following retirement or other separation from employment.
- Change-in-control agreements with selected executive officers are designed to promote stability and dedication to shareholder value in the event of a fundamental transaction affecting the ownership of the Company and to enable the executives to evaluate such a transaction impartially.

### ***Compensation Risk***

In administering the executive compensation program, the Compensation Committee attempts to strike an appropriate balance among the elements of our compensation program to achieve the objectives described above. Each of the elements of the program is discussed in greater detail herein. In reviewing the Company's overall compensation program in the context of the risks identified in the Company's enterprise risk management processes, the Compensation Committee does not believe that the risks the Company faces are materially increased by the Company's compensation programs and, therefore, the Compensation Committee does not believe that the program creates a reasonable likelihood of a material adverse effect on the Company.





### ***Benchmarking Competitive Compensation***

The Compensation Committee has retained Pay Governance LLC ( Pay Governance or the consultant ), a nationally-recognized compensation consulting firm, as the Compensation Committee s consultant to assist it in designing and assessing the competitiveness of our executive compensation program. Annually, the Compensation Committee has the consultant develop a market rate for base salary, total cash compensation and total direct compensation for each of the named executive officer positions, including the allocation between cash compensation and equity incentives. Each market rate represents the compensation level that would be paid to a hypothetical, seasoned performer in a position having similar responsibilities and scope, in an organization of similar size and type as the Company.

In developing the market rates for the named executive officers, the Compensation Committee s consultant used compensation data from all 61 investor-owned utilities in the utility industry database used by the consultant to determine the market rates for executives of utility companies. The Compensation Committee believes that utilizing the data from only utility companies and adjusting the Company s revenues as described below, to better align the Company s data with the data in the utility industry database, provides an appropriate comparison for determining the market rates for the Company s named executive officers given that we are primarily a utility company. Also, due to the relatively limited number of investor-owned water utility companies of the Company s size, the Compensation Committee believes that using the broader utility market data provides reasonable and reliable data for determining competitive compensation levels. All 61 companies in the utility industry database used by the consultant are listed in Appendix A to this Proxy Statement. The Company has no involvement in the selection of the companies that are included in the database used by the consultant. Each company listed in Appendix A was used in the development of the market rates for 2012, as described in this paragraph.

The Company, the Compensation Committee and Pay Governance are mindful that compensation levels for executives of companies are typically aligned with a company s size as defined by revenues. In other words, executives in companies with higher revenues are generally paid more than executives with comparable positions in companies with lower revenues. The Compensation Committee and Pay Governance have concluded that the Company s revenues under-represent the complexity and scope of the Company s business given the Company s low cost of goods sold relative to energy-based utilities. The cost of goods sold as a percentage of revenues is significant for energy-based utilities due to their fuel, gas and other power costs. These commodity costs are subsequently recovered through the revenues of the energy-based utilities as they are ultimately passed through to the customer. The Company, like other water utilities, does not have a comparable commodity cost. The purpose of the adjusted revenue analysis is to create a consistent comparison to the compensation data in the utility database used by the consultant by estimating the revenue that the Company would earn if its cost of goods sold was in similar proportion to that of energy-based utilities. In order to determine a factor by which to adjust the Company s annual revenues, the Compensation Committee recommended that the consultant analyze the income statements of a sample of delivery-focused (i.e., non-power generating) utilities, chosen by the consultant with no input from the Company, to develop a typical cost of goods sold factor attributable to commodity costs.

The consultant s analysis determined that the commodity costs of the cost of goods sold averaged 50% to 55% of revenues for these companies and calculated what the Company s adjusted revenues would be using this factor. Since there are certain complexities associated with procuring these commodities at the energy-based utilities, the consultant recommended, and the Compensation Committee agreed, that it would be appropriate to discount the market rates generated by the adjusted revenue methodology. Thus, it was agreed that the Company average the market data produced using the Company s adjusted revenue scope with market data generated using the Company s actual revenue scope in determining the market rates for the Company s executives.

Because the companies listed in Appendix A vary widely in terms of revenues, the independent compensation consultant used regression analysis to size-adjust the benchmark data for each named executive officer s revenue responsibility using the Company s actual and adjusted revenues, where possible, and averaging the results to determine market rates for base salary, total cash compensation and total direct compensation for each named executive officer. Tabular data were used where regression data were unavailable due to insufficient correlation between officer positions in the Company and the companies in the database and/or limited sample size to ensure the accuracy of the regression analysis. Regression analysis is an objective calculation that identifies a relationship between one variable (in this case, total cash compensation, equity incentives and total direct compensation) and

another variable that is related to it (in this case, total company revenues). Therefore, in developing the market rates for total cash compensation, equity incentives and total direct compensation, the independent compensation consultant uses regression analysis to determine what the companies in Appendix A would pay at the median for positions comparable to those of the Company's named executive officers.

The Compensation Committee considers target total direct compensation levels that are within a range of 15% of the market rates developed by the consultant for each position to be competitive. Variances within this range can be a result of performance, experience and other factors. At the beginning of 2013, the average of the target total cash compensation for the Company's five named executive officers was 14% below the competitive benchmark, and the average of the target total direct compensation for the Company's five named executive officers was 12% below the competitive benchmark. Payouts of prior cash incentives and changes in the value of equity incentives granted in previous years are not taken into account in determining the amounts of current awards because annual incentives are intended to reward annual performance and the Compensation Committee makes grants of equity incentives based on their grant date value and the applicable competitive benchmarks for each named executive officer's position.

#### ***Determination of Actual Compensation***

The Compensation Committee determines the actual amount of each element of annual compensation to award to the Company's executive officers, including the named executive officers, with the goal of having the target total direct compensation opportunity for the executive officers generally within a range of 15% above or below the market rate for their position over time. We emphasize pay for performance, especially for our higher-level executives. Therefore, the named executive officers tend to receive a sizable portion of their total annual compensation from annual cash incentives and equity incentives. In addition, the percentages of total direct compensation represented by base salary, annual cash incentive opportunities and equity incentives for the named executive officers are generally in line with the percentages represented by these elements of total direct compensation for the competitive market rate benchmarks.

#### ***Base Salary***

A competitive base salary is necessary to attract and retain a talented and experienced workforce. Actual salaries for the named executive officers are determined by the Compensation Committee by considering both the market rate for the position and internal equity with both the other named executive officers and other employees in the Company. The Compensation Committee's goal is to maintain base salaries generally within a range of 15% above or below the market rate over time for each of the named executive officers, although deviations from this goal may occur due to promotions, the executive's performance and the time the executive has been in a particular salary grade. Base salaries are considered for adjustment annually and adjustments are based on general movement in external salary levels, changes in the market rate for the named executive officers' positions, individual performance, internal equity and changes in individual duties and responsibilities. At the beginning of 2012, three senior vice presidents were promoted to executive vice president and their duties and responsibilities were substantially re-aligned. For 2012, the salary increases for the named executive officers reflected these promotions and averaged 12.7%. The Chief Executive Officer's 2012 base salary increase was 3.3%.

#### ***Annual Cash Incentive Awards***

Annual cash incentives under the Annual Cash Incentive Compensation Plan are intended to motivate management to focus on the achievement of annual objectives that will, among other things, improve the level of service to our customers, control the cost of service and enhance our financial performance. The annual cash incentive portion of the compensation package is based on a target incentive award for each executive, which is stated as a percentage of their individual base salary. The Compensation Committee selects a target annual incentive percentage for each executive so that the executive's target total cash compensation, consisting of base salary and target annual cash incentive, when combined with the executive's target equity incentives, is generally in a range of 15% above or below the total direct compensation for the market rate for that position. The target incentive award for 2012 as a percentage of base salary for each of the named executive officers was: Nicholas DeBenedictis 75%; David P. Smeltzer 45%; Christopher H. Franklin 50%; Karl M. Kyriss 50%; and Christopher P. Luning 35%.

Actual annual incentive awards for executive officers are calculated using the following formula:

$$\text{Salary} \times \text{Target Incentive Percentage} \times \text{Company Factor} \times \text{Individual Factor}$$

The Company Factor for the named executive officers is a percentage based on the performance of the Company against an annual financial target.

The Individual Factor is a percentage based on the executive's performance against individual objectives established separately for each executive each year.

The Company Factor ranges from 35%, if 75% of the annual financial performance target is achieved, to 125%, if 110% or more of the annual financial target is achieved. The Company Factor will be 0% if the Company and business unit does not achieve at least 75% of the annual financial performance target. The scale for determining the Company Factors is as follows:

	Percent of Target	Company Factor
Threshold	<75%	0%
	75	35
	80	40
	85	45
	90	60
	95	80
	100	100
	105	110
Maximum	>110	125

We feel that this approach strikes a reasonable balance between pay for performance and encouraging our management team to make appropriate decisions for the longer-term interest of the Company. For the period of 2009 through 2012, the Company Factors for the named executive officers have ranged from 73% to 125%.

The financial performance target for determining the Company Factor for 2012 for the named executive officers is Aqua America's budgeted annual net income from continuing operations. Net income is utilized as the performance metric because it is a key performance metric for management, is impacted by management's efforts to control costs for the benefit of the Company's customers and growth in net income forms the basis for enhancing shareholder value. Adjustments may be made to the actual net income results to reflect the impact of: changes in reporting / classification not impacting economic substance but inadvertently impacting the comparison to target; changes in accounting related to the adoption of new accounting standards; and other factors as designated by the Compensation Committee.

For purposes of determining the Company Factor for 2012, the range of 75% to 110% of Aqua America's net income was \$103,706,000 to \$152,103,000.

For 2012, (1) the 2012 100% Company Factor Amount was \$138,275,000, (2) the 2012 Actual Company Factor Amount was \$184,087,000 and (3) the Resulting 2012 Company Factor for each named executive officer for purposes of calculating the 2012 annual cash incentive award paid in 2013 was 125%. The 2012 100% Company Factor Amount represents the amount of net income required for the named executive officer to achieve a Resulting Company Factor of 100%.

The Individual Factor ranges from 0% to 150% and is determined based on the individual executive's performance against separate objectives established for each executive each year, along with discretionary points based on the individual's performance. Each named executive officer has approximately ten individual objectives each year. The Compensation Committee and Board of Directors approve the objectives for the Chief Executive Officer, and the Chief Executive Officer approves the objectives and point weighting for each objective for the other executive officers. The other executives must achieve objectives with a point rating of at least 70 points to be eligible to receive an annual cash incentive award and the maximum points that an executive can achieve based on the executive's performance against his or her objectives is 110 points. Up to 40 discretionary points can be awarded for exceptional performance or for achievements on matters not covered by the executive's original objectives, for a maximum total Individual Factor of 150%. For the Chief Executive Officer, the Individual Factor is based on the



overall assessment by the Compensation Committee and the Board of Directors of his achievements with respect to his objectives with a maximum of 150 points for all the objectives combined. Thus, the maximum Individual Factor rating he can achieve is 150% based on achieving all of his objectives for the year as determined by the Compensation Committee.

The individual annual objectives established for the executive officers, including the named executive officers, will vary depending on their primary areas of responsibility, but the majority of the objectives can be categorized into common areas of emphasis. These common areas of emphasis are customer growth and strategy, improving customer service, cost control, performance improvement, compliance and revenue improvement. The Company considers the executive officers' annual objectives achievable, but challenging. The individual objectives for the named executive officers in 2012 focused on the following areas:

Nicholas DeBenedictis

- Strategic planning
- Succession planning
- Customer service
- Customer and revenue growth / new ventures
- Capital planning / environmental compliance
- Managing controllable costs / operational efficiency
- Legislative / public policy initiatives
- Investor Relations

David P. Smeltzer

- Rate case management
- Debt financing
- Operating cost control
- Sarbanes-Oxley Act compliance
- Strategic tax initiatives
- Retirement plan investment management
- Strategic planning

Christopher H. Franklin

- Customer and revenue growth
- Water quality

- Operational efficiencies
- Organizational change management
- Operating cost control
- Environmental compliance

Karl M. Kyriss

- Regulated and non-regulated capital investment
- Regulated and non-regulated corporate development
- Strategic planning
- Revenue improvements
- Cost control
- Procurement improvements
- I/S systems utilization expansion

Christopher P. Luning

- Regulated and non-regulated corporate development
- Outside legal expense control
- Strategic planning
- Retirement plan investment management
- Healthcare and human resources management
- Litigation and claims management
- Operating cost control

For the period of 2009 through 2012, the Individual Factors achieved by the named executive officers based on their performance against their objectives and discretionary points have ranged from 110% to 150%. In 2012, the named executive officers substantially met or exceeded their individual objectives and as a result, the Individual Factors for the named executive officers for 2012 were: Nicholas DeBenedictis 150%; David P. Smeltzer 126%; Christopher H. Franklin 124%; Karl M. Kyriss 120%; and Christopher P. Luning 117%.

Actual cash incentive awards under the Annual Cash Incentive Compensation Plan for the named executive officers are determined based on the applicable Company Factor, certified by the Company's Chief Financial Officer and Director of Internal Audit, and each executive officer's Individual Factor. For the Chief Executive Officer, the Board of Directors reviews and approves his Individual Factor based on the Compensation Committee's assessment of the Chief Executive Officer's performance against his objectives. For the other named executive officers, the Compensation Committee reviews and approves the Individual Factors based on the Chief Executive Officer's assessment of the named executive officers' performance against their objectives and possible discretionary points recommended by the Chief Executive Officer. Regardless of Aqua America's financial performance, the Compensation Committee retains the authority to determine the final Company Factor, and the actual payment and amount of any annual cash incentive award is always subject to the discretion of the Compensation Committee. The Compensation Committee has not exercised this discretion to grant an annual cash incentive to a named executive officer outside of the provisions of the Plan or to deny a cash incentive award to a named executive officer that was otherwise earned under the Plan.

Based on the above-described factors, the following table shows the target annual cash incentive and the actual annual cash incentive approved by the Compensation Committee for 2012 for the named executive officers. The target annual cash incentive is calculated assuming a 100% Company Factor and a 100% Individual Factor for each of the named executive officers, except the Chief Executive Officer, for whom the target assumes a 150% Individual Factor based on how the Compensation Committee assesses his overall performance as described above.

	2012 Target Cash Incentive (\$)	2012 Total Actual Cash Incentive (\$)
N. DeBenedictis	714,375	892,969
D. Smeltzer	153,000	240,975
C. Franklin	155,000	240,250
K. Kyriss	155,000	232,500
C. Luning	71,750	104,934

### *Equity Incentives*

Our use of equity incentives is intended to reward executives and other employees for (1) enhancing our financial health, which also benefits our customers, (2) improving our long-term performance through both revenue increases and cost control, and (3) achieving increases in the Company's equity and shareholder value, as well as helping to retain executives due to the longer term nature of these incentives. Under the terms of our 2009 Omnibus Equity Compensation Plan, the Compensation Committee and the Board of Directors may grant stock options, dividend equivalents, stock units, stock awards, stock appreciation rights and other stock-based awards to officers, directors, key employees and key consultants of Aqua America and its subsidiaries who are in a position to contribute materially to the successful operation of our business.

As part of its review of the total compensation package for our executives, the Compensation Committee annually reviews our equity incentive compensation program. Starting in 2011, the Compensation Committee began using a combination of performance units and restricted stock units to better link the named executive officer's long-term incentive compensation to performance enhancements that result in increased shareholder value and enhance our long-term financial stability, which also benefits our customers, and to help retain our executives.

We aim to strike a balance between the incentive and retention goals of our equity grants. All of the equity grants to our Chief Executive Officer are subject to performance goals, as described below. For our other named executive officers, two-thirds of their equity grant is in the form of performance share units, with the performance metrics described below, and one-third are in the form of time-based restricted share units.

Annual restricted stock or restricted stock unit grants (together referred to as restricted stock) entitle the grantee to receive the number of shares granted at the end of a given period of time, or in increments over a period of years on the anniversaries of the grant date, provided the grantee remains an employee of the Company, unless separation is due to death, disability, retirement or termination following a Change in Control. For annual restricted stock grants to the named executive officers, dividends or dividend equivalents on the restricted stock are accumulated and paid when the shares of restricted stock vest. For the 2012 annual grant of restricted stock to the Chief Executive Officer, vesting is subject to achievement of a year-over-year increase in the Company's operating income in any of 2012, 2013 or 2014. For the 2013 annual grant of restricted stock to the Chief Executive Officer, vesting is subject to the Company's return on equity exceeding the Company's average return on equity for the 5-year period of 2008 through 2012 in either of 2013 or 2014. For the restricted stock grants to the other named executive officers, vesting is not subject to performance criteria. Adjustments will be made to actual operating income results to reflect the impact of unbudgeted gains or losses, certain non-cash charges arising from changes in accounting or fair value and other factors as designated by the Compensation Committee. Adjustments will be made to actual return on equity to reflect the impact of: changes in reporting / classification not impacting economic substance but inadvertently impacting the comparison to target; changes in accounting related to the adoption of new standards; and other factors as designated by the Compensation Committee.



Performance share or performance share unit grants (together referred to as performance shares) provide the grantee with the opportunity to earn awards of shares based on performance against designated metrics. Participants are granted a target number of shares that can increase to 200% of the target or decrease to zero based on the Company's actual performance compared to the designated metrics. For the performance share grants made by the Company in 2012, the period over which the Company's performance will be measured will be the three-year period of 2012 through 2014. Dividends on the performance shares will accrue and be paid at the end of the performance period based on the number of shares actually earned, if any.

The metrics for the performance shares granted in 2012 are as follows:

- For 25% of the performance shares granted, the number of shares to be paid out at the end of the performance period will be determined based on the Company's Total Shareholder Return (TSR) over the performance period compared to the TSR for the companies in the S&P Midcap Utility Index, based on the following table:

Percentile Ranking Versus Peers	Payout as a % of Target
90 <sup>th</sup>	200%
50 <sup>th</sup>	100%
30 <sup>th</sup>	50%
Below 30 <sup>th</sup>	0%

- For another 25% of the performance shares granted, the number of shares to be paid out at the end of the performance period will be determined based on the Company's TSR at the end of the performance period compared to the TSR for the six other large investor-owned water companies (American Water Works Company, American States Water Company, Connecticut Water Service, Inc., California Water Service Group, Middlesex Water Company and SJW Corporation), based on the following table:

Ordinal Ranking (including Aqua) Versus Peers	Payout as a % of Target (7 companies) <sup>1</sup>
1 <sup>st</sup>	200%
2 <sup>nd</sup>	170%
3 <sup>rd</sup>	130%
4 <sup>th</sup>	100%
5 <sup>th</sup>	50%
6 <sup>th</sup>	0%
7 <sup>th</sup>	0%

<sup>1</sup> The grant provides for alternative rankings if the number of investor owned water companies decreases.

- For the remaining 50% of the performance shares granted, the number of shares to be paid out at the end of the performance period will be determined based on the Company's compound annual growth rate in earnings per share over the performance period, based on the following table:

Aqua America Compound Annual EPS Growth Rate (2011-2014)	Payout as a % of Target
10%	200%
5%	100%
1%	50%
0%	0%

Adjustments may be made to the actual earnings per share results to reflect the impact of unbudgeted gains or losses, certain non-cash charges arising from changes in accounting or fair value and other factors as designated by the Compensation Committee.

In light of the impact of the repair tax accounting change implemented by the Company on the Company's future results, the Compensation Committee approved a change to the performance metrics for the performance shares granted in 2013. The Compensation Committee increased the portion of the performance shares tied to the Company's TSR to even more closely align the value realized by the executives to increases in shareholder value. The TSR metrics will remain the same, but the percentage of the performance shares that have their payout determined based on the Company's TSR over the three-year performance period (2012–2015) compared to the TSR for companies in the S&P Midcap Utility Index will be increased from 25% to 30% and the percentage the performance shares that have their payout determined based on the Company's TSR over the three-year performance period (2012–2015) compared to the TSR for the six other large investor-owned water companies will also be increased from 25% to 30%. The payouts on the remaining 40% of the performance shares granted in 2013 will be determined based on the metrics described below. Management and the Committee believe that, given the impact of the repair tax accounting change over the next few years, it is more appropriate to focus the remaining 40% of the metrics for the performance shares on controlling the operations and maintenance ratio at the Company's largest subsidiary and on achieving the planned earnings before taxes at the Company's other operations. The operations and maintenance ratio is a key metric for measuring management's efficiency and keeps a focus on cost control for the benefit of customers and shareholders. The earnings before taxes metric for the operations other than Aqua Pennsylvania helps focus management on growth and cost control at these other smaller operations, which benefits both our customers and our shareholders. Therefore,

- For 20% of the performance shares granted, the number of shares to be paid out at the end of the performance period (2012–2015) will be determined based on the average of the annual ratio of operations and maintenance expense to revenues over the period of 2013 through 2015 for the Company's Aqua Pennsylvania operations using the following scale:

<b>Aqua Pennsylvania O&amp;M Ratio Metric</b>	
<b>Aqua Pennsylvania 3-year Average O&amp;M Ratio</b>	<b>Percent of 20% of Performance Shares Earned</b>
31.41%	50%
30.41%	100%
28.41%	200%

If Aqua Pennsylvania's ratio of operations and maintenance expense to revenues is below the 31.41% level and falls between the measuring points on the foregoing schedule, the percentage vesting will be based on linear interpolation between the applicable measuring points.

- For 20% of the performance shares granted, the number of shares to be paid out at the end of the performance period (2012–2015) will be determined based on the Company's total cumulative income from continuing operations before income taxes plus the Company's income from discontinued operations before income taxes, less the corresponding amounts from Aqua Pennsylvania over the period of 2013 through 2015 using the following scale:

<b>Non-Pennsylvania Earnings Before Taxes</b>	
<b>Non-Pennsylvania 3-year Combined Earnings Before Taxes (\$000's omitted)</b>	<b>Percent of 20% of Performance Shares Earned</b>
\$218,454	50%
\$242,727	100%
\$267,000	200%

If the Company's non-Pennsylvania earnings before taxes is above \$218,454 and falls between the measuring points on the foregoing schedule, the percentage vesting will be based on linear interpolation between the applicable measuring points.

Adjustments will be made to the Aqua Pennsylvania operations and maintenance expense ratio or the non-Pennsylvania earnings before taxes to reflect changes in accounting related to new accounting standards, changes due to regulatory requirements, unbudgeted transaction costs associated with potential or completed transactions and other factors as designated by the Compensation Committee.

The Compensation Committee bases its annual equity incentive awards for the executives on the competitive levels for these awards as described herein and does not consider any increase or decrease in the value of past equity incentive awards in making this decision. In considering the number of equity incentive awards to be granted in total to all employees each year, the Compensation Committee considers the number of equity incentive awards outstanding and the number of equity incentive awards to be awarded as a percentage of Aqua America's total shares outstanding. The number of equity incentive awards granted annually to all employees has been less than 1.0% of Aqua America's total shares outstanding.

Equity incentive awards are generally all made on the same grant date. It is our policy to make the grant date of equity compensation grants the date that the Compensation Committee approves the grants, which is either the date of the Compensation Committee's meeting or the date of the Board meeting following the Compensation Committee's meeting. The dates for all Board and Compensation Committee meetings, including the dates for the Compensation Committee to approve the equity grants, are set in advance, subject to changes for scheduling conflicts, and is independent of the timing of our disclosure of any material non-public information other than our normal annual earnings release.

#### ***Retirement Plans***

Our qualified retirement plans are intended to provide competitive retirement benefits to help attract and retain employees. Our non-qualified retirement plans are intended to: (1) provide executives with a retirement benefit that is comparable on a percentage of salary basis to that of our other employees participating in our qualified pension plan by providing the benefits that are limited under current Internal Revenue Service regulations; and (2) provide our Chief Executive Officer with a total retirement benefit based on 25 years of service at normal retirement age. Starting in 2009, the Company began to fund the trust for the benefits under the non-qualified retirement plans using trust-owned life insurance. An executive's retirement benefits under our qualified and non-qualified retirement plans are not taken into account in determining the executive's current compensation.

#### ***Non-qualified Deferred Compensation Plans***

We maintain a non-qualified Executive Deferred Compensation Plan that allows eligible members of management to defer all or a portion of their salary and annual cash incentives, which enables participants to save for retirement and other life events in a tax-effective manner. Deferred amounts are deemed invested in one or more mutual funds selected by the participant under trust-owned life insurance policies on the lives of eligible executives. In addition, in order to provide executives with the full Company matching contribution available to other employees, executives who choose to defer up to six percent of their salary under one of Aqua America's 401(k) plans, but do not receive the full Aqua America matching contribution under the plans due to the Internal Revenue Service regulations limiting the total dollar amount that can be deferred under a 401(k) plan (\$16,500 for 2010 and 2011 and \$17,000 for 2012), receive the portion of the Aqua America matching contribution that would otherwise be forfeited by the executive as an Aqua America contribution into the Executive Deferral Plan. Effective January 1, 2009, the Company began to fund the trust holding amounts deferred by the participants in the Executive Deferral Plan using trust-owned life insurance. An executive's deferrals, Aqua America's contributions and earnings on deferrals and contributions under our non-qualified deferred compensation plan are not taken into account in determining the executive's current compensation.

#### ***Severance Plans***

All salaried employees, including the named executive officers, are covered by our severance policy. The policy provides eligible employees, subject to the terms of the policy, with a severance benefit of two weeks of the employee's weekly base salary per credited year of service if the employee's employment is terminated because the employee's position is discontinued due to business conditions or a reorganization and no comparable employment is available and offered to the employee. The policy provides a minimum severance benefit of four weeks and a

maximum benefit of 26 weeks of the employee's base weekly salary at the time of termination and a minimum of one month of continued medical benefits and a maximum of six months of continued medical benefits following termination to eligible employees. Employees must sign a general release in order to receive these severance benefits. These benefits are available to all eligible salaried employees.

Our Chief Executive Officer will be entitled to the benefits under his Employment Agreement described on page 48 if his employment is terminated (a) by the Company without cause, (b) by the Chief Executive Officer for good reason or (c) by his death or disability as set forth in the Employment Agreement, whether or not that termination occurs after a change-in-control.

### *Change-in-Control Agreements*

We maintain change-in-control agreements with certain executives, including the named executive officers. These change-in-control agreements are intended to minimize the distraction and uncertainty that could affect key management in the event we become involved in a transaction that could result in a change in control of Aqua America and to enable the executives to impartially evaluate such a transaction. Under the terms of these agreements, the covered executives are entitled to certain severance payments and a payment in lieu of the continuation of benefits if they experience a termination of employment other than for cause, or in the event the executive resigns for good reason, as defined in the agreements, within two years following a change-in-control of Aqua America. (See the description of "Potential Payments Upon Termination or Change-in-Control" on pages 48 through 55.) These agreements are intended to induce the covered executives to remain with Aqua America and to reinforce and encourage their continued attention and dedication to their duties and responsibilities in the event of a possible change-in-control.

These change-in-control agreements are referred to as "double trigger" agreements since they only provide a benefit to executives whose employment is terminated, or who have good reason to resign, following a change-in-control. These change-in-control agreements do not provide any payments or benefits to the covered executives merely as a result of a change-in-control, although other benefits, such as the vesting of equity incentives, may be triggered under our other plans as a result of a change-in-control. Only the agreement with our Chief Executive Officer signed in 1992 includes a provision allowing him to receive the benefits under the agreement if he resigns within 12 months after a change-in-control as a result of his determination that circumstances have changed with respect to Aqua America and he is no longer able to effectively perform his duties and responsibilities. Because of the unique role of a chief executive officer in a corporation, we believe that such a provision is appropriate. Each of the change-in-control agreements, except the agreement with the Chief Executive Officer, limit the amount of the payments under the agreements to the Internal Revenue Service's limitation on the deductibility of these payments under Section 280G of the Internal Revenue Code (the "Code"). The agreement with the Chief Executive Officer does not contain this limitation and requires Aqua America to reimburse him for certain tax impacts if the payments under his agreement exceed the Section 280G limit by at least 10%. See "The Impact of Tax Considerations on Executive Compensation Decisions" on page 34. Payment under the Chief Executive Officer's agreement is, however, contingent on his agreement to a 12-month non-compete agreement.

The Company has determined that there will be no tax gross-ups in any new change-in-control agreements with executives in the future and that all such agreements will be subject to the limitations under Section 280G of the Code.

We believe that the multiples of compensation and other benefits provided under the change-in-control agreements, as described on pages 48 through 50 are consistent with the multiples in the market. Executives who receive payments under their change-in-control agreements in connection with their separation from employment following a change-in-control will not be entitled to any payments under our normal severance policy, nor will our Chief Executive Officer be entitled to receive the separate severance payment under his Change in Control and Severance Agreement for a termination following a change-in-control.

### **The Role of Management in the Executive Compensation Process**

Our Senior Vice President and General Counsel assists the Compensation Committee by preparing schedules showing the present compensation of executives and compiling the recommended salary grade midpoints, market rates, target annual cash incentives and target range of equity compensation awards from the information provided by the Compensation Committee's consultant. Our Chief Executive Officer compiles and presents the supporting information for the individual executives' performance against their objectives and his recommendations for any discretionary points for the calculation of the Individual Factor under the Annual Cash Incentive Compensation Plan. He also provides the Compensation Committee with his recommendations for annual salary increases, any changes in target annual cash incentive percentages and equity incentive awards for the other executive officers. Our Chief Executive Officer also provides the Compensation Committee with a self-assessment of his performance against his objectives. Our Chief Financial Officer provides the Compensation Committee with certifications as to our financial performance for purposes of determining the Company Factor for the Annual Cash Incentive Compensation Plan, our performance against the criteria established by the Compensation Committee for the vesting of restricted stock grants and the payment of performance shares. These financial measures are also certified by our Director of Internal Audit. Our Chief Executive Officer makes recommendations to the Compensation Committee with respect to the compensation awards for the named executive officers other than himself, but the ultimate decisions regarding compensation for these officers are made by the Compensation Committee.

### **The Role of the Compensation Committee's Consultant in the Executive Compensation Process**

Pay Governance, the Compensation Committee's compensation consultant reviews the Company's executive compensation program for the Compensation Committee and annually provides an analysis showing the market rate for base salary, total cash compensation and total direct compensation for each of the named executive officer positions, including the allocation between cash compensation and equity incentives. The compensation consultant discusses the proposed actual compensation awards for the named executive officers and provides research and input to the Compensation Committee on changes to the compensation program.

Pay Governance provides no other services to the Company other than serving as the Compensation Committee's compensation consultant. The Compensation Committee has concluded that Pay Governance is an independent consultant after considering the factors relevant to Pay Governance's independence from management, including the factors set forth in the NYSE and SEC rules regarding compensation consultant independence.

### **The Impact of Tax Considerations on Executive Compensation Decisions**

While Aqua America's executive compensation program is structured to be sensitive to the deductibility of compensation for federal income tax purposes, the program is principally designed to achieve our objectives as described above. Section 162(m) of the Code generally precludes the deduction for federal income tax purposes of more than \$1 million in compensation (including long-term incentives) paid individually to our Chief Executive Officer and the other named executive officers in any one year, subject to certain specified exceptions. We have determined that it may be appropriate for our Chief Executive Officer's compensation to be at a level such that a portion is not deductible for federal income tax purposes.

As noted above, under the change-in-control agreement with our Chief Executive Officer, our payments to our Chief Executive Officer will not be subject to limitations under Section 280G of the Code if the amounts payable to him under his agreement exceed the Section 280G limit by more than 10%, and, therefore, a portion of the payments may not be deductible. If the amounts payable to our Chief Executive Officer exceed the Section 280G limit by more than 10%, he shall be paid an additional amount such that the net amount he retains after deduction of any excise tax imposed under Section 4999 of the Code, and any federal, state and local income and employment tax and excise tax imposed upon such additional amount shall be equal to the payment otherwise due under the agreement. We included these provisions in our Chief Executive Officer's change-in-control agreement because we did not want the potential excise tax to serve as a disincentive to our Chief Executive Officer's pursuit of a change-in-control transaction that might otherwise be in the best interests of our shareholders. We believe that, in light of our Chief Executive Officer's record of performance, this determination is appropriate.

### Equity Ownership Requirements

In 2005, the Board of Directors established stock ownership guidelines for the named executive officers to encourage these executives to maintain a significant ownership interest in the Company and to help align the interests of these executive officers with the long-term performance of the Company. In 2012, these guidelines were modified to recognize the different levels of executives who may be among the named executive officers and to state the guidelines in terms of the number of shares to be held rather than a dollar value, in order to avoid fluctuations in the number of shares to be held based on variations in the Company's stock price. In establishing the number of shares to be held, the Compensation Committee used a round number of shares, the value of which approximates the following multiples of the midpoint of the base salary grade for the executives:

Position	Approximate Multiple of Salary Midpoint	Number of Shares
Chief Executive Officer	5	150,000
Executive Vice President	3	40,000
Senior Vice President	2	20,000

Shareholdings, as defined for ownership requirement purposes, include shares held directly or beneficially, and shares under our Employee Stock Purchase Plan or 401(k) plans. Shareholdings do not include exercisable stock options or restricted shares still subject to restrictions. The named executive officers are expected to have shareholdings consistent with these guidelines within five years after their becoming a named executive officer or after receiving a significant promotion. An executive who has not achieved the guideline within this five-year period is expected to retain one-half of any equity awards, after any required tax withholding, in Company stock and to use 10% of any annual cash incentive awards after tax to purchase shares of Company stock until the guideline is met. Each of the named executive officers other than the Chief Executive officer received a significant promotion in 2012, starting a new five-year period. It is the Company's policy not to permit hedging or short-selling of the Company's stock by its executive officers.

### Clawback of Incentive Compensation

In the event of a significant restatement of our financial results caused by executive fraud or willful misconduct, the Compensation Committee reserves the right to review the cash incentive compensation received by the executives with respect to the period to which the restatement relates, recalculate Aqua America's results for the period to which the restatement relates and seek reimbursement of that portion of the cash incentive compensation that was based on the misstated financial results from the executive or executives whose fraud or willful misconduct was the cause of the restatement.

**COMPENSATION COMMITTEE REPORT**

The Executive Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis on pages 21 through 35 with management. Based on this review and discussion, the Executive Compensation Committee recommended to the Company's Board of Directors, and the Board of Directors approved, the inclusion of the Compensation Discussion and Analysis in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and proxy statement for the 2013 Annual Meeting of Shareholders.

Respectfully submitted,

William P. Hankowsky, Chairman  
Lon R. Greenberg  
Ellen T. Ruff

## CURRENT COMPENSATION

## SUMMARY COMPENSATION TABLE

The following Summary Compensation Table shows compensation paid or earned by the Company's Principal Executive Officer, Principal Financial Officer and the next three most highly compensated executive officers of the Company during the fiscal years ended December 31, 2010, 2011 and 2012.

## SUMMARY COMPENSATION TABLE

Name and Principal Position	Year	Salary (\$)(1)	Bonus (\$)	Grant Date Fair Value of Stock and Option Awards (\$)(2)	Non-Equity Incentive Plan Compensation (\$)(1)(3)	Change in Pension Value and Non-qualified Deferred Compensation Earnings (\$)(4)	All Other Compensation (\$)(5)	Total Compensation (\$)
Nicholas DeBenedictis Chief Executive Officer (Principal Executive Officer)	2012	629,231		969,726	892,969	884,665	181,692	3,558,283
	2011	599,346		1,948,082	729,006	608,972	193,319	4,078,725
	2010	554,499		1,525,760	682,080	543,654	219,124	3,525,117
David P. Smeltzer Executive V.P. and Chief Financial Officer (Principal Financial Officer)	2012	338,846		281,080	240,975	603,767	40,629	1,505,297
	2011	303,952		220,943	182,466	367,005	50,657	1,125,023
	2010	284,889		190,300	163,548	207,357	48,971	895,065
Christopher H. Franklin Executive V.P. and President and Chief Operating Officer, Regulated Operations	2012	307,885		252,972	240,250	332,989	34,840	1,168,936
	2011	249,977		145,384	136,425	199,168	42,328	773,282
	2010	240,943		138,500	121,286	91,987	33,952	626,668
Karl M. Kyriss Executive V.P. and President, Aqua Capital Ventures	2012	303,092		252,972	232,500	478,144	37,397	1,304,105
	2011	256,669		148,239	113,568	296,186	46,357	861,019
	2010	246,655		138,500	117,994	185,922	37,823	726,894
Christopher Luning Senior Vice President, General Counsel and Secretary	2012	200,153		112,432	104,934	88,964	24,937	531,420

## Notes:

- (1) Salary and Non-equity Incentive Plan Compensation amounts include amounts deferred by the individual.
- (2) The grant date fair value of stock based compensation is based on their fair market value on the date of grant as determined in accordance with the Financial Accounting Standards Board's (FASB) accounting guidance for stock compensation. The assumptions used in calculating the fair market value are set forth in the Employee Stock and Incentive Plan footnote to the Company's audited financial statements in the Company's Annual Report on Form 10-K.
- (3) Non-Equity Plan Incentive Compensation is shown for the year in which the compensation is earned, regardless of when paid.
- (4) The change in pension value is based on the aggregate change in the actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial pension plans (including supplemental plans) from the pension plan measurement date used for financial statement reporting purposes in the Company's audited financial statements for the prior completed fiscal year to the pension



plan measurement

date used for financial statement reporting purposes in the Company's audited financial statements for the covered fiscal year. The amounts in this column also include any changes in cash surrender value of separate life insurance policies purchased with deferred compensation. Those separate life insurance policies were eliminated prior to 2011. The amount for Mr. DeBenedictis in 2010 includes the change in cash surrender value of life insurance of \$11,934.

- (5) For 2012, the amount includes: (i) dividends paid on restricted stock grants pending the vesting or forfeiture of the grants of \$47,440 for Mr. DeBenedictis, \$990 for Mr. Smeltzer, \$825 for Mr. Franklin \$825 for Mr. Kyriss and \$2,505 for Mr. Luning; (ii) dividend equivalents paid to the named executives during the year of \$105,600 to Mr. DeBenedictis, \$30,400 to Mr. Smeltzer, \$25,600 to Mr. Franklin, \$25,600 to Mr. Kyriss and \$16,000 to Mr. Luning; (iii) Company Matching contributions to the Company's 401(k) plan; (iv) dividends on vested restricted stock for Mr. DeBenedictis of \$8,946; and (v) the taxable value of group term life insurance of \$12,206 for Mr. DeBenedictis, \$1,739 for Mr. Smeltzer, \$1,026 for Mr. Franklin, \$4,514 for Mr. Kyriss and \$422 for Mr. Luning.

For 2011, the amount includes: (i) dividends paid on restricted stock grants pending the vesting or forfeiture of the grants of \$30,833 for Mr. DeBenedictis, \$4,038 for Mr. Smeltzer, \$3,150 for Mr. Franklin and \$3,150 for Mr. Kyriss; (ii) dividend equivalents paid to the named executives during the year of \$139,975 to Mr. DeBenedictis, \$40,038 to Mr. Smeltzer, \$32,175 to Mr. Franklin and \$32,175 to Mr. Kyriss; (iii) Company Matching contributions to the Company's 401(k) plan; (iv) dividends on vested restricted stock for Mr. DeBenedictis of \$4,327; and (v) the taxable value of group term life insurance of \$11,797 for Mr. DeBenedictis, \$1,573 for Mr. Smeltzer, \$828 for Mr. Franklin, and \$3,722 for Mr. Kyriss.

For 2010, the amount includes: (i) dividends paid on restricted stock grants pending the vesting or forfeiture of the grants of \$48,736 for Mr. DeBenedictis, \$4,765 for Mr. Smeltzer, \$2,950 for Mr. Franklin and \$2,950 for Mr. Kyriss; (ii) amounts contributed by the Company to the Executive Deferral Plan representing the amount of the Company's Matching Contribution under the Company's 401(k) Plan that could not be contributed to the 401(k) Plan as a result of the Internal Revenue Code restrictions on the amount a participant can contribute as a salary deferral to the plan of \$1,800 for Messrs. DeBenedictis and Smeltzer; (iii) dividend equivalents paid to the named executives during the year of \$123,200 to Mr. DeBenedictis, \$33,600 to Mr. Smeltzer, \$25,200 to Mr. Franklin and \$26,320 to Mr. Kyriss; (iv) Company Matching contributions to the Company's 401(k) plan; (v) perquisites for Mr. DeBenedictis, which consisted of reimbursement for legal services related to his employment agreement and changes to the Company's compensation plans and other miscellaneous expenses totaling \$26,972 and \$392, respectively; and (vi) the taxable value of group term life insurance of \$10,674 for Mr. DeBenedictis, \$1,456 for Mr. Smeltzer, \$764 for Mr. Franklin and \$2,296 for Mr. Kyriss.

The 2012 base salary increases for Messrs. Smeltzer, Franklin and Kyriss, included promotional increases associated with their promotion from senior vice president to executive vice president and for Messrs. Franklin and Kyriss a substantial re-alignment of their duties and responsibilities. The 2012 base salary increase for Mr. Luning included a promotional increase associated with his promotion from vice president to senior vice president and his assumption of the position of general counsel.

The 2010 stock award for Mr. DeBenedictis includes a special grant of 57,000 shares of restricted stock made in connection with Mr. DeBenedictis' agreement to enter into an employment agreement in January 2010 to remain as the Company's Chief Executive Officer beyond his normal retirement date through January 2013. The 2011 stock award for Mr. DeBenedictis includes a special stock grant of 50,000 shares of restricted stock made in connection with Mr. DeBenedictis' agreement to extend his employment agreement at the request of the Board of Directors for an additional two and one-half years through June 2015.

Starting with the annual restricted stock grants to the named executive officers in 2010, dividends on shares of restricted stock are accumulated and paid to the named executive officer when the shares of restricted stock are released from restrictions. For prior restricted stock grants to the named executive officers and the restricted stock grants to the Chief Executive Officer in connection with his 2010 employment agreement and the 2011 extension thereof, dividends pending the release of the stock from restrictions are paid to the grantee. In either event, the dividends are included in the All Other Compensation column of the Summary Compensation Table set forth above for the year the dividends are paid. All amounts deferred by participants in the Executive Deferral Plan and all prior deferrals under the Plan are deemed invested in a variety of mutual funds selected by each participant under trust-

owned life insurance used by the Company to fund the Executive Deferral Plan, therefore, there are no preferential or above-market earnings on these deferrals. There was a separate life insurance policy for Mr. DeBenedictis under the Plan through March 2010, so the increase in the cash value of such insurance policy is included in the Change in Pension Value and Non-Qualified Deferred Compensation Earnings through that date. Mr. DeBenedictis purchased that insurance policy from the trust holding amounts deferred under the Executive Deferral Plan for the policy's cash surrender value in March 2010.

**GRANTS OF PLAN-BASED AWARDS**

The following table sets forth information regarding equity and non-equity awards granted to the named executive officers in 2012.

**Grants of Plan-Based Awards**

Name	Grant Date	Estimated Future Payouts Under Non-Equity Incentive Plan Awards(1)			Estimated Future Payouts Under Equity Incentive Plan Awards (5)(6)			All Other Stock Awards:	All Other Option Awards:	Exercise or Base Price of Option Awards (\$/Sh)	Grant Date Fair Value of Stock and Option Awards (\$)(8)
		Threshold (\$)(2)	Target (\$)(3)	Maximum (\$)(4)	Threshold (#)	Target (#)	Maximum (#)	Number of Shares of Stock or Units (7)(#)	Number of Securities Underlying Options (#)		
N. DeBenedictis	2/24/12	116,681	714,375	892,969	13,800	41,400	55,200				969,726
D. Smeltzer	2/24/12	37,485	153,000	286,875	4,000	8,000	16,000	4,000			281,080
C. Franklin	2/24/12	37,975	155,000	290,625	3,600	7,200	14,400	3,600			252,972
K. Kyriss	2/24/12	37,975	155,000	290,625	3,600	7,200	14,400	3,600			252,972
C. Luning	2/24/12	17,579	71,750	134,531	1,600	3,200	6,400	1,600			112,432

Notes:

- (1) The executive's Non-Equity Incentive Plan Awards are calculated based on the executive's current annual salary multiplied by the executive's target incentive compensation percentage times an Individual Factor times a Company Factor.
- (2) The Threshold Non-Equity Incentive Plan Award is based on the minimum Individual Factor of 70% and the minimum Company Factor of 35%.
- (3) The Target Non-Equity Incentive Plan Award is based on an Individual Factor of 100% (150% for the CEO - N. DeBenedictis) and a Company Factor of 100%.
- (4) The Maximum Non-Equity Incentive Plan Award is based on the maximum Individual Factor of 150% and the maximum Company Factor of 125%.
- (5) The February 24, 2012 Equity Incentive Plan Awards in these columns are composed of restricted stock units and performance share units for the CEO, Mr. DeBenedictis, and performance share unit grants for the other named executive officers. The restricted stock unit grant for Mr. DeBenedictis vests in three annual installments on the anniversaries of the grant date, subject to performance conditions, but there are no threshold or maximum amounts related to this grant.
- (6) The performance unit grants vest on the third anniversary of the grant date.
- (7) The restricted stock unit grants for the other named executive officers in this column are not subject to performance conditions and vest on the third anniversary of the grant date.
- (8) The grant date fair value of restricted stock and option awards is based on their fair market value on the date of grant as determined under the Financial Accounting Standards Board's ("FASB") accounting standards for stock compensation. The assumptions used in calculating

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the fair market value under FASB's accounting standard for stock compensation are set forth in the 'Employee Stock and Incentive Plan' footnote to the Company's audited financial statements in the Company's Annual Report on Form 10-K.

Equity awards in 2011 and 2012 consisted of restricted stock units and performance share units. The normal annual award of restricted stock units to the Chief Executive Officer in 2011 vests one-half each year over a period of two years, subject to the Company's achievement of a year-over-year increase in the Company's operating income in either 2011 or 2012. The normal annual award of restricted stock units to the Chief Executive Officer in 2012 vests one-third each year over a period of three years, subject to the Company's achievement of a year-over-year increase in the Company's operating income in either 2012, 2013 or 2014. In the case of both the 2011 and 2012 grant of restricted stock units to the Chief Executive Officer, the restricted stock units are not payable to the Chief Executive Officer until the end of the restricted period, notwithstanding any earlier vesting of the restricted stock unit awards. The special restricted stock award to the Chief Executive Officer in connection with the extension of his employment agreement to June 30, 2015 vests over a two-year period in 2014 and 2015, subject to a year-over-year increase in the Company's operating income in either 2012, 2013 or 2014. The restricted stock unit grants to the other named executive officers vest at the end of three years from the grant date. The performance share unit grants to the named executive officers vest at the end of three years from the grant date, but the amount of the payout can range from zero to 200% of the target grant depending on the Company's performance against the performance goals described on pages 30 through 32 above. The threshold level of performance share units that a grantee can earn is 50% of the target grant and the maximum level a grantee can earn is 200% of the target grant. The threshold, target and maximum payout for each of the named executive officers is shown in the Grants of Plan-Based Awards Table above. The Compensation Committee has approved a policy for certain adjustments to the calculation of the Company's operating income for purposes of determining whether the designated performance goals for the restricted stock grants, and for the calculation of earnings per share for purposes of determining the extent to which the performance goal tied to earnings per share for the performance share units, as described on pages 29 through 32, have been met.

If the Company does not achieve the required financial performance to meet the designated performance criteria, the shares of restricted stock that are subject to such performance criteria that would otherwise vest are forfeited. Therefore, the full number of shares of restricted stock that are subject to performance criteria is included in the Target column under the Estimated Future Payouts Under Equity Incentive Plan Awards in the Grants of Plan Based Awards Table above. Restricted stock units that are not subject to performance criteria are included in the All Other Stock Awards column in the Grants of Plan-Based Awards Table above.

## OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END

The following table sets forth information on outstanding stock option and stock awards held by the named executive officers at the end of 2012.

## Outstanding Equity Awards at Fiscal Year-End

Name	Option Awards					Stock Awards		Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)	
N. DeBenedictis								196,134 (1)(7) \$4,985,726
	36,031			\$ 16.1475	3/1/2014			
	93,333			\$ 18.3338	2/28/2015			
	55,000			\$ 29.4600	3/7/2016			
	55,000			\$ 23.2600	2/22/2017			
	55,000			\$ 20.1800	2/26/2018			
	55,000			\$ 19.1200	2/26/2019			
	36,666	18,334 (6)		\$ 17.1400	1/22/2020			
D. Smeltzer								42,885 (2)(7) \$1,090,137
	13,532			\$ 16.1475	3/1/2014			
	19,999			\$ 18.3338	2/28/2015			
	15,000			\$ 29.4600	3/7/2016			
	15,000			\$ 23.2600	2/22/2017			
	15,000			\$ 20.1800	2/26/2018			
	15,000			\$ 19.1200	2/26/2019			
	11,666	5,834 (6)		\$ 17.1400	1/22/2020			
C. Franklin								33,124 (3)(7) \$ 842,012
	1,196			\$ 12.4830	3/3/2013			
	10,415			\$ 16.1475	3/1/2014			
	13,332			\$ 18.3338	2/28/2015			
	10,000			\$ 29.4600	3/7/2016			
	10,000			\$ 23.2600	2/22/2017			
	12,500			\$ 20.1800	2/26/2018			
	12,500			\$ 19.1200	2/26/2019			
	10,000	5,000 (6)		\$ 17.1400	1/22/2020			

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Name	Option Awards		Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Stock Awards		Equity Incentive Plan Awards: Number of Shares, Units or Other Rights That Have Not Vested (#)	Equity Incentive Plan Awards: Market or Payout Value of Unearned Shares, Units or Other Rights That Have Not Vested (\$)
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable					Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Vested (\$)		
K. Kyriss									33,322 (4)(7)	\$ 847,045
	13,332				\$ 16.1475	3/1/2014				
	13,332				\$ 18.3338	2/28/2015				
	12,000				\$ 29.4600	3/7/2016				
	10,000				\$ 23.2600	2/22/2017				
	12,500				\$ 20.1800	2/26/2018				
	12,500				\$ 19.1200	2/26/2019				
	10,000	5,000 (6)			\$ 17.1400	1/22/2020				
C. Luning									16,569 (5)(7)	\$ 421,184
	5,000				\$ 29.4600	3/7/2016				
	5,000				\$ 23.2600	2/22/2017				
	2,500				\$ 20.1800	2/26/2018				
	5,000				\$ 19.1200	2/26/2019				
	6,666	3,334 (6)			\$ 17.1400	1/22/2020				

Notes:

- Of Mr. DeBenedictis 196,134 shares, 76,334 are restricted shares of common stock, 35,800 are restricted share units, and 84,000 are performance share units. Of the 76,334 shares of restricted stock: 7,333 shares vest on January 22, 2013; 19,000 shares vest on January 31, 2013; 25,000 shares vest on January 31, 2014; and 25,000 shares vest on January 31, 2015. Of the 35,800 restricted stock units: 11,000 vested on February 25, 2012, but will not be issued until February 25, 2013 and 11,000 vest on February 25, 2013; and 4,600 vest on February 24, 2013, 4,600 vest on February 24, 2014, and 4,600 vest on February 24, 2015, but these 13,800 restricted stock units will not be issued until February 24, 2015. Of the 84,000 performance share units: 28,800 vest on February 25, 2014; and 55,200 vest on February 24, 2015, and are subject to certain performance criteria.
- Of Mr. Smeltzer s 42,885 shares, 7,500 are restricted shares of common stock, 7,335 are restricted share units, and 28,050 are performance share units. Mr. Smeltzer s 7,500 restricted shares of common stock vest on January 22, 2013. Of the 7,335 restricted share units, 3,335 vest on February 25, 2014 and 4,000 vest on February 24, 2015. Of the 28,050 performance share units: 12,050 vest on February 25, 2014; and 16,000 vest on February 24, 2015, and are subject to certain performance criteria.
- Of Mr. Franklin s 33,124 shares, 5,000 are restricted stock, 5,794 are restricted stock units, and 22,330 are performance share units. Mr. Franklin s 5,000 restricted shares of common stock vest on January 22, 2013. Of the 5,794 restricted stock units, 2,194 vest on February 25, 2014 and 3,600 vest on February 24, 2015. Of the 22,330 performance share units: 7,930 vest on February 25, 2014; and 14,400 vest on February 24, 2015, and are subject to certain performance criteria.

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- (4) Of Mr. Kyriss' 33,322 shares, 5,000 are restricted stock, 5,838 are restricted stock units, and 22,484 are performance share units. Mr. Kyriss' 5,000 restricted shares of common stock vest on January 22, 2013. Of the 5,838 restricted stock units, 2,238 vest on February 25, 2014 and 3,600 vest on February 24, 2015. Of the 22,484 performance share units: 8,084 vest on February 25, 2014; and 14,800 vest on February 24, 2015, and are subject to certain performance criteria.
- (5) Of Mr. Luning's 16,569 shares, 3,000 are restricted stock, 2,807 are restricted stock units, and 10,762 are performance share units. Mr. Luning's 5,000 restricted shares of common stock vest on January 22, 2013. Of the 2,807 restricted stock units, 1,207 vest on February 25, 2014 and 1,600 vest on February 24, 2015. Of the 10,762 performance share units: 4,362 vest on February 25, 2014; and 6,400 vest on February 24, 2015, and are subject to certain performance criteria.
- (6) 100% vested on January 22, 2013.
- (7) For the purposes of this table, performance share units are calculated as follows based on the three performance criteria:
- 1) 25% of the performance shares will be earned based on Aqua's percentile ranking for Total Shareholder Return (TSR) within the S&P MidCap Utilities Index. As of 12/31/2012, Aqua's TSR in this group is between the 30<sup>th</sup> and 50<sup>th</sup> percentile rank for the 2011 grant and above the 90th percentile rank for the 2012 grant. Therefore 75% of this 25% portion of the performance shares would be paid out for the 2011 grant and 200% of this 25% portion for the 2012 grant.
  - 2) 25% of the performance shares will be earned based on attainment of Aqua's ordinal ranking for TSR compared to a specified peer group of seven investor-owned water companies. As of 12/31/2012, Aqua is ranked fourth amongst our competitors in regards to TSR for the 2011 grant and third amongst our competitors for the 2012 grant. According to the payout schedule, 100% and 130% of this 25% portion of the performance shares would be granted for 2011 and 2012 respectively.
  - 3) 50% of the performance shares will be earned based on attainment of a three-year compound annual growth rate in earnings per share. As of 12/31/2012 Aqua's earnings per share is \$1.40. If we assume the same growth rate at the end of the performance period as for the three-year period of 2009-2012, 200% of this 50% portion of the performance shares would be granted for both the 2011 and 2012 grants.

These three performance criteria add up to 144% and 183% multipliers of the granted performance shares for the 2011 and 2012 grants respectively. According to SEC regulations, if the fiscal year's performance has exceeded the threshold, as it has in this case, then the number of performance share units disclosed in this table shall be based on the next higher performance measure. In this case, that is the maximum payout of 200% of the performance shares and is recorded as such in the table above.

### OPTION EXERCISES AND STOCK VESTED

The following table sets forth (1) the number of shares of Aqua America's common stock acquired by the named executive officers in 2012 from the exercise of stock options, (2) the value realized by those officers upon the exercise of those stock options based on the difference between the market price for our Common Stock on the date of exercise and the exercise price for the options, (3) the number of shares of restricted stock or performance shares previously granted to the named executive officers that vested in 2012, and (4) the value realized by those officers upon the vesting of such shares based on the closing market price for our shares of Common Stock on the vesting date.

#### Option Exercises and Stock Vested

Name	Option Awards		Stock Awards	
	Number of Shares	Value Realized	Number of Shares	Value Realized
	Acquired on Exercise (#)	on Exercise (\$)	Acquired on Vesting (#)	on Vesting (\$)
N. DeBenedictis	43,286	443,013	33,666	742,929
D. Smeltzer	27,299	240,355	6,000	134,940



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C. Franklin	0	0	5,000	112,450
K. Kyriss	2,633	27,902	5,000	112,450
C. Luning	0	0	3,000	67,470

**RETIREMENT PLANS AND OTHER POST-EMPLOYMENT BENEFITS**

**PENSION BENEFITS**

The following table sets forth (1) the number of years of credited service for the named executive officers under our various retirement plans as of December 31, 2012, (2) the actuarial present value of accumulated benefits under those plans as of December 31, 2012 and (3) any payments made to the named executive officers in 2012 under those plans.

**Pension Benefits**

Name	Plan Name	Number of Years of Credited Service (#)	Present Value of Accumulated Benefit (\$)	Payments During Last Fiscal Year (\$)
N. DeBenedictis Switzerland	Retirement Income Plan for Aqua America, Inc. and Subsidiaries	21	2,368,208<	

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Name of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percentage of Class if All Common Stockholders Fully Exercise Subscription Rights	Percentage of Class if the Standby Underwriters Purchase the Maximum Amount of Common Stock Pursuant to the Standby Underwriter Agreements
Heritage Cie S.A. P.O. Box 1507 2 Rue Thalberg 1211 Geneva 1 Switzerland			(12)

\* Less 1%

- (1) Includes 330,000 shares underlying presently exercisable options. Does not include 190,000 shares subject to unexercised stock options awarded to Mr. Julian Hammond, a former employee of the Company and Mr. Russ Hammond's son. Mr. Hammond disclaims ownership of his son's shares.
- (2) Includes 580,000 shares underlying presently exercisable options.
- (3) Mr. Perry was elected to the Board on April 1, 2008.
- (4) Includes 1,510,000 shares underlying presently exercisable options.
- (5) Includes 546,000 shares underlying presently exercisable options.
- (6) Includes 2,966,000 shares underlying presently exercisable options held by directors and executive officers as a group.
- (7) Security ownership information for the beneficial owner is taken from the Form 4 dated July 27, 2008.
- (8) Security ownership information for the beneficial owner is taken from the Form 4 dated July 27, 2008.
- (9) Security ownership information for the beneficial owner is taken from the Form 4 dated July 27, 2008.
- (10) Security ownership information for the beneficial owner is taken from the Form 13G/A filed on February 8, 2008.

- (11) The Class represents Common Stock outstanding as at April, 18, 2008. This excludes any convertible shares and warrants attached to outstanding convertible loans at this date although these shares are included in Forms 13G filed by convertible note-holders.
- (12) We expect that Caldwell Associates Limited, Provincial Securities Limited and Heritage Cie S.A. will not purchase the Unsubscribed Shares for investment and instead they will sell them on the open market or in private transactions, however, if they do hold their shares for investment they will each own a maximum of 20.66%, 10.33% and 8.66%, respectively, of the issued and outstanding shares of common stock assuming that they acquire and hold their entire allotment of shares, excluding any additional shares they may elect to acquire in lieu of commissions. See Standby Underwriting and Plan of Distribution .

## **CERTAIN INCOME TAX CONSIDERATIONS**

### **Certain U.S. Federal Income Tax Consequences.**

The following is a summary of the material U.S. federal income tax consequences of the acquisition, ownership and disposition of Rights or Underlying Shares by U.S. stockholders. This summary deals only with persons that are U.S. stockholders and that will hold the Rights and Underlying Shares as capital assets. The discussion does not cover all aspects of U.S. federal income taxation that may be relevant to, or the actual tax effect that any of the matters described herein will have on, the acquisition, ownership or disposition of Rights or the Underlying Shares by particular investors, and does not address state, local, foreign or other tax laws. In particular, this summary does not address tax considerations applicable to investors that own (directly or indirectly) 10% or more of our voting shares, nor does this summary discuss all of the tax considerations that may be relevant to certain types of investors subject to special treatment under the U.S. federal income tax laws, such as certain financial institutions, insurance companies, partnerships or other entities classified as partnerships for U.S. federal income tax purposes, investors liable for the alternative minimum tax, individual retirement accounts and other tax-deferred accounts, tax-exempt organizations, dealers in securities or currencies, investors that will hold the Underlying Shares as part of straddles, hedging transactions or

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conversion transactions for U.S. federal income tax purposes or investors whose functional currency is not the U.S. dollar.

The summary is based on the tax laws of the U.S., including the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations thereunder, published rulings and court decisions all as of the date hereof and all subject to change at any time, possibly with retroactive effect.

THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS FOR GENERAL INFORMATION ONLY. ALL PROSPECTIVE PURCHASERS SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING THE SECURITIES, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAW.

## **Rights**

The tax consequences of the allocation of the Rights will depend on whether the Rights Offering is part of a disproportionate distribution within the meaning of Section 305 of the Code. The Company believes and intends to take the position, and the following discussion assumes, that the allocation of the Rights is not part of a disproportionate distribution for purposes of Section 305 of the Code.

The allocation of the Rights to U.S. stockholders will be treated for U.S. federal income tax purposes as a distribution of a stock right with respect to the shares of common stock held by each stockholder (referred to in this section as Shares ) entitled to receive Rights. The receipt of the Rights will not be included in the gross income of a U.S. stockholder. If the fair market value of the Rights at the time of the distribution equals fifteen percent (15%) or more of the fair market value of the Shares at such time the U.S. stockholder will be required to allocate the adjusted basis of the Shares immediately before the distribution of the Rights between the Shares and the Rights in proportion to their relative fair market values immediately after the distribution. If the fair market value of the Rights at the time of the distribution is less than fifteen percent (15%) of the fair market value of the Shares at such time, the U.S. stockholder will have a basis of zero in the Rights received unless the U.S. stockholder makes an election to allocate the adjusted basis of the Shares between the Underlying Shares and the Rights as described above. Such election must be made by the U.S. stockholder on the tax return for the year in which the distribution occurs and must satisfy the requirements of U.S. Treasury Regulations. The holding period of the Rights will include the period for which the U.S. stockholder has held the Shares with respect to which the Rights are distributed. The holding period of a purchaser of the Rights will commence on the date of purchase. If a U.S. stockholder exercises the right to purchase Underlying Shares, the holding period of the Underlying Shares will commence on the date of the exercise and will not include any period for which the holder of the Rights held the Shares with respect to which the Rights were distributed or the period for which the holder held the Rights. The exercise of Rights to purchase Underlying Shares will not cause a U.S. Rights Holder to recognize income. The U.S. Rights Holder's basis in the Underlying Shares purchased by exercise of the Rights will equal the sum of the basis, if any, in the Rights exercised to purchase the Underlying Shares and the amount paid for the Underlying Shares (including any servicing fee charged to the U.S. Rights Holder by his broker, bank or trust company). A sale of the Rights generally will be taxed in the same manner as described for a sale of Underlying Shares under Sale or Other Disposition below.

The discussion above relating to the U.S. federal income tax consequences of the Rights Offering assumes that the Rights Offering is not part of a disproportionate distribution within the meaning of Section 305 of the Code. A disproportionate distribution is a distribution or series of distributions, including deemed distributions, that has the effect of the receipt of cash or other property by some stockholders or holders of debt instruments convertible into stock (including interest payments to the holders of the debt) and an increase of a proportionate interest of other stockholders in a company's assets or earnings and profits. The Company has not distributed any cash or other property

with respect to any other class of the Company's stock and currently does not expect to make any such distribution. In addition, although the Company has Notes outstanding that are convertible into common stock and on which it has paid interest, under applicable Treasury regulations the receipt of Rights will not be part of a disproportionate distribution if a full

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adjustment is made in the conversion price of the Notes to reflect the Rights Offering. The Note Purchase Agreements pursuant to which the Notes were issued require an adjustment to the conversion price of the Notes as a result of the Rights Offering, and we intend to make this adjustment. The Treasury regulations do not directly address the adjustment mechanism contained in the Note Purchase Agreements pursuant to which the Notes were issued. Thus, it is uncertain whether the adjustment to the conversion price required by the Note Purchase Agreements qualifies as a full adjustment. In addition, although the Company does not currently plan to make a distribution with respect to any other class of stock, there can be no assurance that such distribution will not be made. It is also unclear whether the fact that we also have outstanding options and warrants could cause the receipt of the Rights to be part of a disproportionate distribution. If, contrary to our expectations, the Company makes a distribution of cash or property with respect to a class of stock other than its common stock, if the adjustment to the conversion price of the Notes is not treated as a full adjustment, or if the existence of our outstanding options and warrants causes the receipt of the Rights to be part of a disproportionate distribution, the Internal Revenue Service may take the position that a recipient of the Rights has received a distribution equal to the fair market value of the Rights as of date of the distribution. Any such distribution would be treated as dividend income to the extent of the Company's current and accumulated earnings and profits, with any excess being treated as a return of capital to the extent thereof and then as capital gain. The recipient's tax basis in such Rights would be equal to the fair market value of the Rights as of the date of the distribution.

U.S. stockholders who allow the Rights received by them on the date of issuance to expire unexercised will not recognize any gain or loss, and no adjustment will be made to the basis of their shares of common stock.

## **Sale or Other Disposition**

Upon a sale or other disposition of Underlying Shares, a U.S. stockholder generally will recognize capital gain or loss for U.S. federal income tax purposes equal to the difference, if any, between the amount realized on the sale or other disposition and the U.S. stockholder's adjusted tax basis in the Underlying Shares, each determined in U.S. dollars. This capital gain or loss will be long term capital gain or loss if the U.S. stockholder's holding period in the Underlying Shares exceeds one year. For a non-corporate U.S. stockholder, the current maximum long-term capital gains rate is 15%. Any gain or loss generally will be U.S. source.

## **Backup Withholding and Information Reporting**

Payments of dividends and other proceeds with respect to Underlying Shares in the U.S. by a U.S. paying agent or other U.S. intermediary will be reported to the Internal Revenue Service and to the U.S. stockholder as may be required under applicable regulations. Backup withholding may apply to these payments if the U.S. stockholder fails to provide an accurate taxpayer identification number or certification of foreign or other exempt status or fails to report all interest and dividends required to be shown on its U.S. federal income tax returns. Certain U.S. stockholders (including, among others, corporations) are not subject to backup withholding. U.S. shareholders should consult their tax advisers as to their qualification for exemption from backup withholding and the procedure for obtaining an exemption.

## **STANDBY UNDERWRITING AND PLAN OF DISTRIBUTION**

The common stock offered pursuant to the Rights Offering is being offered by us directly to all holders of our common stock. We intend to distribute Subscription Rights Certificates, copies of this prospectus, and certain other relevant documents to those persons that were holders of our common stock at 4:00 p.m., U.S. Eastern time (CET), on August 1, 2008, the Record Date for the Rights Offering. In the event that the Rights Offering is not fully subscribed by the holders of our common stock, the Standby Underwriters will purchase up to an aggregate of 242,000,000 Unsubscribed Shares (as defined below) pursuant to their respective Standby Underwriting Agreements.





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### **Determination of Subscription Price**

The Subscription Price was previously determined as a result of negotiations between the Company and potential standby underwriters. The Company's objective in establishing the Subscription Price was the achievement of the targeted proceeds from the Offering while providing Rights Holders with an opportunity to make an additional investment in the Company, and thus avoid an involuntary dilution of their proportionate ownership position in the Company.

In approving the Subscription Price, the Board of Directors considered such factors as the alternatives available to the Company for raising capital, the Company's long and short term loan obligations, the market price of the common stock, the business prospects for the Company and the general condition of the securities markets. There can be no assurance, however, that the market price of the common stock will not decline during the subscription period, or that, following the issuance of the Rights and of the common stock upon exercise of Rights, a subscribing Rights Holder will be able to sell shares of common stock purchased in the Rights Offering at a price equal to or greater than the Subscription Price.

Further, in approving the Subscription Price, the Board of Directors acted upon the recommendation of a committee composed of the independent directors of the Board of Directors of the Company (the Independent Committee) comprised of Messrs. Michael Ayre, Russ Hammond and Anthony Perry.

### **Standby Underwriting Agreements**

Prior to the commencement of the Rights Offering, the Company has entered into substantially identical Standby Underwriting Agreements pursuant to which each of the Standby Underwriters has severally and not jointly agreed, subject to certain conditions, to acquire from the Company at the Subscription Price on the expiration date, of the Right Offering, up to a maximum of 242,000,000 of the Underlying Shares (the Unsubscribed Shares) remaining after the exercise of the Basic Subscription Privilege by all of the Rights Holders. The Standby Underwriters have also been granted the right to receive a commission equal to 7% of the aggregate Subscription Price in respect of all of the shares the subject of the Rights Offering which they may elect to receive in shares of common stock in lieu of cash at a cost per share equal to the Subscription Price; provided, however, that if a Standby Underwriter is an existing stockholder it will only receive a commission for its part of the underwritten amount that exceeds the pro rata amount of shares that it would receive pursuant to an exercise of its Rights. Each Standby Underwriter further agrees that it will not and it will cause its directors, shareholders (registered or beneficial) or associates not to deal in any shares if the effect of such dealing would in any way impinge upon the ability to subscribe for all the unsubscribed shares without the Standby Underwriter or its respective directors, shareholders (registered or beneficial) or associates exceeding a holding of 49.99% of the aggregate issued shares in the capital of the Company. The Standby Underwriting Agreements further provide that:

the underwriting commissions will be paid even if the Company does not carry out the Rights Offering and in such event will be paid on December 31, 2008;

each Standby Underwriter agrees to comply with all applicable laws and stock exchange regulations and not to sell, offer to sell or solicit offers to purchase any of the shares it purchases in the United States or to U.S. persons or to engage in any directed selling efforts (as each term is defined in Regulation S promulgated under the U.S. Securities Act of 1933, as amended) in the United States;

among other customary representations and warranties each Standby Underwriter represents and warrants that it is not a U.S. person and is not and is not required to be a member of the U.S. Financial Industry Regulatory Authority, Inc. or registered as a broker-dealer under Section 15 of the U.S. Securities Exchange Act of 1934,

as amended;

the subscription period for Underlying Shares shall not exceed four weeks; and

the Standby Underwriting Agreements further provide that the obligations of the Standby Underwriters are conditioned upon the consummation of the Rights Offering prior to December 31, 2008.

See The Rights Offering .

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The names of each Standby Underwriter, together with his or its maximum commitment amount for Unsubscribed Shares, relationship to the Company, if any, and maximum number of shares in lieu of commission, are set forth in the following table:

Name	Maximum No. Unsubscribed Shares	Relationship to Company	Maximum No. Commission Shares
Caldwell Associates Limited P.O. Box 198 St. Peter Port Guernsey GYI 4HU	100,000,000	None	7,000,000
Provincial Securities Limited 2 Rue Thalberg 1211 Geneva 1 Switzerland	50,000,000	See footnote 1	3,500,000
Heritage Cie S.A. P.O. Box 1507 2 Rue Thalberg 1211 Geneva 1 Switzerland	42,000,000	None	2,940,000
Salahi Öztürk Strateji Menkul Degeri A.Ş. Maya Akar Center Kat: 26 Büyükdere Cd. No: 100-102 Esentepe, Istanbul, Turkey	20,000,000	See footnote 2	1,400,000
Oaman Necdel Turckay Sirateji Menkul Degeri A.Ş. Maya Akar Center Kat: 26 Büyükdere Cd. No: 100-102 Esentepe, Istanbul, Turkey	15,000,000	None	1,050,000
Hasan Gürhan Berker Strateji Menkul Degeri A.Ş. Maya Akar Center Kat: 26 Büyükdere Cd. No: 100-102 Esentepe, Istanbul, Turkey	5,000,000	None	350,000
Fevzi Bozer Strateji Menkul Degeri A.Ş. Maya Akar Center Kat: 26 Büyükdere Cd. No: 100-102 Esentepe, Istanbul, Turkey	5,000,000	None	350,000
Hasip Buldanlioglu Strateji Menkul Degeri A.Ş. Maya Akar Center Kat: 26 Büyükdere Cd. No: 100-102 Esentepe, Istanbul, Turkey	5,000,000	None	350,000

Total:	242,000,000	None	16,940,000
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- (1) Mr. Russ Hammond, a non-employee director of the Company, is also an Investment Advisor to Provincial Securities Limited who became a minority shareholder in the Norio and North Kumisi (Block XIc) Production Sharing Agreement through a farm-in agreement to the Norio MK72 well. On September 4, 2003 the Company concluded a deal to purchase Provincial Securities Limited's minority interest in CanArgo Norio Ltd. by a share swap for shares in the Company. The purchase was achieved by issuing 6 million restricted shares of Common Stock in the Company to the minority interest holders in CanArgo Norio Ltd. Of the interests in CanArgo Norio Ltd., Provincial Securities Limited owned 4% and received 2,234,719 shares of the Company's Common Stock. Provincial Securities Limited also had an interest in Tethys Petroleum Limited (formerly named Tethys Petroleum Investments Limited) (Tethys), a Guernsey company, established to develop potential projects in Kazakhstan, in which the Company had a minority interest until June 2005 when the Company acquired the remaining 55% interest in Tethys which it did not own. Pursuant to this transaction, Provincial Securities Limited received 5,500,000 shares of the Company's Common Stock

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in exchange for its interest in Tethys. Mr. Hammond did not receive any compensation in connection with these transactions and disclaims any beneficial ownership of Provincial Securities Limited or of any shares of the Company's Common Stock owned by Provincial Securities Limited. In August 2007, the Company disposed of its interest in Tethys.

- (2) Mr. Salahi Öztürk currently owns warrants to purchase 1,000,000 common shares of our common stock exercisable at \$0.63 per share. The warrants expire on April 26, 2009. Mr. Öztürk currently owns warrants to purchase 1,000,000 shares of common stock exercisable at \$0.63 per share. The warrants expire on April 26, 2009. Pursuant to an Amended and Restated Loan and Warrant Agreement dated August 27, 2004 Mr. Öztürk advanced a loan, the balance of which was \$1,050,000 on February 14, 2006, the date on which we exercised our option to force conversion of the loan into 1,521,739 shares of our common stock.

The Standby Underwriters are restricted to offering the Unsubscribed Shares directly to the public located outside the United States and who are not U.S. Persons (as each is defined in Regulation S promulgated under the Securities Act). The Standby Underwriters may also offer the Unsubscribed Shares through the facilities of the Oslo Stock Exchange to certain foreign securities dealers at prices which may represent concessions from the prices at which such shares are then being offered to the public. The Standby Underwriters may allow, and such dealers may reallow, a concession to certain brokers and dealers. The amount of such concessions and reallowances will be determined from time to time by the Standby Underwriters. In effecting such transactions, the Standby Underwriters may realize profits and losses independent of the compensation referred to below.

Except for the Standby Underwriting Agreements or as otherwise disclosed in this prospectus, we have not agreed to enter into any standby or other arrangements to purchase or sell any Rights or any Underlying shares of our common stock.

## **The Manager**

We have engaged Glitnir to act as the manager and to provide the Company with financial advice and assistance in connection with the Rights Offering, including: giving us advice on the structuring, timing and project management of the Offering; assisting us in connection with the preparation of documentation in relation to the Offering; acting as Norwegian Subscription Agent for the Offering; and assisting us in the co-ordination of the closing and settlement of the Offering.

Glitnir shall be entitled the following fees and expenses: (1) a \$10,000 commencement fee, payable irrespective of whether the Rights Offering is successfully completed or not, provided however that such commencement fee shall be deducted from the transaction fees (as next referred to) if the Rights Offering is completed; (2) transaction fees comprising (i) an arrangement fee equal to 2.5% of the gross proceeds of the Rights Offering (but no less than \$600,000) and (ii) a discretionary fee up to 0.5% of the gross proceeds of the Rights Offering, payable only and entirely at the Company's discretion, taking into consideration, among other things, the Company's satisfaction of the services provided by Glitnir; and (3) Glitnir's costs and expenses incurred in connection with Glitnir's engagement (payable irrespective of whether the Rights Offering is successfully completed or not).

For a period of 12 months from June 26, 2008 (being the date of Glitnir's engagement by the Company), the Company is to give Glitnir the right to make an offer or participate in negotiations for new assignments or transactions (falling within the scope of Glitnir's engagement in connection with the Offering), where the Company decides to appoint an investment firm.

Under the terms of the Company's engagement of Glitnir, the Company accepts: (1) that neither Glitnir nor any other member of the Glitnir Group (nor any of its or their respective owners, directors, officers, employees, consultants and

agents) shall be liable to the Company or any of its directors, officers, employees, consultants or agents for any claim, loss, damage, liability, cost or expense suffered by the Company or any such other person arising out of, or related to, the engagement, except if caused by gross or willful negligence on the part of Glitnir; (2) that Glitnir shall under no circumstances be liable for any indirect or consequential losses; and (3) that Glitnir's liability towards the Company shall in all circumstances be limited to the fees due and payable by the Company to Glitnir pursuant to the engagement.

The Company also agrees to indemnify, defend and hold harmless Glitnir, the Glitnir Group and their respective owners, directors, officers, employees, consultants and agents (each an Indemnified Person ) from and against all claims, actions, proceedings, demands, losses, damages, liabilities, costs and expenses (1) arising

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out of or in connection with any untrue statement or alleged untrue statement of a fact, any material omission or alleged material omission or misleading statement contained in any investor presentation, prospectus or other marketing material or information disclosed or published by the Company in connection with the engagement and (2) otherwise arising out of or in connection with the engagement or any other matter or activity referred to or contemplated in the engagement letter between the Company and Glitnir or which arise out of any breach by the Company of any of its obligations, duties or any warranties in connection with the engagement, which any Indemnified Person may suffer or incur in any jurisdiction (but in the case of (2) above such indemnification shall be under exception of claims, losses, damages, liabilities, costs or expenses that arise primarily out of or are based primarily upon any action or failure to act by Glitnir that constitutes gross or willful negligence on the part of Glitnir).

Neither Glitnir nor any of the Standby Underwriters has prepared any report or opinion constituting a recommendation or advice to us or to our stockholders in connection with the Rights Offering, nor have they prepared an opinion as to the fairness of the Subscription Price or the terms of the Rights Offering. Neither Glitnir nor any Standby Underwriter expresses any opinion or makes any recommendation to the holders of our common stock as to the purchase by any person of any shares of our common stock or whether they should sell their Rights or let them lapse unexercised. Glitnir and the Standby Underwriters also express no opinion as to the prices at which the Rights and the shares that are to be distributed in connection with the Rights Offering may trade if and when they are issued or at any future time.

Glitnir may in the future provide various investment banking, financial advisory and other services for us and our affiliates. In addition, as indicated above, Provincial Securities has in the past engaged in certain transactions with us and our affiliates and Mr. Ozturk has loaned the Company money, which was repaid, for which he also earned warrants to purchase shares of our common stock.

We estimate that our total expenses of this Offering, excluding underwriting commissions, will be approximately \$ .

We have been advised that the Rights will be listed for trading on the AMEX and the OSE under the symbols and , respectively. It is anticipated that trading in the Rights will commence on or about the second day after the commencement of the Rights Offering and the issuance of the Rights.

Other than the manager, the Company has not employed any brokers, dealers or underwriters to solicit the exercise of Rights in this Rights Offering and no underwriting commissions, fees or discounts will be paid in connection with this Rights Offering other than those payable to the Standby Underwriters. Certain employees of the Company may solicit responses from stockholders and Rights Holders, but such employees will not receive any commissions or compensation for such services other than their normal employment compensation. Computershare is acting as the US Subscription Agent and the manager is also acting as the Norwegian Subscription Agent for the Rights Offering. We will pay all customary fees and expenses for the US Subscription Agent (the fees of the manager for acting as the Norwegian Subscription agent are included in its fee described above) related to the Rights Offering. We have also agreed to indemnify the Subscription Agents with respect to certain liabilities that they may incur in connection with the Rights Offering.

The Company maintains three stock option plans, under which adjustments to outstanding options may be made to reflect the impact of the Offering. Likewise, under the terms of the Company's Subordinated Notes and 12% Subordinated Notes and certain warrants to purchase shares of common stock issued by the Company, the respective conversion prices and exercise prices of such Notes and such warrants will be reset to \$0.10 on successful closing of the Rights Offering resulting in a possible maximum issue of up to 173,611,111 shares of common stock upon conversion of the Notes and exercise of such warrants; provided, however, the Company intends to repay in advance of their stated maturity date up to \$5,000,000 in aggregate principal amount of such Notes, which if such Notes are not converted in advance of such payment will reduce such maximum amount of issuable shares of common

stock to 123,611,111. The Company has not been advised of the intentions of the Noteholders in this regard.



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**LIMITATION OF LIABILITY AND INDEMNIFICATION**

**Limitation of Liability**

Our Amended and Restated Certificate of Incorporation limits or eliminates the liability of our directors to us or our stockholders for monetary damages to the fullest extent permitted by the Delaware General Corporation Law. Delaware law provides that a director of CanArgo will not be personally liable to CanArgo or our stockholders for monetary damages for a breach of fiduciary duty as a director, except for liability: (1) for any breach of the director's duty of loyalty; (2) for acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law; (3) for the payment of unlawful dividends, stock purchases or redemptions; and some other actions prohibited by Delaware corporate law; and (4) for any transaction resulting in receipt by the director of an improper personal benefit.

**Indemnification**

Delaware General Corporation Law provides that a corporation may indemnify its present and former directors, officers, employees and agents (each, an indemnitee) against all reasonable expenses (including attorneys' fees) judgments, fines and amounts paid in settlement incurred in an action, suit or proceeding, other than in actions initiated by or in the right of the corporation, to which the indemnitee is made a party by reason of service as a director, officer, employee or agent, if such individual acted in good faith and in a manner which he or she reasonably believed to be in, or not opposed to, the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe his or her conduct was unlawful. A Delaware corporation shall indemnify an indemnitee to the extent that he or she is successful on the merits or otherwise in the defense of any claim, issue or matter associated with an action, suit or proceeding, including one initiated by or in the right of the corporation. Our Bylaws provide for indemnification of directors and officers to the fullest extent permitted by Delaware General Corporation Law.

Delaware General Corporation Law allows and our Bylaws provide for the advance payment to an indemnitee for expenses prior to the final disposition of an action, provided that the indemnitee undertakes to repay any such amount advanced if it is later determined that the indemnitee is not entitled to indemnification with regard to the action for which the expenses were advanced.

Our directors and officers are insured, under policies of insurance maintained by us, within the limits and subject to the limitations of the policies, against certain expenses in connection with the defense of actions, suits or proceedings, to which they are parties by reason of being or having been such directors or officers.

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers or persons who may control us pursuant to the foregoing provisions, we have been informed that in the opinion of the SEC such indemnification is against public policy as expressed in the Act and is therefore unenforceable.

**SECTION 203 OF THE DELAWARE GENERAL CORPORATION LAW**

Section 203 of the Delaware General Corporation Law, which is applicable to CanArgo as a Delaware corporation, prohibits various business combinations between a Delaware corporation and an interested stockholder, that is, anyone who beneficially owns, alone or with other related parties, at least 15% of the outstanding voting shares of a Delaware corporation. Business combinations subject to Section 203 include mergers, consolidations, sales or other dispositions of assets having an aggregate market value equal to 10% or more of either the aggregate market value of the

consolidated assets of the corporation or the aggregate market value of all of the outstanding stock of the corporation, some transactions that would increase the interested stockholder's proportionate share ownership in the corporation and any receipt by the interested stockholder of the benefit, directly or indirectly (except proportionately as a stockholder of the corporation), of any loans, advances, guarantees, pledges or other financial benefits provided by the corporation or any direct or indirect

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majority-owned subsidiary. Section 203 prohibits this type of business combination for three years after a person becomes an interested stockholder, unless:

the business combination is approved by the corporation's board of directors prior to the date the person becomes an interest stockholder;

upon consummation of the transaction which results in the stockholder becoming an interested stockholder, the interested stockholder acquired at least 85% of the voting stock of the corporation, other than stock held by directors who are also officers or by specified employee stock plans, in the transaction in which it becomes an interested stockholder; or

the business combination is approved by a majority of the board of directors and by the affirmative vote of two-thirds of the outstanding voting stock that is not owned by the interested stockholder at an annual or special meeting of stockholders.

## **LEGAL MATTERS**

The validity of the shares of common stock offered hereby has been passed upon for us by Satterlee Stephens Burke & Burke LLP, New York, New York.

## **EXPERTS**

The consolidated financial statements of CanArgo Energy Corporation as of December 31, 2007 and 2006 and for each of the years in the three year period ending December 31, 2007, incorporated in this prospectus by reference from CanArgo Energy Corporation's Annual Report on Form 10-K for the year ended December 31, 2007, as amended, which, have been audited by L J Solding Associates LLC, independent registered public accountants, as stated in their reports, which are incorporated herein by reference, and have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

The oil and gas reserve data incorporated by reference to our Annual Report on Form 10-K for the year ended December 31, 2007, as amended, has been prepared by Oilfield Production Consultants (OPC) Limited and such reserve report dated January 1, 2008 has been incorporated herein in reliance upon the authority of such firm as experts in estimating proved oil and gas reserves.

## **WHERE YOU CAN FIND MORE INFORMATION**

We are subject to the information and reporting requirements of the Exchange Act under which we file periodic reports, proxy statements and other information with the Securities and Exchange Commission (SEC). You may read and copy any document we file at the SEC's public reference rooms at the Public Reference Section of the SEC at 100 F Street, N.E., Washington, DC 20549-7010 and at the Commission's Regional Offices located at 3 World Financial Center, RM 4300, New York, New York 10281-1022 and 500 West Madison Street, Suite 1400, Chicago, Illinois 60661. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. Our SEC filings are also available to the public from the SEC's Internet site at <http://www.sec.gov> which contains reports, proxy and information statements and other information regarding issuers that file electronically.

This prospectus is part of a registration statement that we filed with the SEC (registration number 333-150625). The registration statement of which this prospectus forms a part contains more information than this prospectus regarding CanArgo Energy Corporation and our common stock, including certain exhibits. You can get a copy of the registration statement from the SEC at the addresses listed above or from its Internet site. You can also obtain information about

us from our Internet site at <http://www.canargo.com>.

Our common stock is listed on the Oslo Stock Exchange in Norway under the symbol **CNR** and also on The American Stock Exchange under the symbol **CNR**. Information about us is also available at the Oslo Stock Exchange website ([www.ose.no](http://www.ose.no)), and at the offices of The American Stock Exchange, 86 Trinity Place, New York, NY 10005.

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**DOCUMENTS INCORPORATED BY REFERENCE**

The SEC allows us to incorporate by reference the information we file with them, which means that we can disclose important information to you by referring you to those documents that are considered part of this prospectus. Later information that we file with the SEC will automatically update and supersede this information. We incorporate by reference the documents listed below and any future filings made by us with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934 until this offering of securities has been completed:

Annual Report on Form 10-K for the year ended December 31, 2007, as amended;

Quarterly Reports on Form 10-Q for the fiscal quarters ended March 31, 2008 and June 30, 2008;

The description of CanArgo's common stock contained in Form 8-A/12B dated April 19, 2004;

Definitive Proxy Materials filed on June 18, 2008; and

Current Reports on Form 8-K filed on January 8, 2008, February 11, 2008, February 14, 2008, March 6, 2008, March 28, 2008, April 28, 2008, June 3, 2008, June 16, 2008, July 7, 2008, July 21, 2008, July 25, 2008, and August 11, 2008.

We will provide without charge to each person, including any beneficial owner, to whom a copy of this prospectus is delivered, upon written or verbal request, a copy of the foregoing documents. Written or telephone requests for such copies should be directed to the Corporate Secretary, CanArgo Energy Corporation, PO Box 291, St Peter Port, Guernsey, GY1 3RR, British Isles, +(44) 1481 729 980.

You should rely only on the information contained in this prospectus and any supplement. We have not authorized any other person to provide you with different or additional information. If anyone provides you with different or additional information, you should not rely on it. This prospectus is not an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in or incorporated by reference in this prospectus and any supplement is accurate as of its date only. Our business, financial condition, results of operations and prospects may have changed since that date.

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**CANARGO ENERGY CORPORATION**

**Subscription Rights to Purchase**

**Shares**

**of**

**Common Stock**

**PROSPECTUS**

, 2008

Until , 2008 all dealers that buy, sell or trade in our common stock, whether or not participating in this offering, may be required to deliver a prospectus. This is in addition to the dealers' obligation to deliver a prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

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**Table of Contents****PART II****INFORMATION NOT REQUIRED IN THE PROSPECTUS****Item 14. *Other Expenses of Issuance and Distribution.***

The following table sets forth the estimated expenses, all of which are to be borne by the Company, in connection with the registration, issuance and distribution of the securities being registered hereby other than underwriting discounts and commissions. All amounts are estimates except the SEC registration fee.

SEC Registration Fee	\$ 1,970
Legal Fees and Expenses	
Accountant's Fees and Expenses	
Printing Expenses	
Subscription Agent Fees and Expenses	
Transfer Agent and Registrar Fees and Expenses	
Miscellaneous	
Total	\$

**Item 16. *Exhibits.***

The following exhibits are filed as part of this registration statement.

<b>Exhibit No.</b>	<b>Description of Exhibit</b>
------------------------	-------------------------------

Management Contracts, Compensation Plans and Arrangements are identified by an asterisk (\*) Documents filed herewith are identified by a cross ( ).

- |       |   |
|-------|---|
| 1(6)  | Form of Standby Underwriting Agreement between the Company and the Standby Underwriters dated July 24, 2008 (Incorporated by reference to Exhibit 1.0 attached to the Form 8-K of CanArgo filed on July 24, 2008).  |
| 3(4)  | Certificate of Amendment of the Certificate of Incorporation of CanArgo Energy Corporation as filed by the Office of the Secretary of State of Delaware on July 21, 2008 (Incorporated by reference to Exhibit 3.1 attached to the Form 8-K of CanArgo filed on July 21, 2008). |
| 4(1)  | Form of Subscription Rights Certificate .   |
| 5(1)  | Opinion of Satterlee Stephens Burke & Burke LLP re: legality of securities being registered .   |
| 10(1) | Manager's Engagement Agreement .  |
| 23.1  | Consent of Satterlee Stephens Burke & Burke LLP to the use of their opinion with respect to the legality of the securities being registered (included in opinion filed as Exhibit 5(1)) .   |
| 23(2) | Consent of L J Soldinger Associates LLC .   |
| 24(1) | Power of attorney of certain signatories (contained on the signature page included in Part II of the Registration Statement) .  |
| 99(1) | Form of Instructions as to Use of Subscription Rights Certificate .   |
| 99(2) | Form of Notice of Guaranteed Delivery for Rights Certificates .   |

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- 99(3) Form of Letter of Stockholders who are Record Holders .
- 99(4) Form of Letters to Brokers, Dealers, Commercial Banks, Trust Companies and Other Nominees .
- 99(5) Form of Letter to Clients who are Beneficial Holders .
- 99(6) Form of Nominee Holder Certification .
- 99(7) Beneficial Owner Election Form .
- 99(8) Form of Notice of Important Tax Information .

Filed herewith

To be filed by amendment

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**Item 17. Undertakings**

a. The undersigned Registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this Registration Statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act of 1933;

(ii) To reflect in the prospectus any facts or events arising after the effective date of the Registration Statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the Registration Statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20 percent change in the maximum aggregate offering price set forth in the Calculation of Registration Fee table in the effective Registration Statement;

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the Registration Statement or any material change to such information in the Registration Statement;

Provided, however, that paragraphs (a)(1)(i), (a)(1)(ii) and (a)(i)(iii) of this section do not apply if the registration statement is on Form S-3 or Form F-3 and the information required to be included in a post-effective amendment by those paragraphs is contained in reports filed with or furnished to the Commission by the Registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the Registration Statement, or is contained in a form of prospectus filed pursuant to Rule 424(b) that is part of the Registration Statement.

(2) That, for the purposes of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new Registration Statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof.

(3) To remove from registration by means of a post-effective amendment any of the securities being registered which remain unsold at the termination of the offering.

b. The undersigned registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, as amended (the Act), each filing of the registrant's annual report pursuant to section 13(a) or section 15(d) of the Securities Exchange Act of 1934 (and, where applicable, each filing of an employee benefit plan's annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial *bona fide* offering thereof.

c. The undersigned registrant hereby undertakes to supplement the prospectus, after the expiration of the subscription period, to set forth the results of the subscription offer, the transactions by the underwriter during the subscription period, the amount of unsubscribed securities to be purchased by the underwriter, and the terms of any subsequent reoffering thereof. If any public offering by the underwriter is to be made on terms differing from those set forth on the cover page of the prospectus, a post-effective amendment will be filed to set forth the terms of such offering.

d. Insofar as indemnification for liabilities arising under the Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the provisions described in Item 15 above, or otherwise, the registrant has been advised that in the opinion of the Commission such indemnification is against public policy as expressed in the Act and is, therefore, unenforceable. In the event that a claim for indemnification

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against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Act and will be governed by the final adjudication of such issue.

e. The undersigned Registrant hereby undertakes:

(1) For purposes of determining any liability under the Act, the information omitted from the form of prospectus filed as part of a registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Act shall be deemed to be part of the registration statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

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**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and has duly caused this registration statement to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of London on August 20, 2008.

**CANARGO ENERGY CORPORATION**

By: /s/ Vincent McDonnell

Vincent McDonnell  
Chief Executive Officer

**POWER OF ATTORNEY**

**KNOW ALL MEN BY THESE PRESENTS:**

That the undersigned officers and directors of CanArgo Energy Corporation, a Delaware corporation, do hereby constitute and appoint Vincent McDonnell and Jeffrey Wilkins, and either of them, the lawful attorney and agent, with power and authority to do any and all acts and things and to execute any and all instruments which said attorney and agent, determine may be necessary or advisable or required to enable said corporation to comply with the Securities Act of 1933, as amended, and any rules or regulations or requirements of the Securities and Exchange Commission in connection with this Registration Statement. Without limiting the generality of the foregoing power of authority, the powers granted include the power and authority to sign the names of the undersigned officers and directors in the capacities indicated below to this Registration Statement, to any and all amendments, post-effective amendments and supplements thereof and to any and all instruments or documents filed as part of or in connection with such Registration Statement, and each of the undersigned hereby certifies and confirms all that said attorney and agent, shall do or cause to be done by virtue hereof. The Power of Attorney may be signed in several counterparts.

**IN WITNESS WHEREOF**, the undersigned has executed this Power of Attorney as of the dates indicated below.

Pursuant to the requirements of the Securities Act of 1933, as amended, this Registration Statement has been signed by the following persons in the capacities and on the dates indicated.

By: /s/ Jeffrey Wilkins

Date: August 20, 2008

Jeffrey Wilkins, Chief Financial Officer and Director

By: /s/ Vincent McDonnell

Date: August 20, 2008

Vincent McDonnell, Chairman of the Board,  
President and Chief Executive Officer

By: /s/ Russ Hammond

Date: August 20, 2008

Russ Hammond, Director

By: /s/ Anthony Perry

Date: August 20, 2008

Anthony Perry, Director

By: /s/ Michael Ayre

Date: August 20, 2008

Michael Ayre, Director

By Vincent McDonnell, Attorney in Fact

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**EXHIBIT INDEX**

<b>Filed Herewith</b>	<b>Exhibit</b>
4(1)	Form of Subscription Rights Certificate .
10(1)	Manager's Engagement Agreement .
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99(6)	Form of Nominee Holder Certification .
99(7)	Beneficial Owner Election Form .
99(8)	Form of Notice of Important Tax Information .

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