

AQUA AMERICA INC
Form 8-K/A
April 15, 2019

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K/A

CURRENT REPORT

Pursuant to Section 13 or 15(d)

of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): October 22, 2018

Aqua America, Inc.

(Exact name of registrant as specified in its charter)

Pennsylvania 001-06659 23-1702594
(State or other jurisdiction (Commission (I.R.S. Employer

of incorporation) File Number) Identification No.)

762 West Lancaster Avenue

19010-3489

Bryn Mawr, Pennsylvania

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (610) 527-8000

Not Applicable

(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933 (§230.405 of this chapter) or Rule 12b-2 of the Securities Exchange Act of 1934 (§240.12b-2 of this chapter).

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Explanatory Note

As previously reported in a Current Report on Form 8-K filed on October 23, 2018 (the “Initial Form 8-K”), Aqua America, Inc. (the “Company”) entered into a Purchase Agreement (the “Purchase Agreement”) with LDC Parent LLC, a Delaware limited liability company (“Seller”), to acquire all of the issued and outstanding limited liability company membership interests of LDC Funding LLC, a Delaware limited liability company (“LDC”), from Seller (the “Peoples Gas Acquisition”). LDC is the ultimate parent of Peoples Natural Gas Company LLC (“Peoples Natural Gas Company”), Peoples Gas Company LLC (“Peoples Gas”), Delta Natural Gas Company Inc. (“Delta”), Peoples Gas WV LLC, Peoples Gas KY LLC, Peoples Homeworks LLC, PNG Gathering LLC, Delta Resources LLC, Delgasco LLC and Enpro LLC, and collectively these businesses are referred to as “Peoples”.

Peoples Natural Gas Company, Peoples Gas, Delta, Peoples Gas WV LLC and Peoples Gas KY LLC are also collectively referred to as “the regulated companies”.

Peoples Homeworks LLC, PNG Gathering LLC, Delta Resources LLC, Delgasco LLC and Enpro LLC are also collectively referred to as the “non-regulated companies”

This Form 8-K/A amends the Initial Form 8-K to include the financial statements and pro forma financial information required by Items 9.01(a) and 9.01(b) of Form 8-K, as well as additional information regarding Peoples, and should be read in conjunction with the Initial Form 8-K.

Other Events

Item 8.01

The following are risk factors, business description and management’s discussion of financial condition and results of operations as set forth in the financial statements of LDC as of December 31, 2018 and 2017, and for the three years ended December 31, 2018, related to Peoples’s business. This information provides further details regarding the business of Peoples and is being provided in connection with the proposed Peoples Gas Acquisition.

The Peoples Gas Acquisition has not yet occurred and is subject to customary closing conditions set forth in the Purchase Agreement, including, among others, (1) the absence of any law or governmental order prohibiting the consummation of the Acquisition, (2) the accuracy of the parties’ representations and warranties, subject to customary materiality standards and certain other exceptions, (3) compliance in all material respects of the parties with their applicable covenants under the Acquisition Agreement, subject to certain exceptions, (4) the absence of a “material adverse effect” with respect to LDC and its subsidiaries and (5) receipt of certain regulatory approvals, including from the public utility commission in Pennsylvania and West Virginia. The closing of the Acquisition is not subject to any financing condition. We currently expect the Acquisition will close in mid-2019. For further information regarding the Acquisition, please refer to our Annual Report on Form 10-K filed on February 26, 2019, and the Initial Form 8-K.

Risk Factors related to Peoples

Transporting, distributing and storing natural gas involves numerous risks that may result in accidents and other operating risks and costs.

Natural gas transportation, distribution and storage activities inherently involve a variety of hazards and operational risks, such as leaks, accidental explosions, damage caused by third parties and mechanical problems, which could cause substantial financial losses. These risks could result in serious personal injury, loss of human life, significant damage to property, environmental pollution, impairment of operations and substantial losses to Peoples. The location of pipelines and storage facilities near populated areas, including residential areas, commercial business centers and industrial sites, could increase the level of damages resulting from these risks. These activities may also subject Peoples to litigation or administrative proceedings. Such litigation or proceedings could result in substantial monetary judgments, fines or penalties against Peoples or otherwise be resolved on unfavorable terms.

Peoples is subject to federal and state laws and regulations requiring it to maintain certain safety and system integrity measures by identifying and managing storage and pipeline risks. In addition, companies that supply and transport gas to Peoples are also subject to similar regulations and other restrictions related to their activities. Compliance with these laws and regulations, or future changes in these laws and regulations, may, directly or indirectly, result in increased capital, operating and other costs which may not be recoverable in a timely manner or at all from customers in rates. In accordance with customary industry practices, Peoples maintains insurance against a significant portion, but not all, of these risks and losses. To the extent any of these events occur or regulations change, it could adversely affect the financial condition and results of operations of Peoples.

Regulation of Peoples's business may impact its customer tariffs, costs and profitability.

Peoples is subject to regulation by federal, state and local authorities. At the state level, Peoples is regulated in Pennsylvania by the Pennsylvania Public Utility Commission ("PAPUC"), in Kentucky by the Kentucky Public Service Commission ("KYPSC"), and in West Virginia by the West Virginia Public Service Commission ("WVPSC"). These state public service commissions regulate many aspects of the Peoples distribution operations, including construction and maintenance of facilities, required capital expenditures and planned capital expenditures, including pipe replacement programs, operations, safety, the rates Peoples may charge customers, the terms of service to its customers, transactions with its affiliates, the rate of return it is allowed to realize, and the accounting treatment for certain aspects of its operations. In addition, Peoples's utility operating subsidiaries are required to maintain certain capitalization ratios, which could affect their ability to pay dividends or make distributions. Rate increases and rate supplements to recover Peoples's costs and maintain its rate of return are subject to regulatory review and approval. There can be no assurance that Peoples will be able to obtain rate increases or rate supplements or continue its current rates of return.

Peoples could incur additional costs and otherwise be adversely impacted if required to adjust to new laws or regulations, revisions to existing laws or regulations or changes in interpretations of existing laws or regulations. In addition, as the regulatory environment for the natural gas industry increases in complexity, the risk of inadvertent noncompliance could also increase. If Peoples fails to comply with applicable laws and regulations, whether existing or new, it could be subject to fines, penalties, disallowance of cost recovery or other enforcement action by the authorities that regulate Peoples operations.

Warmer-than-normal weather conditions can adversely impact Peoples's financial condition and results of operations.

Peoples's revenues are temperature sensitive and vary from year-to-year, depending on weather conditions, with a substantial portion (approximately 70% in 2018) of Peoples's total throughput occurring in the first and fourth quarters of the year. As a result, warmer-than-normal-weather conditions can decrease the amount of natural gas Peoples sells in any year, which would adversely affect its financial condition and results of operations.

Peoples's ability to meet customers' natural gas requirements may be impaired if contracted natural gas supplies and interstate pipelines services are not available, are not delivered in a timely manner or if federal regulations decrease its available capacity, which may result in a loss of customers and an adverse effect on Peoples's financial conditions and results of operations.

Peoples is responsible for acquiring sufficient natural gas supplies, interstate pipeline capacity and storage capacity to meet current and future customers' peak, annual and seasonal natural gas requirements. Peoples relies on third-party service providers, as it purchases a portion of its natural gas supply from interstate sources and relies on interstate pipelines to transport natural gas to its distribution system, in addition to local production that is delivered directly into its pipeline system. The Federal Energy Regulatory Commission ("FERC") regulates the transportation of the natural gas received from interstate sources, and any change in regulatory policies could increase Peoples's transportation costs or decrease its available pipeline capacity. A decrease in interstate pipeline capacity available, an increase in competition for interstate pipeline transportation service or other interruptions to pipeline gas supplies could reduce Peoples's normal interstate supply of natural gas. Additionally, federal or state legislation could restrict or limit natural gas drilling, which could decrease the supply of available natural gas. If Peoples is unable to maintain access to a reliable and adequate natural gas supply or sufficient pipeline capacity to deliver that supply, it may be unable to meet its customers' requirements resulting in a loss of customers and an adverse effect on Peoples's financial conditions and results of operations.

Peoples has traditionally used local production as its primary source of supply to fulfill its supply requirements. In order to absorb local gas into its system, Peoples has in place a network of pipelines and related facilities that move the gas either to customers located where gas is produced or to the more populated areas of the service territory where the greatest level of consumption occurs, and, in summer months, to Peoples's on-system and off-system storage facilities. This network of facilities includes gathering lines, compressor stations and transmission lines. Peoples has entered into gas purchase agreements with various producers to supply this local production. A decrease in this supply could occur, for example, if the local gas producers no longer drill wells to offset natural well production decline or if such producers decide to cease production or produce into another pipeline. State and federal legislation or regulations could also limit drilling activities and in turn limit gas supply. If supply is limited, Peoples would be faced with purchasing gas supplies likely at a higher cost and may not be able to find alternative gas supply, and accordingly, may be unable to meet customer requirements, resulting in a loss of customers and an adverse effect on its financial condition and results of operations.

Workforce-related risks may affect Peoples's results of operations.

Peoples is subject to various workforce-related risks, including the risk that it will be unable to attract and retain qualified personnel; that it will be unable to effectively transfer the knowledge and expertise of an aging workforce to new personnel as those workers retire; and that it will be unable to reach collective bargaining arrangements with the unions that represent certain of its workers, which could result in work stoppages. Additionally, Peoples relies on outside resources to supplement its workforce, including construction crews which are key to Peoples's infrastructure replacement program. Peoples faces the same risks associated with these outside resources as it does with its own workforce. As a result, Peoples may be unable to hire or retain an adequate number of individuals who are knowledgeable about public utilities and the natural gas industry or face a lengthy time period associated with skill development and knowledge transfer. Failure to address these risks may result in increased operational and safety

risks as well as increased costs. Even with reasonable plans in place to address succession planning and workforce training, Peoples cannot control the future availability of qualified labor. If Peoples is unable to successfully attract and retain an appropriately qualified workforce, it could adversely affect Peoples's financial condition and results of operations.

Environmental laws and regulations may require significant expenditures or increase operating costs.

Peoples is subject to federal, state and local environmental laws and regulations affecting many aspects of its present and future operations. These laws and regulations subject Peoples to inspections and require Peoples to obtain and comply with a wide variety of environmental licenses, permits and approvals. Failure to comply with these laws and regulations and failure to obtain any required permits and licenses may result in a variety of administrative, civil and criminal enforcement measures, including the assessment of mandatory penalties, the imposition of remedial actions and the issuance of orders enjoining future operations, which may be material. In addition, existing environmental laws and regulations could be revised or reinterpreted and/or new laws and regulations could be adopted or become applicable to Peoples or its facilities, thereby impacting Peoples cost of compliance. The discovery of presently unknown environmental conditions, including former manufactured gas plant sites, and claims against Peoples under environmental laws and regulations may result in expenditures and liabilities, which could be material. If these events occur, they could have an adverse effect on Peoples's financial condition and results of operations.

Climate change and regulatory and legislative developments in the energy industry related to climate change may in the future adversely affect operations and financial results.

Climate change, and the extent of regulatory or legislative changes to address the potential for climate change, could adversely affect operations and financial results of Peoples. It is difficult to quantify the impacts of climate change with any degree of specificity, but the impacts could adversely affect Peoples's business, financial condition and results of operations. For example, to the extent climate change results in warmer temperatures, financial results could be adversely affected through lower gas volumes and revenues. In addition, there have been a number of federal and state legislative and regulatory initiatives proposed in recent years in an attempt to control or limit the effects of global warming and overall climate change, including by limiting greenhouse gas emissions, such as methane and carbon dioxide. The adoption of this type of legislation or the adoption of related regulations by federal or state governments mandating a substantial reduction in greenhouse gas emissions in the future could have far-reaching and significant impacts on the energy industry. Such new legislation or regulations could result in increased compliance costs or additional operating restrictions, affect the demand for or supply of natural gas or impact the prices charged to customers. At this time, it is not possible to anticipate the potential impact of such laws or regulations, but they could have an adverse effect on Peoples's business, financial condition and results of operations.

Peoples may incur significant costs and liabilities resulting from pipeline integrity and other similar programs and related repairs.

Certain of Peoples's pipeline operations are subject to pipeline safety laws and regulations. The DOT's (US Department of Transportation) PHMSA (Pipeline and Hazardous Materials Safety Administration) has adopted regulations requiring pipeline operators to develop integrity management programs, including more frequent inspections and other measures, for transmission pipelines located in "high consequence areas," which are those areas where a leak or rupture could do the most harm. The regulations require pipeline operators, including Peoples, to, among other things:

- perform ongoing assessments of pipeline integrity;
- develop a baseline plan to prioritize the assessment of a covered pipeline segment;
- identify and characterize applicable threats that could impact a high consequence area;
- improve data collection, integration, and analysis;
- develop processes for performance management, record keeping, management of change and communication;
- repair and remediate pipelines as necessary; and
- implement preventive and mitigating action.

Peoples is required to maintain pipeline integrity testing programs that are intended to assess pipeline integrity. Peoples is also required to establish and maintain a Distribution Integrity Management Program for all distribution assets. This program requires protocols for identifying risks and threats to the distribution systems. The program incorporates a relative risk model to measure risk reduction to these threats. Any repair, remediation, preventative or mitigating actions may require significant capital and operating expenditures. Should Peoples fail to comply with applicable statutes and related rules, regulations and orders, it could be subject to significant penalties and fines.

Changes to income tax policy, certain tax elections, tax regulations and future taxable income could adversely impact Peoples's financial condition and results of operations.

Peoples has generated annual taxable losses that have resulted in federal and state net operating losses. Peoples plans to utilize these net operating losses in the future to reduce income tax obligations. The value of these net operating losses could be reduced if Peoples cannot generate enough taxable income in the future to utilize the net operating losses before they expire due to lower than expected financial performance or regulatory actions or if the Internal Revenue Service does not agree with certain filing positions of Peoples. Changes to income tax policy, laws and regulations, including but not limited to changes in tax rates, the deductibility of certain expenses including interest and state and local income taxes and/or changes in the deductibility of certain expenditures for property, could adversely impact Peoples. Those impacts could include reducing the value of its net operating losses and could result in adverse impacts on Peoples's financial condition and results of operations.

Peoples's liquidity may be adversely affected by delays in recovery of its costs, due to regulation.

In the normal course of business, there is a lag between when Peoples incurs increases in certain of its costs and the time in which those costs are considered for recovery in the ratemaking process. Cash requirements for increased operating costs, increased funding levels of defined benefit pension and postretirement costs, capital expenditures and other increases in the costs of doing business can require outlays of cash prior to the authorization of increases in rates charged to customers, as approved by the PAPUC, KYPSC and WVPSC. Accordingly, Peoples's liquidity can be adversely impacted to the extent higher costs are not timely recovered from its customers.

Peoples's liquidity and, in certain circumstances, its results of operations may be adversely affected by the cost of purchasing natural gas during periods in which natural gas prices are rising significantly.

Peoples's regulated companies purchase their natural gas supply primarily through a combination of requirements contracts, some of which contain minimum purchase obligations, monthly spot purchase contracts and forward purchase contracts. The price paid for natural gas acquired under forward purchase contracts is fixed prior to the delivery of the natural gas. Additionally, a portion of natural gas purchases is injected into natural gas storage facilities in the non-heating months and withdrawn from storage for delivery to customers during the heating months.

Peoples's short-term borrowing requirements and liquidity are also significantly affected by the seasonal nature of the natural gas business. Changes in the price of natural gas and the amount of natural gas needed to supply customers' needs due to, for example, colder than expected seasonal temperatures, could significantly affect the price and amount of natural gas Peoples is required to purchase and the timing of such purchases, and in turn affect its borrowing requirements and liquidity position. As a result, Peoples's short-term borrowings and its liquidity needs typically reach their highest levels in the winter months. If Peoples fails to secure sufficient natural gas supplies at appropriate prices

(due to, for example, more extreme winter conditions) and is required to purchase additional natural gas supplies or purchase natural gas at elevated prices, it could adversely affect Peoples's borrowing levels, liquidity and financial condition.

Peoples's tariff rate schedules contain Purchased Gas Adjustment ("PGA") clauses that permit filings for rate adjustments to recover the cost of purchased gas. Subject to regulatory approval, as described below, changes in the cost of purchased gas are flowed through to customers and may affect uncollectible amounts and cash flows and can therefore impact Peoples's financial condition and results of operations.

The state regulatory commissions approve the PGA changes on an interim basis, subject to refund and the outcome of a subsequent audit and prudence review. Due to such review process, there is a risk of a disallowance of full recovery of these costs. Peoples is also subject to regulations and standards with regards to the amount of lost and unaccounted for gas that may be recovered from customers. Any material disallowance of purchased gas costs would adversely affect Peoples's financial condition and results of operations.

Increases in the prices that Peoples charges for gas may also adversely affect Peoples's business because increased prices could lead customers to reduce usage and cause some customers to have trouble paying the resulting higher bills. These higher prices may increase bad debt expenses and ultimately reduce earnings. Rapid increases in the price of purchased gas may result in an increase in short-term debt.

Peoples's nonregulated companies purchase natural gas utilizing a combination of requirements contracts, some of which contain minimum purchase obligations, monthly spot purchase contracts and forward purchase contracts. Although price risk for the non-regulated companies is mitigated to a degree by efforts aimed at balancing supply and demand, there are practical limitations on the ability to accurately predict demand and any failure to do so could adversely affect Peoples's financial condition and results of operations.

Peoples's business activities are concentrated in three states.

Peoples provides natural gas distribution services to customers in Pennsylvania, Kentucky and West Virginia. Changes in the regional economies, politics, regulations and weather patterns of these states could negatively impact Peoples's growth opportunities and the usage patterns and financial condition of customers and could adversely affect Peoples's financial condition and results of operations.

Peoples may be adversely affected by economic conditions.

Periods of slowed economic activity generally result in decreased energy consumption, particularly by industrial and large commercial companies, a loss of existing customers and fewer new customers, especially from reduced construction of new buildings. As a consequence, national or regional recessions or other downturns in economic activity could adversely affect Peoples's financial condition and results of operations or restrict future growth. Economic conditions in Peoples's service territories may also adversely impact Peoples's ability to collect accounts receivable, resulting in an increase in bad debt expense and adversely affecting its financial condition and results of operations.

Competition and industry trends could impact Peoples's ability to retain existing customers or acquire new customers, which could have an adverse impact on its business, results of operations and financial condition.

Peoples faces the risk that customers may bypass gas distribution services by gaining distribution directly from interstate pipelines, other gas distributors or other energy sources. Increased competition or other changes in legislation, regulation or policies could have a material adverse effect on Peoples's business, financial condition or results of operations. Moreover, changes in wholesale natural gas prices compared with prices for electricity, fuel oil, coal, propane or other energy sources may affect Peoples's retention of natural gas customers and may adversely impact its financial condition and results of operations.

In addition, over time, average customer gas consumption has declined, as more energy efficient appliances and furnaces have been installed and conservation programs have been implemented. If Peoples is unable to compete

effectively or if customers further reduce their gas needs, Peoples may lose existing customers, sell less gas to its customers and/or fail to acquire new customers, which could have a material adverse effect on its business, results of operations and financial condition.

Increased dependence on technology may hinder Peoples's business operations and adversely affect the financial condition and results of operations if such technologies fail.

Over the last several years, Peoples has implemented or acquired a variety of technological tools, including both Peoples-owned information technology and technological services provided by outside parties. These tools and systems support critical functions, including Peoples's integrated planning, scheduling and dispatching of field resources, its automated meter reading system, its customer care and billing, procurement and accounts payable operational logistics, management reporting and its external financial reporting. The failure of these or other similarly important technologies, or Peoples's inability to have these technologies supported, updated, expanded or integrated into other technologies, such as the Company's, could hinder its business operations and adversely impact Peoples's financial condition and results of operations. Although Peoples has, when possible, developed alternative sources of technology and sought to build redundancy into its computer networks and tools, there can be no assurance that it will be able to do so in the future or that these efforts would protect against potential issues related to the loss or failure of any such technologies or Peoples's use of such technologies.

A cyberattack may disrupt Peoples's operations or lead to a loss or misuse of confidential and proprietary information or potential liability.

Peoples is subject to cybersecurity risks primarily related to breaches of security pertaining to sensitive customer, employee and vendor information maintained by Peoples or its third-party vendors in the normal course of business, as well as breaches in the technology utilized in Peoples's natural gas distribution operations and other business processes. Peoples utilizes an industrial control system to remotely control, monitor and measure the flow of natural gas through its pipelines from a central location. A loss of confidential data, particularly personal customer data, or proprietary data or security breaches of its industrial control system could adversely affect Peoples's reputation, diminish customer confidence, disrupt operations and subject Peoples to possible financial liability, any of which could have a material effect on Peoples's financial condition and results of operations.

We may make certain changes in connection with our integration of the Peoples business.

We anticipate that the Peoples Gas Acquisition will close in mid-2019, following receipt of all required regulatory approvals. The Peoples Gas Acquisition is complex and, if the acquisition is consummated, we will devote significant time and resources to integrating the Peoples businesses. As part of this integration, we expect certain management changes, which could result in the potential disruption of our ongoing businesses and the business of Peoples, distraction of our management and the potential impairment of relationships with employees.

Peoples may not have effective internal control over financial reporting such that we may not be able to report our financial results accurately or on a timely basis.

Peoples is currently a privately held entity and therefore does not have to comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. As such, Peoples's management has not performed a formal evaluation of its internal controls over financial reporting, nor has an independent registered public accounting firm conducted an audit to express an opinion on the effectiveness of Peoples's internal controls. Subsequent to the effective date of the Peoples Gas Acquisition, we will undertake efforts to evaluate Peoples's internal controls and comply with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. The initial evaluation of Peoples's internal controls could identify internal control deficiencies which may require remediation.

Peoples's Business

Overview

Peoples, which consists of Peoples Natural Gas Company, Peoples Gas, Delta, and other utility and non-utility subsidiaries, primarily engages in regulated distribution and transportation of natural gas to approximately 740,000 residential, commercial and industrial customers in Pennsylvania, West Virginia and Kentucky. Peoples's service territory is depicted below.

In 2018, approximately 42% of Peoples's total throughput was to residential customers and approximately 58% was to commercial and industrial customers. The table below reflects the number of Peoples's customers by state as of December 31, 2018:

	Residential	Commercial/ Industrial	Total Customers
Pennsylvania	644,515	48,729	693,244
West Virginia	11,824	1,044	12,868
Kentucky	33,348	5,353	38,701
Total	689,687	55,126	744,813

Supply and Transportation

Peoples's gas supply strategy is to ensure dependable gas supply which is available for delivery when needed and that is economically priced. Peoples purchases its natural gas from intrastate, interstate and local sources. Peoples transports its natural gas supplies through various intrastate and interstate pipelines under contracts with remaining terms, including extensions, varying from one month to fifteen years. Peoples anticipates that these gas supply and transportation contracts will be renewed or replaced prior to their expiration.

In 2018, Peoples purchased the majority of its gas supply off the following Interstate Pipelines:

Interstate Pipeline Supplies	Percent of Supply Volumes	
Equitrans Midstream	55	%
Dominion Energy Transmission	12	%
Columbia Gulf	10	%
Tennessee	5	%
Texas Eastern	2	%
Columbia Transmission	1	%
National Fuel	1	%

Peoples also receives a portion of its natural gas supply from local production. Local gas purchases account for approximately 14% of Peoples's total gas supply procured on behalf of customers and are gathered from local production systems. Three suppliers provided more than 5% of Peoples Gas Supply in 2018, with Equitrans Production, Centerpoint Energy and Range Resources providing 43%, 12% and 5% of Peoples's gas supply, respectively.

The regulations of the states in which Peoples operates allow it to pass through changes in the cost of natural gas to its customers under purchased gas adjustment provisions in its tariffs. Depending upon the jurisdiction, the purchased gas adjustment factors are updated periodically, ranging from quarterly to annually. The changes in the cost of gas billed to customers are subject to review by the applicable regulatory bodies.

Peoples uses various third-party storage services or owned natural gas storage facilities to meet peak-day requirements and to manage the daily changes in demand due to changes in weather.

Peoples owns and operates an underground natural gas storage facility with a capacity of 8.3 billion cubic feet ("Bcf"). It has a working capacity of 3.7 Bcf available for use during the heating season and a maximum daily withdrawal rate of 66 million cubic feet ("MMcf"). Additionally, Peoples has contracted for off-system storage from interstate pipelines. The total amount of off-system storage under contract to Peoples is 30.2 Bcf with a maximum daily withdrawal rate of 504 MMcf.

On an ongoing basis, Peoples enters into contracts to provide sufficient supplies and pipeline capacity to meet its customer's natural gas requirements. However, it is possible for limited service disruptions to occur from time to time due to weather conditions, transportation constraints and other events. As a result of these factors, supplies of natural gas may become unavailable from time to time, or prices may increase rapidly in response to temporary supply constraints or other factors. In 2018, Peoples purchased its natural gas supply from 12 suppliers and over 100 local

producers to meet its customers' natural gas requirements. Peoples and its subsidiaries entered into firm agreements with suppliers, including major producers and marketers, intended to provide flexibility to meet the temperature sensitive needs of its customers. In Pennsylvania, Peoples's distribution system is connected to 6 interstate pipelines, where Peoples maintains capacity it believes is sufficient to meet its customers' gas requirements. In Kentucky, Delta's distribution system is connected to 4 interstate pipelines, where Delta maintains capacity it believes is sufficient to meet its customers' gas requirements. In West Virginia, Peoples's distribution system is connected to 1 interstate pipeline, as well as local production, to meet its customers' gas requirements.

Seasonality

Natural gas sales to residential, commercial and industrial customers are seasonal. In 2018, approximately 70% of Peoples total throughput occurred in the first and fourth quarters. These patterns reflect the higher demand for natural gas for heating purposes during the colder months.

Assets

As of December 31, 2018, Peoples owned approximately 15,200 linear miles of natural gas distribution mains, varying in size from one-half inch to 36 inches in diameter, 2,400 miles of gathering pipeline and 310 miles of intrastate transmission/storage pipeline. Generally, in each of the cities, towns and rural areas served by Peoples, it owns the underground gas mains and service lines, metering and regulating equipment located on customers' premises and the district regulating equipment necessary for pressure maintenance. With a few exceptions, the measuring stations at which Peoples receives gas are owned, operated and maintained by others, and its distribution facilities begin at the outlet of the measuring equipment. These facilities, including odorizing equipment, are usually located on land owned by suppliers.

Competition

Peoples faces the risk that customers may bypass gas distribution services by gaining distribution directly from interstate pipelines, other gas distributors or other energy sources.

Employees

As of December 31, 2018, Peoples had 1,498 full-time employees, of which 873 are subject to collective-bargaining agreements and represented by organized labor unions. Peoples believes labor relations with its employees are good.

Merger with Delta

On September 20, 2017, Peoples acquired 100% of the outstanding shares of Delta for \$217.6 million in cash ("Delta Acquisition"). Delta is a local gas distribution company, serving residential, commercial and industrial customers in Kentucky.

Regulation of Peoples's Business

Economic Regulation

Peoples's utility operations are subject to regulation by their respective state utility commissions, the WVPSC (West Virginia), the PAPUC (Pennsylvania) and the KYPSC (Kentucky), which have broad administrative power and authority to regulate billing rates, determine franchise areas and conditions of service, approve acquisitions and authorize the issuance of securities. The utility commissions also establish uniform systems of accounts and approve the terms of contracts with affiliates and customers, business combinations with other utility systems and loans and other financings. The policies of the utility commissions often differ from state to state and may change over time.

The profitability of Peoples utility operations is influenced to a great extent by the timeliness and adequacy of rate allowances granted by the respective utility commissions. Each commission has historically utilized cost-of-service ratemaking where base rates are established to recover normal operating expenses, exclusive of natural gas costs and other track expenses, and a reasonable rate of return on Peoples's rate base. Rate base consists primarily of the property, plant and equipment related to Peoples's regulated business, natural gas in storage, offset by accumulated depreciation and certain deferred income taxes. Peoples's regulated rates were most recently adjusted in the following cases:

People Natural Gas Company	Docket No. R-2012-2285985
Peoples Gas	Docket No. R-2013-2355886
Delta	Case No. 2010-00116

In January 2019, Peoples filed a request for increased base rates with the PAPUC for Peoples Natural Gas Company. This base rate case requests an annual revenue increase of approximately \$95 million, which would represent an increase of 14% in total revenues for Peoples Natural Gas Company. The rate case utilizes a fully projected future test year of October 31, 2020 and requests a return on common equity of 11.25%. The request allocates a majority of the requested increase to the fixed monthly customer charge as opposed to the volumetric rate, which would mean that the increase in revenue would be less dependent on customer usage and would instead occur more evenly throughout the year. The outcome of the base rate case is subject to review by the PAPUC and other intervening parties.

Rate Design Strategies

Sales of natural gas to residential and commercial customers are largely seasonal and are impacted by weather. Trends in the average consumption among natural gas residential and commercial customers have tended to decline as more efficient appliances and furnaces are installed. Revenues are derived from a combination of a monthly customer charge which is fixed and a volumetric charge based on the quantity of natural gas consumed.

Infrastructure Replacement

In the majority of natural gas service territories, the commissions have authorized bare steel and cast iron replacement programs. In Pennsylvania, Peoples filed a Long-Term Infrastructure Replacement program with the PAPUC where Peoples has committed to the replacement of bare steel and cast iron pipe. On February 14, 2012, the Governor of Pennsylvania signed into law Act 11 of 2012, which provided a Distribution System Improvement Charge (“DSIC”) mechanism for certain utilities to recover costs related to repair, replacement or improvement of eligible distribution property that has not previously been reflected in rates or rate base. Through a DSIC, subject to an earnings test, a utility may recover the fixed costs of eligible infrastructure incurred during the three months ended one month prior to the effective date of the charge, thereby reducing the historical regulatory lag associated with cost recovery through the traditional rate-making process. In Kentucky, Delta has a pipe replacement program tariff, which allows adjustment of regulated rates annually to earn a return on capital expenditures incurred subsequent to Delta’s last rate case which are associated with the replacement of bare steel and vintage plastic pipe.

Operating Expense Cost Recovery Mechanisms

Gas costs incurred to serve Peoples’s customers are the most significant operating expense. Peoples’s regulated rates, in all jurisdictions, contain a PGA, which are reflected in its tariffs. The PGA clause allows Peoples to timely charge for changes in the cost of purchased gas, inclusive of unaccounted for gas expense based on actual experience. PGA procedures involve periodic filings and hearings before the state regulatory commissions to establish price adjustments for a designated future period. The procedures also provide for inclusion in later periods of any variances between actual recoveries representing the estimated costs and actual costs incurred. The PGA is subject to periodic review and audit by the state regulatory commissions who also have the authority to disallow previously incurred costs.

In Pennsylvania, the gas cost component of uncollectible accounts expense, gas procurement costs and certain costs to maintain a supplier choice program, where customers can elect their natural gas supplier, are recovered by mechanisms outside of typical base rate recovery. Additionally, in Pennsylvania, Peoples recovers the costs related to universal service programs, whereby customers who meet certain income guidelines receive assistance toward paying their monthly bill, weatherization services and other programs.

In Kentucky, the gas cost component of uncollectible accounts expense is recovered outside of base rate recovery.

In all jurisdictions, base rates have been reduced to reflect the change in the corporate income tax rate from 35% to 21%, under the Tax Cuts and Jobs Act.

Non-regulated operations

Peoples's non-regulated subsidiaries derive revenues from natural gas marketing, production and processing of natural gas liquids and home warranty programs. In 2018, non-regulated revenues represented approximately 4% of Peoples's total consolidated revenues for 2018.

Department of Transportation

In December 2006, Congress enacted the Pipeline, Inspection, Protection, Enforcement and Safety Act of 2006 (“2006 Act”), which reauthorized the programs adopted under the Pipeline Safety Improvement Act of 2002 (“2002 Act”). These programs included several requirements related to ensuring pipeline safety, and a requirement to assess the integrity of pipeline transmission facilities in areas of high population concentration.

Pursuant to the 2006 Act, PHMSA, an agency of the DOT, issued regulations, effective February 12, 2010, requiring operators of gas distribution pipelines to develop and implement integrity management programs similar to those required for gas transmission pipelines, but tailored to reflect the differences in distribution pipelines. Operators of natural gas distribution systems were required to write and implement integrity management programs by August 2, 2011. Peoples’s natural gas distribution systems met this deadline.

Pursuant to the 2002 Act and the 2006 Act, PHMSA has adopted a number of rules concerning, among other things, distinguishing between gathering lines and transmission facilities, requiring certain design and construction features in new and replaced lines to reduce corrosion and requiring pipeline operators to amend existing written operations and maintenance procedures and operator qualification programs. PHMSA also updated its reporting requirements for natural gas pipelines effective January 1, 2011.

In December 2011, Congress passed the Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011 (“2011 Act”). This act increased the maximum civil penalties for pipeline safety administrative enforcement actions; required the DOT to study and report on the expansion of integrity management requirements and the sufficiency of existing gathering line regulations to ensure safety; required pipeline operators to verify their records on maximum allowable operating pressure; and imposed new emergency response and incident notification requirements. In 2016, the Protecting our Infrastructure of Pipelines and Enhancing Safety Act of 2016 (“2016 Act”) reauthorized PHMSA’s pipeline safety programs through 2019 and provided limited new authority, including the ability to issue emergency orders, to set inspection requirements for certain underwater pipelines and to promulgate minimum safety standards for natural gas storage facilities, as well as to provide increased transparency into the status of as-yet-incomplete PHMSA actions required by the 2011 Act.

Compliance with PHMSA’s regulations, performance of the remediation activities by Peoples’s natural gas distribution companies and intrastate pipelines and verification of records on maximum allowable operating pressure will continue to require increases in both capital expenditures and operating costs. The level of expenditures will depend upon several factors, including age, location and operating pressures of the facilities. In particular, the cost of compliance with the DOT’s integrity management rules will depend on integrity testing and the repairs found to be necessary by such testing. Changes to the amount of pipe subject to integrity management, whether by expansion of the definition of the type of areas subject to integrity management procedures or of the applicability of such procedures outside of those defined areas, may also affect incurred costs. Implementation of the 2011 and 2016 Acts by PHMSA may result in other regulations or the reinterpretation of existing regulations that could impact compliance costs. In addition,

Peoples may be subject to the DOT's enforcement actions and penalties if it fails to comply with pipeline regulations.

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Natural Gas Gathering

Peoples's service territory is uniquely situated in the Marcellus Shale production region. Approximately 30% of the natural gas supply on the system is from locally produced gas, which Peoples gathers and transports into its distribution system. Peoples's gathering system is regulated by the PAPUC which includes various safety, environmental and, in some circumstances, anti-discrimination requirements, and in some instances complaint-based rate regulation. Peoples's gathering operations may be subject to ratable take and common purchaser statutes in the states in which it operates.

Peoples's gathering operations could be adversely affected should they be subject in the future to the application of state or federal regulation of rates and services. Peoples's gathering operations could also be subject to additional safety and operational regulations relating to the design, construction, testing, operation, replacement and maintenance of gathering facilities. Peoples cannot predict what effect, if any, such changes might have on its operations, but the industry could be required to incur additional capital expenditures and increased costs depending on future legislative and regulatory changes.

Environmental Regulation

Peoples's operations are subject to stringent and complex laws and regulations pertaining to the environment. As an owner or operator of natural gas pipelines, distribution systems and storage, and the facilities that support these systems, Peoples must comply with these laws and regulations at the federal, state and local levels.

Failure to comply with these laws and regulations may trigger a variety of administrative, civil and criminal enforcement measures, including the assessment of monetary penalties, the imposition of remedial actions and the issuance of orders enjoining future operations. Certain environmental statutes impose strict, joint and several liability for costs required to assess, clean up and restore sites where hazardous substances have been stored, disposed or released.

Management's Discussion and Analysis of Financial Condition and Results of Operations of Peoples

The following discussion and analysis should be read in combination with LDC's financial statements filed as Exhibit 99.1 hereto and incorporated herein by reference. Certain tables and charts contained in this section may not add due to rounding.

Overview

Peoples receives gas revenues by selling gas directly to customers at approved rates or by transporting gas through its pipelines at approved rates to customers that have purchased gas directly from other producers, brokers, or marketers. For the year ended December 31, 2018, operating revenues were \$914 million.

Certain factors affecting results of operations

Peoples's business is affected by various factors, including the key factors and trends discussed below. Peoples's past earnings and results of operations are not necessarily indicative of its future earnings and results of operations. Peoples's earnings and results of its operations are affected by numerous factors, including:

- effects of acquisitions, including the Delta Acquisition, the acquisition of Peoples by Aqua America and any revised organizational structure;
- Peoples's ability to recover the costs of purchasing and distributing natural gas to its customers;
 - the impact of weather and other factors, such as customer conservation, on revenues and expenses;
- changes in the regulatory environment at the federal, state and local levels, as well as decisions by regulators, that impact Peoples's ability to earn its authorized rate of return in its service territories, including pipe replacements;
- impacts of federal, state and local regulations and tax laws;
- the effect of natural gas price volatility on the business; and
- the ability to manage costs, integrate and standardize operations, and upgrade infrastructure.

Peoples's operations are affected by the cost of natural gas, which is passed through to customers using a PGA clause and include commodity price, transportation and storage costs. These costs are reflected in the income statement as

purchased gas expenses. Therefore, increases in the cost of gas are offset by a corresponding increase in revenues. Accordingly, contribution margin, a non-GAAP financial measure, defined as operating revenues less purchased gas expense, is a useful and relevant measure to analyze Peoples's financial performance. Contribution margin can be derived directly from Peoples's consolidated statements of incomes, filed as part of Exhibit 99.1 hereto.

	Years ended December		
	31,		
	2018	2017	2016
	(in millions)		
Operating revenue	\$914.0	\$805.1	\$682.6
Purchased gas	392.7	316.5	217.0
Contribution margin	\$521.3	\$488.6	\$465.6

However, the term Contribution margin is not intended to represent income from operations, the most comparable GAAP financial measure, as an indicator of operating performance and should only be used in conjunction with income from operations. In addition, our measurement of Contribution margin is not necessarily comparable to similarly titled measures reported by other companies.

Results of Operations

The following table presents the consolidated statements of income for LDC Funding LLC for the years ended December 31, 2018, 2017 and 2016. For additional information, please refer to the notes to the consolidated financial statements of LDC Funding LLC, filed as Exhibit 99.1 hereto.

	Years ended December 31,		
	2018	2017	2016
	(in millions)		
Operating revenue	\$914.0	\$805.1	\$682.6
Operating expenses:			
Purchased gas	392.7	316.5	217.0
Other operations and maintenance	220.3	200.8	191.6
Depreciation and amortization	88.4	77.7	71.5
Other taxes	16.3	12.8	11.7
Total operating expenses	717.8	607.8	492.0