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070640 - 60

October 4, 2007

**VIA HAND DELIVERY**

Ms. Ann Cole  
Commission Clerk  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399-0850

RECEIVED-FPSC  
07 OCT -4 PM 3:29  
COMMISSION  
CLERK

Re: Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock, and Secured and/or Unsecured Debt, and to Enter into Agreements for Interest Rate Swap Products, Equity Products and Other Financial Derivatives and to Exceed Limitation Placed on Short Term Borrowings in 2008.

Dear Ms. Cole:

Enclosed for filing, please find an original and 5 copies of the Application of Chesapeake Utilities Corporation for Authority to Issue Stock, Secured and Unsecured Debt, and to Enter into Agreements for Interest Rate Swap Products, Equity Products, and other Financial Derivative, and to Exceed the Limitation on Short Term Borrowings During the Calendar Year 2008, along with a copy of the pleading on diskette in Word format.

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- COM \_\_\_\_\_
- CTR \_\_\_\_\_
- ECP 2 (CD)
- GCL 1
- OPC 1
- RCA \_\_\_\_\_
- SCR \_\_\_\_\_
- SGA \_\_\_\_\_
- SEC \_\_\_\_\_
- OTH 1

Enclosures

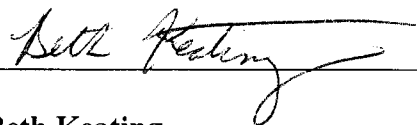
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FPSC-COMMISSION CLERK

Ms. Ann Cole, Commission Clerk  
October 4, 2007  
Page 2

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Your assistance in this matter is greatly appreciated. If you have any questions, please do not hesitate to contact me.

Sincerely,



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**Beth Keating**  
**AKERMAN SENTERFITT**  
106 East College Avenue, Suite 1200  
Tallahassee, FL 32302-1877  
Phone: (850) 224-9634  
Fax: (850) 222-0103

070640

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

In re: Application by Chesapeake Utilities )  
Corporation for Authorization to Issue Common )  
Stock, Preferred Stock and Secured and/or )  
Unsecured Debt, and to Enter into Agreements )  
For Interest Rate Swap Products, Equity )  
Products and Other Financial Derivatives and to )  
Exceed Limitation Placed on Short-Term )  
Borrowings in 2008 )

COMMISSION  
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07 OCT -4, PM 3: 28

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**APPLICATION BY CHESAPEAKE UTILITIES CORPORATION FOR  
AUTHORIZATION TO ISSUE COMMON STOCK, PREFERRED STOCK AND  
SECURED AND/OR UNSECURED DEBT, AND TO ENTER INTO  
AGREEMENTS FOR INTEREST RATE SWAP PRODUCTS, EQUITY  
PRODUCTS AND OTHER FINANCIAL DERIVATIVES, AND TO EXCEED  
LIMITATION PLACED ON SHORT-TERM BORROWINGS IN 2008**

Chesapeake Utilities Corporation (Chesapeake, the Company or Applicant) respectfully files this Application, pursuant to Section 366.04 (1), Florida Statutes, seeking authority in 2008 to issue up to 5,000,000 shares of Chesapeake common stock; up to 1,000,000 shares of Chesapeake preferred stock; up to \$80,000,000 in secured and/or unsecured debt; to enter into agreements for up to \$40,000,000 in Interest Rate Swap Products, Equity Products and other Financial Derivatives; and to obtain authorization to exceed the limitation placed on short-term borrowings by Section 366.04, Florida Statutes, so as to issue short-term obligations in 2008, in an amount not to exceed \$70,000,000.

1. Name and principal business offices of Applicant:

- a) Chesapeake Utilities Corporation  
P.O. Box 615  
909 Silver Lake Boulevard  
Dover, Delaware 19904
- b) Chesapeake Utilities Corporation  
Florida Division  
1501 Sixth Street, NW  
Winter Haven, Florida 33881

DOCUMENT NUMBER-DATE

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2. Incorporated:

Chesapeake Utilities Corporation – Incorporated under the laws of the state of Delaware on November 12, 1947 and qualified to do business in Florida, Maryland, and Pennsylvania

3. Person authorized to receive notices and communications in this respect:

Beth Keating, Esquire  
Akerman Senterfitt  
Suite 1200  
106 East College Avenue  
Tallahassee, Florida 32301  
(850) 224-9634  
(850) 222-0103 (Fax)

Attorneys for Chesapeake Utilities Corporation

4. Capital Stock and Funded Debt

Chesapeake has authority by provisions contained in the Certificate of Incorporation, as amended, to issue common stock as follows:

- a) Common stock having a par value of \$0.4867 per share.
- b) Amount authorized: 12,000,000 shares.
- c) Amount outstanding as of June 30, 2007: 6,743,136
- d) Amount held in Treasury: 0 shares.
- e) Amount pledged by Applicant: None.
- f) Amount owned by affiliated corporations: None.
- g) Amount held in any fund: None.

Chesapeake has authority by provisions contained in its Certificate of Incorporation, as amended, to issue preferred stock as follows:

- a) Preferred stock having a par value of \$0.01 per share.
- b) Amount authorized: 2,000,000 shares.
- c) Amount outstanding as of June 30, 2007: 0 shares.
- d) Amount held in Treasury: None.

- e) Amount pledged by Applicant: None.
- f) Amount owned by affiliated corporations: None.
- g) Amount held in any fund: None.

The funded indebtedness by class and series are as follows:

- (a)1 8.25% Convertible Debentures due March 1, 2014 are convertible prior to maturity, unless previously redeemed, into shares of common stock of Chesapeake at a conversion price of \$17.01 per share. Interest on the Debentures is payable on the first day of March and September, commencing September 1, 1989. The Debentures are redeemable at 100% of the principal amount plus accrued interest (i) on March 1 in any year, commencing in 1991, at the option of the holder and (ii) at any time within 60 days after request on behalf of a deceased holder. At Chesapeake's option, beginning March 1, 1990, the Debentures may be redeemed in whole or in part at redemption prices declining from 107.25%, plus accrued interest. No sinking fund will be established to redeem the Debentures. As of June 30, 2007, there is a remaining balance of \$1,905,000 on this issue.
- (a)2 7.97% Unsecured Senior Notes due February 1, 2008, and issued on February 9, 1993 in the principal amount of \$10,000,000 bearing interest payable semi-annually with provisions for payment of interest only prior to February 1, 1999; thereafter, principal shall be payable, in addition to interest on the unpaid balance, over ten (10) years at the rate of \$1,000,000 per annum. As of June 30, 2007, there is a remaining balance of \$1,000,000 on this issue.
- (a)3 6.91% Unsecured Senior Notes due October 1, 2010, and issued on October 2, 1995 in the principal amount of \$10,000,000 bearing

interest payable quarterly with provisions for payment of interest only prior to October 1, 2000; thereafter, principal shall be payable, in addition to interest on the unpaid balance, over eleven (11) years at the rate of \$909,091 per annum. As of June 30, 2007 there is a remaining balance of \$3,636,364 on this issue.

(a)4 6.85% Unsecured Senior Notes due January 1, 2012 and issued on December 15, 1997 in the principal amount of \$10,000,000 bearing interest payable semi-annually with provisions for payment of interest only prior to January 1, 2003; thereafter, principal shall be payable, in addition to interest on the unpaid balance, over ten (10) years at the rate of \$1,000,000 per annum. As of June 30, 2007, there is a remaining balance of \$5,000,000 on this issue.

(a)5 7.83% Unsecured Senior Notes due January 1, 2015 and issued on December 29, 2000 in the principal amount of \$20,000,000 bearing interest payable semi-annually with provisions for payment of interest only prior to January 1, 2006; thereafter, principal shall be payable, in addition to interest on the unpaid balance, over ten (10) years at the rate of \$2,000,000 per annum. As of June 30, 2007, there is a remaining balance of \$16,000,000 on this issue.

(a)6 6.64% Unsecured Senior Notes due October 31, 2017 and issued on October 31, 2002 in the principal amount of \$30,000,000 bearing interest payable semi-annually with provisions for payment of interest only prior to October 31, 2007; thereafter, principal shall be payable, in addition to interest on the unpaid balance, over eleven (11) years at the rate of \$2,727,272 per annum. As of June 30, 2007, there is a remaining balance of \$30,000,000 on this issue.

(a) 7 5.50% Unsecured Senior Notes due October 12, 2020 and issued on October 12, 2006 in the principal amount of \$20,000,000 bearing interest payable quarterly with provisions for payment of interest only prior to October 12, 2011; thereafter, principal shall be payable, in addition to interest on the unpaid balance, for ten (10) years at the rate of \$2,000,000 per annum. As of June 30, 2007 there is a remaining balance of \$20,000,000 on this issue. On September 6, 2005, the Delaware Public Service Commission issued Order No. 6708 approving the issuance of up to \$20,000,000 of Chesapeake's 5.50% Unsecured Senior Notes. A copy of the Order and a copy of the Agreement in Principle with Prudential Investment Management, LLC have been previously filed with the FPSC within Exhibit C of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed Limitation Placed on Short-Term Borrowings in 2006, Docket No. 050630-GU, dated September 21, 2005, and are hereby incorporated by reference. A copy of the \$20,000,000 Note Agreement for the 5.50% Unsecured Senior Notes has been filed with the FPSC within Exhibit C of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed Limitation Placed on Short-Term Borrowings in 2007, Docket No. 060728-GU, dated December 26, 2006, and is hereby incorporated by reference.

(b) The amounts authorized are set forth above.

(c) The amounts outstanding at June 30, 2007 are set forth above.

- (d) Amount held as reacquired securities: None.
- (e) Amount pledged by Applicant: None.
- (f) Amount owned by affiliated corporations: None.
- (g) Amount in Sinking Fund or other funds: None.
- (h) Additional information:

(h)1 As of the filing date, the Company had two unsecured, committed bank lines of credit in the amounts of \$5,000,000 and \$10,000,000; and two unsecured, uncommitted bank lines of credit in the amounts of \$35,000,000 and \$30,000,000. For the \$30,000,000 unsecured, uncommitted line of credit, \$5,000,000 of the total line can be used to guarantee letters of credit issued by Chesapeake or one of its subsidiaries for up to 364 days. As of June 30, 2007, the total short-term borrowing outstanding under the bank lines of credit was \$21,500,000.

5. Authorizations Requested

Chesapeake requests authorization from the FPSC to issue up to 793,223 new shares of its common stock during 2008 for the purpose of administering Chesapeake's Retirement Savings Plan, Performance Incentive Plan, Dividend Reinvestment and Stock Purchase Plan, conversion of the Company's Convertible Debentures, Directors Stock Compensation Plan, and Employee Stock Awards Plan. The share breakdown for each specific purpose is as follows:

| <u>Number of Shares</u> | <u>Purpose</u>  |
|-------------------------|---|
| 61,830                  | Issuance pursuant to the Company's Retirement Savings Plan.           |
| 200,000                 | Issuance under the terms of the Company's Performance Incentive Plan. |



|         |  |
|---------|--|
| 400,000 | Issuance pursuant to the Company's Dividend Reinvestment and Stock Purchase Plan.  |
| 111,993 | Issuance under the terms of the Company's outstanding 8 ¼% Convertible Debentures. |
| 14,400  | Issuance pursuant to the Company's Directors Stock Compensation Plan.              |
| 5,000   | Issuance under the terms of the Company's Employee Stock Awards Plan.              |

In addition, Chesapeake is requesting FPSC authorization to issue up to 800,000 shares of Chesapeake stock or an equity-linked instrument equivalent in value in 2008 to permanently finance Chesapeake's ongoing capital expenditure program. The capital expenditure program is subject to continuous review and modification and is funded from short-term borrowings and cash provided by operating activities. The Company, in an effort to manage its capital structure, may from time to time, permanently finance its short-term borrowings through the issuance of common stock or an equity-linked instrument, as opposed to long-term debt.

Chesapeake requests FPSC authorization to issue up to \$40,000,000 in secured an/or unsecured debt during 2008 for general corporate purposes including, but not limited to, working capital, retirement of short-term debt, retirement of long-term debt and capital improvements.

Chesapeake is also requesting FPSC authorization during 2008 to issue up to 3,406,777 shares of common stock and up to \$40,000,000 in secured and/or unsecured debt for possible acquisitions. Due to the nature of typical cash for stock acquisitions, the \$40,000,000 in secured and/or unsecured debt may be initially issued through a bridge loan in the form of notes held by banks or some similar form of short-term obligations. For this reason,

Chesapeake seeks FPSC authorization to exceed the limitation placed on short-term borrowings by Section 366.04, Florida Statutes, so as to issue short-term obligations in an amount not to exceed \$70,000,000 during 2008. The bridge financing would subsequently be refinanced as unsecured long-term debt with an estimated rate of interest of up to 300 basis points above U.S. Treasury rates (or extrapolated U.S. Treasury rates) with equivalent average life.

Chesapeake is also requesting authority to issue up to 1,000,000 shares of Chesapeake preferred stock in 2008, for possible acquisitions, financing transactions, and other general corporate purposes, including potential distribution under the Company's Shareholder Rights Agreement ("Rights Agreement") adopted by the Board of Directors on August 20, 1999.

Chesapeake further seeks FPSC approval to enter into financial agreements with institutions in 2008 to negotiate and execute financial derivatives enabling the Company to lock in its future financing costs and minimize its risk. A financial derivative is a risk-shifting agreement, the value of which is derived from the value of an underlying asset. The underlying asset could be a physical commodity, an interest rate, a company's stock, a stock index, a currency, or virtually any other tradable instrument upon which two parties can agree. A financial derivative can be used for hedging, protecting against financial risk, or can be used to speculate on the movement of commodity or security prices, interest rates or the levels of financial indices. Financial derivatives fall into two categories. One consists of customized, privately negotiated derivatives, referred to as over-the-counter (OTC) derivatives or swaps. The other category consists of standardized, exchangeable derivatives, known generically as futures. In

addition, there are various types of products within each of the two categories. The Company has attempted to identify below some of the financial derivatives that the Company may evaluate in 2008, although the listing is not intended to be all-inclusive. Rather, the Company seeks approval to evaluate and employ those financial derivatives that would mitigate its financial risk associated with a particular financing transaction(s).

Chesapeake is proposing to have the flexibility and authority to enter into the following (a) Treasury rate locks, credit spread locks, interest rate swaps, collars, caps and/or floors (the "Interest Rate Swap Products"); (b) equity collars, floors, prepaid forward contracts, covered calls, forward sales and purchases and/or equity-linked instruments (the "Equity Products"); or (c) any other Financial Derivatives that meet the objectives described above on such terms as Chesapeake considers to be appropriate, provided that the notional amount(s) for said Interest Rate Swap Products, Equity Products, and/or other Financial Derivatives do not, in the aggregate, exceed the sum of \$40,000,000.

Chesapeake Utilities Corporation allocates funds to the Florida Division on an as-needed basis, although in no event would such allocations exceed 75 percent of the proposed equity securities (common stock and preferred stock), long-term debt, short-term debt, Interest Rate Swap Products, Equity Products and Financial Derivatives, pursuant to which approval is being sought by this Application.

6. Purposes for which Securities are to be issued:

(a) Chesapeake's Retirement Savings Plan ("RSP") was implemented on February 1, 1977. As of June 30, 2007, the RSP had 319 active participants; a total market valuation of \$40,680,644 and 483,721 shares of the

Company's common stock. The Company filed a revised RSP Document with the Internal Revenue Service ("IRS"), and received a favorable determination letter. The changes made to the RSP Document were primarily associated with the IRS' most recent Code changes and did not change the underlying features of the administration of the RSP. The key driver in filing the revised RSP Document was the IRS' mandated determination letter filing cycle. A copy of the RSP Document filed with the IRS is included herewith at Exhibit C. Pursuant to the RSP, the first 100% of an employee's contribution, up to a maximum 6% of his/her salary is matched by the Company in shares of Chesapeake common stock. Additional employee dollars that are matched by the Company are invested according to the respective employee's 401(k) designation. The RSP was amended at the end of 1998 to provide for a larger employer matching amount, from 60% to as much as 200%, and at the same time the Company's Pension Plan was closed off to new employees. Accordingly, as the employer-matching amount has increased, so has the number of shares being issued under the RSP.

To continue to balance the composition of debt and equity, Chesapeake wants to maintain flexibility in how the RSP is funded, i.e, with new shares of its stock, buying shares on the open market, and/or a combination of both funding methods.

On June 23, 1992, the Delaware Public Service Commission issued Order No. 3425 approving the issuance of up to 100,000 new shares of Chesapeake common stock for the purpose of administering Chesapeake's RSP. Please note that this Order by the Delaware Public Service Commission is "open ended" in the sense that there is no time limit by which the approved securities need to be issued. A copy of the Order has been

previously filed with the FPSC within Exhibit J of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 931112-GU, dated November 17, 1993, and is hereby incorporated by reference. On July 13, 1999, the Delaware Public Service Commission issued Order No. 5165 approving the issuance of an additional 100,000 new shares of Chesapeake common stock for the purpose of administering the RSP. Please note that this Order by the Delaware Public Service Commission is also “open ended” in the sense that there is no time limit by which approved securities need to be issued. A copy of this Order has been previously filed with the FPSC within Exhibit C of the Application by Chesapeake Utilities Corporation for Authorization to issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed Limitation Placed on Short-Term Borrowings in 2000, Docket No. 991631-GU, dated October 20, 1999, and is hereby incorporated by reference. On December 19, 2000, the Delaware Public Service Commission issued Order No. 5609 approving the issuance of an additional 300,000 new shares of Chesapeake common stock for the purpose of administering the RSP. Please note that this Order by the Delaware Public Service Commission is also “open ended” in the sense that there is no time limit by which approved securities need to be issued. A copy of this Order has been previously filed with the FPSC as Exhibit E of the Consummation Report of Securities Issued by Chesapeake Utilities Corporation, Docket No. 991631-GU, dated March 29, 2001, and is hereby incorporated by reference. Pursuant to these Orders, Chesapeake has issued 438,170 new shares of common stock for the RSP as of June 30, 2007. Thus, there remains to be issued 61,830 shares as authorized by the Delaware Public Service Commission.

The FPSC approved the issuance and sale of up to 91,450 shares of common stock for the Plan during 2007 by Order No. PSC-06-1061-FOF-GU issued on December 26, 2006. Chesapeake now seeks FPSC authorization to issue up to 61,830 new shares of Chesapeake common stock for the purpose of administering Chesapeake's Retirement Savings Plan during 2008.

(b) On May 19, 1992, the common stock shareholders of Chesapeake voted in favor of adopting the Chesapeake Utilities Corporation Performance Incentive Plan ("PIP"). On May 19, 1998, the common stock shareholders of Chesapeake approved several amendments to the PIP. A copy of the amended PIP agreement has been previously filed with the FPSC within Exhibit C of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 981213-GU, dated September 23, 1998, and is hereby incorporated by reference.

The purposes of the PIP are (1) to further the long-term growth and earnings of the Company by providing incentives and rewards to those executive officers and other key employees of the Company and its subsidiaries who are in positions in which they can contribute significantly to the achievement of that growth; (2) to encourage those employees to obtain proprietary interests in the Company and to remain as employees of the Company; and (3) to assist the Company in recruiting able management personnel.

To accomplish these objectives, the PIP authorizes the grant of nonqualified stock options, performance shares of the Company's common stock and stock appreciation rights, or any combination thereof. The PIP, as it was originally adopted by the common stock shareholders of Chesapeake

in 1992, provided that over a ten-year period beginning in 1992, any one or more types of awards for up to a total of 200,000 shares of Chesapeake's common stock may be granted. On June 23, 1992, the Delaware Public Service Commission issued Order No. 3425 approving the issuance of up to 200,000 new shares of Chesapeake common stock for the purpose of administering Chesapeake's PIP. A copy of this Order has been previously filed with the FPSC within Exhibit J of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 931112-GU, dated November 17, 1993, and is hereby incorporated by reference. The amendments to the PIP adopted by the common stock shareholders of Chesapeake on May 19, 1998 changed the terms and provisions of the PIP as follows: (1) the aggregate number of shares of common stock subject to awards was increased from 200,000 shares to 400,000 shares; (2) the term of the PIP was extended for five years through December 31, 2005; and (3) the Board of Directors was granted greater flexibility to amend, modify or terminate the PIP, subject to shareholder approval requirements imposed by applicable law. On July 13, 1999, the Delaware Public Service Commission issued Order No. 5165 approving the issuance of an additional 200,000 new shares of Chesapeake common stock for the purpose of administering the PIP, coinciding with these amendments. A copy of this Order has been previously filed with the FPSC within Exhibit C of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed Limitation Placed on Short-Term Borrowings in 2000, Docket No. 991631-GU, dated October 20, 1999, and is hereby incorporated by reference.

As of June 30, 2007, Chesapeake had zero (0) shares of treasury stock, which can be reissued from the Performance Incentive Plan to satisfy outstanding awards.

Pursuant to the PIP, Chesapeake has issued 140,309 shares of common stock as of June 30, 2007. Thus, there remains to be issued 389,876 shares as authorized by the Delaware Public Service Commission. The FPSC approved the issuance and sale of up to 200,000 shares of common stock for the PIP during 2007 by Order No. PSC-06-1061-FOF-GU, issued on December 26, 2006. The pre-existing PIP expired on December 31, 2005 and the Company's current PIP was effective January 1, 2006. Stock awards granted prior to 2006, were under the authority of the pre-existing PIP. Stock awards granted in 2006 through 2014, to the extent earned and awarded in such years, have been and will continue to be issued under the authority of the current PIP.

On February 24, 2005, Chesapeake's Board of Directors adopted the current PIP, which applied to performance beginning January 1, 2006, and approved 400,000 shares of common stock to be authorized and reserved for issuance. The current PIP as adopted by the common shareholders of Chesapeake on May 5, 2005 allows for the issuance of restricted stock in the form of performance share awards. In addition, the current PIP, allows performance shares to be awarded to those key employees of the Company whom a designated committee, composed of independent directors chosen by the Board determines, are in positions to contribute significantly to the long-term growth, development, and financial success of the Company, and will encourage those employees to obtain proprietary interest in the Company and to remain as employees of the Company as well as to assist the



Company in recruiting able management personnel. Under the current PIP, no more than 25,000 shares are to be awarded to any one executive in any calendar year. The current PIP expires on December 31, 2014. On April 26, 2005, the Delaware Public Service Commission issued Order No. 6607 approving the issuance of 400,000 shares of Chesapeake common stock for the purpose of administering the current PIP. A copy of the Application and Order have been previously filed with the FPSC within Exhibit D of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed Limitation Placed on Short-Term Borrowings in 2006, Docket No. 050630-GU, dated September 21, 2005, and is hereby incorporated by reference.

Chesapeake now seeks FPSC authorization to issue up to 200,000 new shares of Chesapeake common stock for the purpose of administering Chesapeake's Performance Incentive Plan during 2008. The 200,000 shares should be adequate to cover any shares issued in 2008 pursuant to awards granted to executives and other key officers of the Company and its subsidiaries for 2007.

(c) Chesapeake's Dividend Reinvestment and Stock Purchase Plan ("DRP") was implemented on April 27, 1989. The DRP Administrator currently has the flexibility of purchasing shares of Chesapeake common stock on the open market, using Treasury stock or issuing new common stock. The gradual issuance of new common stock enables Chesapeake to balance the composition of its capital between common stock and long-term debt. As of June 30, 2007, the DRP had 1,327 stockholder participants.

A copy of the DRP as filed on Registration Statement Form S-3 with the Securities and Exchange Commission has been previously filed with the FPSC as Exhibit D of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 961194-GU, dated October 1, 1996, and is hereby incorporated by reference. On May 23, 1989, the Delaware Public Service Commission issued Order No. 3071 approving the issuance of up to 200,000 new shares of Chesapeake common stock for the purpose of administering Chesapeake's DRP. Please note that this Order by the Delaware Public Service Commission is "open ended" in the sense that there is no time limit by which the approved securities need to be issued. A copy of this Order has been previously filed with the FPSC within Exhibit J of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 931112-GU, dated November 17, 1993, and is hereby incorporated by reference. On December 20, 1995, the Delaware Public Service Commission issued Order No. 4097 approving the issuance of an additional 300,000 new shares of Chesapeake common stock for the purpose of administering Chesapeake's DRP. Please note that this Order by the Delaware Public Service Commission is also "open ended" in the sense that there is no time limit by which the approved securities need to be issued. A copy of this Order has been previously filed with the FPSC within Exhibit E of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 961194-GU, dated October 1, 1996, and is hereby incorporated by reference. On August 5, 2004, Chesapeake's Board of Directors approved 750,000 additional shares of common stock to be authorized and reserved for issuance under the Dividend Reinvestment and Stock Purchase Plan, as well as several

amendments to the terms of the Plan. The amended plan (a) allows for direct stock purchases by persons who at the times of purchase are not shareholders of the Company; (b) establishes the minimum investment amount for direct stock purchases by persons who are not shareholders of the Company; (c) fixes the minimum monthly and maximum annual optional cash investment limits for participating shareholders; (d) allows for direct debiting of shareholder-designated bank accounts for purchases; and (e) adds a provision to the Plan, whereby the Company, with the prior approval of the Board of Directors or under guidelines adopted by the Board of Directors, could on a case-by-case basis waive the maximum annual optional cash investment limit and accept investments in excess of that amount. On December 21, 2004 the Delaware Public Service Commission issued Order No. 6543, approving the issuance of an additional 750,000 shares of Chesapeake common stock for the purpose of administering Chesapeake's amended Dividend Reinvestment and Stock Purchase Plan. Please note that this Order by the Delaware Public Service Commission is "open ended" in the sense that there is no time limit by which the approved securities need to be issued. A copy of this Order has been previously filed with the FPSC within Exhibit C of the Consummation Report of Securities Issued by Chesapeake Utilities Corporation, Docket No. 030942-GU, dated March 22, 2005, and is hereby incorporated by reference. Pursuant to the Orders above, Chesapeake has issued 593,113 new shares of common stock as of June 30, 2007. Thus, there remains to be issued 656,887 shares as authorized by the Delaware Public Service Commission. The FPSC approved the issuance and sale of up to 400,000 shares for the DRP during 2007 by Order No. PSC-06-1061-FOF-GU, issued on December 26, 2006.

Chesapeake now seeks FPSC approval to issue up to 400,000 new shares of Chesapeake common stock for the purpose of administering Chesapeake's amended Dividend Reinvestment and Stock Purchase Plan during 2008.

(d) On April 4, 1989, Chesapeake issued \$5,000,000 in 8.25% Convertible Debentures as part of a public offering. As of June 30, 2007, \$1,905,000 remained outstanding with a conversion price of \$17.01 per share. Hence, the maximum number of shares of common stock that could be issued upon conversion is 111,993. A true and correct copy of the Registration Statement on Form S-2 dated February 16, 1989, as filed with the Securities and Exchange Commission, has been previously filed with the FPSC as Exhibit I of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 931112-GU, dated November 17, 1993, and is hereby incorporated by reference.

The Debentures had a conversion premium greater than the offering price of the common stock issued, no mandatory sinking fund, and became callable after one year at a premium equal to the interest rate less 1%, declining 1/2% per year thereafter. There is an optional bondholder redemption feature, which allows any debenture holder to present any Debenture for redemption, at par, on the anniversary date of the issue, subject to annual limitations of \$10,000 per debenture holder and \$200,000 in the aggregate. These optional redemption rights began on April 1, 1991. In addition, subject to the annual limitations of \$10,000 per debenture holder and \$200,000 in the aggregate, Chesapeake will redeem the Debentures of deceased debenture holders within 60 days of notification. Such redemption of estate Debentures shall be made prior to other Debentures.

On February 14, 1989, the Delaware Public Service Commission issued Order No. 3040 approving the issuance of \$5,000,000 in Convertible Debentures and, inherently, their potential conversion into Chesapeake common stock. Please note that this Order by the Delaware Public Service Commission is "open ended" in the sense that there is no time limit by which the approved securities need to be issued. A copy of this Order has been previously filed with the FPSC within Exhibit J of the Application for Approval of Issuance and Sale of Securities by Chesapeake Utilities Corporation, Docket No. 931112-GU, dated November 17, 1993, and is hereby incorporated by reference.

As of June 30, 2007, a cumulative \$2,170,000 of the Convertible Debentures has been converted. The FPSC approved the issuance and sale of up to 122,986 new shares of Chesapeake common stock for the purpose of honoring conversion rights pursuant to the Company's Convertible Debentures during 2007, by Order No.PSC-06-1061-FOF-GU, issued on December 26, 2006. Chesapeake now seeks FPSC authorization to issue up to 111,993 new shares of Chesapeake common stock for the purpose of honoring these conversion rights during 2008.

(e) On February 24, 2005, the Board adopted Chesapeake's Directors Stock Compensation Plan (DSCP) and on May 5, 2005, the DSCP received shareholder approval. Under the DSCP each non-employee director who is elected as a director or whose service as a director will continue after the date of the respective Annual Meeting will receive, as compensation for services during the ensuing year, an award of no more than 1,200 shares of the Company's common stock on the date of the Company's Annual Meeting. The DSCP enhances the Company's ability to attract, motivate and retain as

non-employee directors persons of training, experience and ability and to encourage the highest level of non-employee director performance by providing such directors with a proprietary interest in the Company's growth and financial success. The DSCP expires on December 31, 2015.

On April 26, 2005, the Delaware Public Service Commission issued Order No. 6607 authorizing Chesapeake to issue up to 75,000 shares of common stock to administer the Company's DSCP.

A copy of the Application, and Order have been previously filed with the FPSC within Exhibit D, as well as the DSCP plan document within Exhibit F of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed the Limitation Placed on Short-Term Borrowings in 2006, Docket No. 050630-GU, dated September 21, 2005, and is hereby incorporated by reference. The FPSC approved the issuance of up to 14,400 shares of common stock for the DSCP during 2007 by Order No. PSC-06-1061-FOF-GU, issued on December 26, 2006. Pursuant to the DSCP, Chesapeake has issued 17,550 new shares of common stock as of June 30, 2007. Thus, there remains to be issued 57,450 shares as previously authorized by the Delaware Public Service Commission.

Chesapeake now seeks FPSC authorization to issue up to 14,400 new shares of Chesapeake common stock for the purpose of administering Chesapeake's DSCP during 2008. The 14,400 shares should be adequate to cover any awards granted to non-employee directors of the Company in 2008.

(f) The Board adopted the Employee Stock Awards Plan (ESAP) on February 24, 2005; allowing the Company to grant stock awards to its top

performing managers and employees of the year; and to have the flexibility to make other awards of stock to employees for exemplary performance. The ESAP received shareholder approval on May 5, 2005. The maximum number of shares that can be issued from the ESAP in any one year is 5,000. The ESAP expires on December 31, 2015.

On April 26, 2005, the Delaware Public Service Commission issued Order No. 6607 authorizing Chesapeake to issue up to 25,000 shares of common stock to administer the Company's ESAP.

A copy of the Application and Order have been previously filed with the FPSC within Exhibit D, as well as the ESAP document within Exhibit G of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed Limitation Placed on Short-Term Borrowings in 2006, Docket No. 050630-GU, dated September 21, 2005, and is hereby incorporated by reference. The FPSC approved the issuance of up to 5,000 shares of common stock for the ESAP during 2007 by Order No. PSC-06-1061-FOF-GU, issued on December 26, 2006. Pursuant to the ESAP, Chesapeake has issued 700 shares of common stock as of June 30, 2007. Thus, there remains to be issued 24,300 shares as previously authorized by the Delaware Public Service Commission. Chesapeake now seeks FPSC authorization to issue up to 5,000 new shares of Chesapeake common stock for the purpose of administering Chesapeake's ESAP during 2008. The 5,000 shares should be adequate to cover any awards granted to managers and employees of the Company and its subsidiaries in 2008.

(g) On July 5, 2006, Chesapeake filed a Shelf Registration Statement on Form S-3 with the Securities Exchange Commission to issue up to

\$40,000,000 in new common stock and/or debt securities over a three-year period. Under the Shelf Registration, the net proceeds from the sale of common stock and/or debt securities would be added to Chesapeake's *general corporate funds* and used for *general corporate purposes* including, but not limited to, financing of capital expenditures, repayment of short-term debt, funding share repurchases, financing acquisitions, investing in subsidiaries and general working capital purposes. A copy of the Shelf Registration Statement is included herewith at Exhibit D.

On November 9, 2006, Chesapeake filed a Prospectus Supplement with the Securities Exchange Commission pursuant to Rule 424(b)(5). The Prospectus Supplement provided financial information about the Company and described the specific terms of the Company's upcoming common stock offering, including the securities the Company would offer, the price of the offered shares, updated number of shares, delivery date of the sold shares, shares outstanding after the issuance, underwriting discounts and commissions as well as proceeds to the Company. A copy of the Prospectus Supplement is included herewith at Exhibit E.

On November 21, 2006, Chesapeake, pursuant to the Prospectus Supplement completed a public stock offering of 600,300 shares of its common stock at \$30.10 per share. The net proceeds of approximately \$17,200,000 million from the sale of the 600,300 shares of common stock were used to repay a portion of the Company's short-term debt under its unsecured lines of credit. Short-term debt has been used to temporarily finance the Company's utility expansion projects.

In connection with the stock offering of Chesapeake's 600,300 shares of common stock, Chesapeake, on November 30, 2006, completed the sale of



90,045 additional shares of its common stock at \$30.10 per share. The sale of the 90,045 shares of common stock was pursuant to the exercise of the over-allotment option by the underwriters. The net proceeds of approximately \$2,600,000 from the sale of the 90,045 over-allotment shares were used to repay a portion of the Company's short-term debt.

On October 16, 2006, the Delaware Public Service Commission issued Order No. 7065 authorizing Chesapeake to issue up to \$40,000,000 in common stock and/or debt securities over a three-year financing period under the Shelf Registration Statement. A copy of the Application and Order are included herewith at Exhibit F. The FPSC approved the issuance of 800,000 shares of common stock for Chesapeake during 2007 by Order No. PSC-06-1061-FOF-GU, issued on December 26, 2006. As of June 30, 2007, the Company has approximately \$20,000,000 remaining under the Shelf Registration Statement as previously authorized by the Delaware Public Service Commission.

Chesapeake now seeks FPSC approval to issue up to 800,000 shares of Chesapeake stock, or an equity-linked instrument equivalent in value in 2008 to permanently finance Chesapeake's ongoing capital expenditure program. Financing for the Company's capital expenditure program is subject to continuous review and modification and is funded from short-term borrowings and cash provided by operating activities. The Company, in an effort to manage its capital structure, may, from time to time permanently finance through the issuance of common stock or an equity-linked instrument, as opposed to long-term debt.

(h) Chesapeake seeks FPSC authorization to issue during 2008 up to

\$40,000,000 in secured and/or unsecured long-term debt with an estimated rate of interest of up to 300 basis points above U.S. Treasury rates (or extrapolated U.S. Treasury rates) with equivalent average life. A portion of the debt issuance of up to \$40,000,000 in secured and/or unsecured long-term debt may be issued under the Company's existing Shelf Registration Statement with approximately \$20,000,000 remaining under the Shelf Registration Statement as of June 30, 2007. Proceeds from this debt issuance would be used for general corporate purposes including, but not limited to, working capital, retirement of short-term debt, retirement of long-term debt and capital improvements. The FPSC approved the issuance and sale of \$40,000,000 in secured and/or unsecured long-term debt during 2007 by Order No. PSC-06-1061-FOF-GU, issued December 26, 2006. As discussed previously, Chesapeake issued \$20,000,000 of 5.50% Unsecured Senior Notes on October 12, 2006, which are due October 12, 2020.

(i) Chesapeake seeks further FPSC authorization to issue during 2008 up to an additional 3,406,777 shares of common stock and an additional \$40,000,000 in secured and/or unsecured long-term debt with an estimated rate of interest of up to 300 basis points above U.S. Treasury rates (or extrapolated U.S. Treasury rates) with equivalent average life. This additional stock and debt would be used to finance Chesapeake's ongoing acquisition program. Chesapeake expects to continue to search for growth opportunities through acquisitions, which fit its long-range plan to achieve the proper mix of business activities. Financing of acquisitions will depend upon the nature and extent of potential acquisitions as well as current market and economic conditions.

The FPSC approved the issuance and sale of 3,366,164 shares of

common stock and \$40,000,000 in secured and/or unsecured long-term debt for this purpose during 2007 by Order No. PSC-06-1061-FOF-GU, issued on December 26, 2006.

(j) Chesapeake seeks FPSC authorization to issue up to 1,000,000 shares of Chesapeake preferred stock during 2008 for possible acquisitions, financing transactions, and other general corporate purposes, including potential distribution under the Company's Rights Agreement adopted by the Board of Directors on August 20, 1999. The Rights Agreement approved by the Board of Directors is designed to protect the value of the outstanding common stock in the event of an unsolicited attempt by an acquirer to take over the Company in a manner or on terms not approved by the Board of Directors. The Rights Agreement is not intended to prevent a takeover of the Company at a fair price and should not interfere with any merger or business combination approved by the Board of Directors. Copies of the Forms 8-A and 8-K filed with the Securities and Exchange Commission in conjunction with the Rights Agreement have been previously filed with the FPSC as Exhibit D of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt and to Exceed Limitation Placed on Short-Term Borrowings in 2000, Docket No. 991631-GU, dated October 20, 1999, and are hereby incorporated by reference. As of June 30, 2007, zero (0) shares of Chesapeake preferred stock have been issued. The FPSC approved the issuance and sale of up to 1,000,000 shares of Chesapeake preferred stock for possible acquisitions, financing transactions, and other general corporate purposes, including potential distribution under the Company's Rights

Agreement, during 2007 by Order No. PSC-06-1061-FOF-GU, issued on December 26, 2006.

(k) Chesapeake is also requesting authority during 2008 to enter into an agreement for financial derivatives including, but not limited to Interest Rate Swap Products, Equity Products, and/or other Financial Derivatives on such terms as Chesapeake considers appropriate provided that the notional amount(s) for said Interest Rate Swap Products, Equity Products, and/or other Financial Derivatives do not, in the aggregate, exceed the sum of \$40 million. On July 9, 2002, the Delaware Public Service Commission issued Order No. 5989 approving the Company's application for approval of the issuance of certain long-term debt, and acknowledging that the Company was considering entering into, or utilizing Interest Rate Swap Products. While the Company does not consider such Interest Rate Swap Products, Equity Products, and/or other Financial Derivatives to involve the actual issuance of securities within the ambit of Section 366.04 (1), Florida Statutes, in an abundance of caution, Chesapeake requests such authority to the extent the FPSC considers Interest Rate Swap Products, Equity Products, and/or other Financial Derivatives subject to its jurisdiction. In the event that the FPSC does not consider Interest Rate Swap Products, Equity Products, and/or other Financial Derivatives to be jurisdictional, Chesapeake requests that that FPSC issue an Order acknowledging the Company's request and confirming the FPSC's absence of jurisdiction regarding these instruments.

A copy of this Order was filed as Exhibit C of the Application by Chesapeake Utilities Corporation for Authorization to Issue Common Stock, Preferred Stock and Secured and/or Unsecured Debt, and to Enter into Agreements for Interest Rate Swap Products, and to Exceed Limitation

Placed on Short-Term Borrowings in 2004, Docket No. 030942-GU, and is hereby incorporated by reference.

7. Purposes for which Securities are to be issued:

The common stock, preferred stock and long-term debt authorized for issuance will be used for the purpose of administering Chesapeake's Retirement Savings Plan, Performance Incentive Plan, Dividend Reinvestment and Stock Purchase Plan, Directors Stock Compensation Plan, Employee Stock Awards Plan, conversion of the Company's Convertible Debentures, financing of the Company's acquisition program and for other corporate purposes including, but not limited to the following: working capital; retirement of short-term debt; retirement of long-term debt; capital improvements; and potential distribution under the Rights Agreement. Chesapeake believes that Interest Rate Swap Products, Equity Products and other Financial Derivatives would provide Chesapeake with an additional opportunity to achieve lower cost funding of existing and prospective debt and equity placements, as well as enhanced flexibility to manage the Company's exposure to risk as market conditions permit. These are all for lawful objects within the corporate purposes of Chesapeake and compatible with the public interest and are reasonably necessary or appropriate for such purposes

8. Counsel:

The legality of the common stock, preferred stock and debt issuances will be passed upon by William A. Denman, Esquire, Parkowski, Guerke and Swayze, P.A., 116 West Water Street, Dover, Delaware 19904, who will rely on Beth Keating, Esquire, Akerman Senterfitt, Suite 1200, 106 East College Avenue, Tallahassee, Florida 32301, as to matters of Florida law.

9. Other Regulatory Agencies:

Under 26 Del. C Section 215 of the Delaware statutes, Chesapeake is regulated by the Delaware Public Service Commission and, therefore, must file a Prefiling Notice, a Notice, and an Application to obtain approval of the Delaware Commission before issuing new securities which mature more than one (1) year from the date of issuance. In addition, a Notice must be filed if Chesapeake expects to incur short-term indebtedness, which exceeds ten percent of the Company's total capitalization. All necessary applications or registration statements have been or will be made as required and will be made a part of the final consummation report to the FPSC as required by Rule 25-8.009, Florida Administrative Code.

The address of the Delaware Commission is as follows:

Delaware Public Service Commission  
861 Silver Lake Boulevard  
Cannon Building  
Dover, Delaware 19904  
Attention: Bruce H. Burcat, Executive Director

10. Control or ownership:

Applicant is not owned by any other company nor is Applicant a member of any holding company system.

11. Exhibits:

The following exhibits submitted with Applicant's Applications in Docket Nos. 030942-GU, 050630-GU, 060728-GU, 931112-GU, 961194-GU, 981213-GU, and 991631-GU, respectively, are incorporated in the instant Application by reference:

Docket No. 030942-GU

Exhibit C: Delaware Public Service Commission Order No. 6543 dated December 21, 2004 pursuant to Chesapeake Utilities

Corporation Dividend Reinvestment and Direct Stock Purchase Plan (750,000 shares) (as filed with the FPSC 2004 Consummation Report of Securities Issued by Chesapeake Utilities Corporation on March 22, 2005).

Exhibit C: Delaware Public Service Commission Order No. 5989 dated July 9, 2002 authorizing the issuance of long-term debt.

Docket No. 050630-GU

Exhibit C: Delaware Public Service Commission Order No. 6708 dated September 6, 2005 for the Issuance of up to \$20,000,000 of Chesapeake Utilities Corporation 5.50% Unsecured Senior Notes;

and

Chesapeake Utilities Corporation Agreement in Principle with Prudential Investment Management (doing business as Prudential Capital).

Exhibit D: Delaware Public Service Commission Application and Order No. 6607 dated April 26, 2005 for the Issuance of up to 500,000 shares of Chesapeake Utilities Corporation Common Stock for administering Chesapeake Utilities Corporation Performance Incentive Plan, Directors Stock Compensation Plan and Employee Stock Awards Plan.

Exhibit E: A copy of Chesapeake Utilities Corporation Performance Incentive Plan document (400,000 shares).

Exhibit F: A copy of Chesapeake Utilities Corporation Directors Stock Compensation Plan document (75,000 shares).

Exhibit G: A copy of Chesapeake Utilities Corporation's Employee Stock Awards Plan document (25,000 shares).

Exhibit H: Delaware Public Service Commission Application and Order No. 6543 dated December 21, 2004 for the issuance of Chesapeake Utilities Corporation Common Stock to satisfy 30,000 Outstanding Warrants (30,000 shares).

Docket No. 060728-GU

Exhibit C: \$20,000,000 Note Agreement for Chesapeake Utilities Corporation 5.50% Unsecured Senior Notes.

Docket No. 931112-GU

Exhibit I: Chesapeake Utilities Corporation Public Offering of Common Stock and Convertible Debentures as filed with the Securities and Exchange Commission on Registration Statement Form S-2 dated February 16, 1989.

Exhibit J: Delaware Public Service Commission Order No. 3425 dated June 23, 1992 for the Issuance of Common Stock pursuant to Chesapeake Utilities Corporation Retirement Savings Plan (100,000 shares);

Delaware Public Service Commission Order No. 3425 dated June 23, 1992 for Issuance of Common Stock pursuant to Chesapeake Utilities Corporation Performance Incentive Plan (200,000 shares);

Delaware Public Service Commission Order No. 3071 dated May 23, 1989 for the Issuance of Common Stock pursuant to Chesapeake Utilities Corporation Dividend Reinvestment and Direct Stock Purchase Plan (200,000 shares);

and

Delaware Public Service Commission Order No. 3040 dated February 14, 1989 authorizing \$5,000,000 for Chesapeake Utilities Corporation 8.25% Convertible Debentures.

Docket No. 961194-GU

Exhibit D: Chesapeake Utilities Corporation Dividend Reinvestment and Stock Purchase Plan as filed with the Securities and Exchange Commission on Registration Statement Form S-3 dated December 1, 1995.

Exhibit E: Delaware Public Service Commission Order No. 4097 dated December 20, 1995, for the issuance of 300,000 shares pursuant to Chesapeake Utilities Corporation's Dividend Reinvestment and Stock Purchase Plan.

Docket No. 981213-GU

Exhibit C: Chesapeake Utilities Corporation Amended Performance Incentive Plan.

Docket No. 981213-GU (as amended on June 25, 1999)

Exhibit A: Chesapeake Utilities Corporation Retirement Savings Plan-Plan Document.

Exhibit B: Chesapeake Utilities Corporation Retirement Savings Plan-Adoption Agreement.



Docket No. 991631-GU

- Exhibit C: Delaware Public Service Commission Order No. 5165 dated July 13, 1999 for the Issuance of Common Stock pursuant to Chesapeake Utilities Corporation Retirement Savings Plan (100,000 shares) and Chesapeake Utilities Corporation Performance Incentive Plan (200,000 shares).
- Exhibit D: Securities and Exchange Commission Form 8-A For Registration of Certain Classes of Securities Pursuant to Section 12(B) or 12(G) of the Securities Exchange Act of 1934 Securities and Exchange Commission Form 8-K Current Report.
- Exhibit E: Delaware Public Service Commission Order No. 5609 dated December 19, 2000 pursuant to Chesapeake Utilities Corporation Retirement Savings Plan (300,000 shares) (as filed with the FPSC Consummation Report of Securities Issued by Chesapeake Utilities Corporation on March 29, 2001).

Filed herewith:

- Exhibit A: Exhibit A consists of the following attachments:
- A(1) Chesapeake Utilities Corporation Annual Report on Form 10-K for the year ended December 31, 2006.
- A(2) Chesapeake Utilities Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2007.
- Exhibit B: Sources and Uses of Funds Statement and Construction Budget.
- Exhibit C: Retirement Savings Plan Document filed with the Internal Revenue Service dated January 30, 2007, effective January 1, 2006.
- Exhibit D: Chesapeake Utilities Corporation Public Offering of Common Stock as filed with the Securities and Exchange Commission on Registration Statement Form S-3 dated July 5, 2006.
- Exhibit E: Chesapeake Utilities Corporation Prospectus Supplement as filed with the Securities and Exchange Commission pursuant to Rule 424(b)(5) dated November 9, 2006.
- Exhibit F: Delaware Public Service Commission Application and Order No. 7065 dated October 16, 2006 for the issuance of up to \$40,000,000 in common stock and/or debt securities over a three-year financing period pursuant to Chesapeake Utilities Corporation's Shelf Registration Statement.

12. Constitutionality of Statute:

Chesapeake has taken the position that the statutory requirement of FPSC approval of the issuance and sale of securities by a public utility, under Section 366.04 (1), Florida Statutes, as applied to Chesapeake, a Delaware corporation engaged in interstate commerce, is unconstitutional, in that it creates an unreasonable burden on interstate commerce. Support for this position is set out in Chesapeake's Petition for declaratory statement disclaiming jurisdiction, as filed in FPSC Docket No. 930705-GU. By FPSC Order No. PSC-93-1548-FOF-GU, issued on October 21, 1993, the FPSC denied the Petition for declaratory statement, while approving the alternative Application for approval of the issuance of up to 100,000 new shares of common stock for the purpose of administering a Retirement Savings Plan. The FPSC found that "the facial constitutionality of a statute cannot be decided in an administrative proceeding," and that since the stock issuance was approved, "the question of constitutionality appears to be academic at this time."

Chesapeake continues to maintain that the assertion of jurisdiction by the FPSC over its securities unconstitutionally burdens interstate commerce, particularly where the Public Service Commission of the State of Delaware has approved their issuance and sale, and/or where the securities do not create a lien or encumbrance on assets of Chesapeake's public utility operations in the State of Florida.

Florida law provides for severe penalties for any willful violation of a statute administered by the FPSC or any of its rules or orders, Secs. 350.127 (1) and 366.095, Florida Statutes. Accordingly, Chesapeake believes it must


submit to FPSC jurisdiction over its securities if it is to avoid assessment of such penalties and to otherwise remain in good standing before the FPSC. It therefore files the instant Application, under protest, and without waiver of its position regarding the unconstitutionality of the statute.

**PRAYER FOR RELIEF**

Based on the foregoing, Chesapeake Utilities Corporation requests that the FPSC issue an Order authorizing it in 2008 to issue up to 5,000,000 shares of common stock, up to 1,000,000 shares of preferred stock, and up to \$80,000,000 of secured and/or unsecured debt, and authorizing it to enter into agreements up to \$40,000,000 in Interest Rate Swap Products, Equity Products and other Financial Derivatives, and to exceed the limitation placed on short-term borrowings by Section 366.04, Florida Statutes, so as to issue up to \$70,000,000 in short-term obligations.

Respectfully submitted,

Date: October 4, 2007

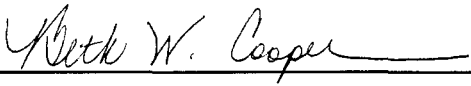


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(850) 222-0103 (Fax)


Attorneys for  
Chesapeake Utilities Corporation

STATE OF DELAWARE       \*  
  \*  
COUNTY OF KENT       \*       SS

BE IT REMEMBERED that on this the day of October 1, 2007, personally appeared before me, a Notary Public for the State of Delaware, Beth W. Cooper, who being by me duly sworn, did depose and say that she is Vice President, Treasurer and Corporate Secretary of Chesapeake Utilities Corporation, a Delaware corporation, and that insofar as the Application of Chesapeake Utilities Corporation states facts, and insofar as those facts are within her personal knowledge, they are true; and insofar as those facts that are not within her personal knowledge, she believes them to be true, that the exhibits accompanying this Application and attached hereto are true and correct copies of the originals of the aforesaid exhibits, and that she has executed this Application on behalf of the Company and pursuant to the authorization of its Board of Directors.

  
\_\_\_\_\_  
Beth W. Cooper  
Vice President, Treasurer and  
Corporate Secretary

SWORN TO AND SUBSCRIBED before me the day and year first above written.

  
\_\_\_\_\_  
Notary Public  
My Commission Expires: 2/19/08

## EXHIBIT A

- A(1) Chesapeake Utilities Corporation Annual Report on Form 10-K for the year ended December 31, 2006.
- A(2) Chesapeake Utilities Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2007.

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-K**

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

For the Fiscal Year Ended: December 31, 2006      Commission File Number: 001-11590

**CHESAPEAKE UTILITIES CORPORATION**

(Exact name of registrant as specified in its charter)

State of Delaware  
(State or other jurisdiction of  
incorporation or organization)

51-0064146  
(I.R.S. Employer  
Identification No.)

909 Silver Lake Boulevard, Dover, Delaware 19904  
(Address of principal executive offices, including zip code)

302-734-6799  
(Registrant's telephone number, including area code)

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

| <u>Title of each class</u>                 | <u>Name of each exchange on which registered</u> |
|--|--|
| Common Stock - par value per share \$.4867 | New York Stock Exchange, Inc.                    |

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

8.25% Convertible Debentures Due 2014  
(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes [  ]. No [X].

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer [  ]      Accelerated filer [X]      Non-accelerated filer [  ]

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

The aggregate market value of the common shares held by non-affiliates of Chesapeake Utilities Corporation as of June 30, 2006, the last business day of its most recently completed second fiscal quarter, based on the last trade price on that date, as reported by the New York Stock Exchange, was approximately \$179.2 million.

As of March 8, 2007, 6,717,348 shares of common stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2007 Annual Meeting of Stockholders are incorporated by reference in Part III.

**CHESAPEAKE UTILITIES CORPORATION**  
**FORM 10-K**  
**YEAR ENDED DECEMBER 31, 2006**

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## PART I

References in this document to “Chesapeake,” “the Company,” “we,” “us” and “our” mean Chesapeake Utilities Corporation and/or its wholly owned subsidiaries, as appropriate.

### Safe Harbor for Forward-Looking Statements

Chesapeake Utilities Corporation has made statements in this Form 10-K that are considered to be “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not matters of historical fact and are typically identified by words such as, but not limited to, “believes,” “expects,” “intends,” “plans,” and similar expressions, or future or conditional verbs such as “may,” “will,” “should,” “would,” and “could”. These statements relate to matters such as customer growth, changes in revenues or gross margins, capital expenditures, environmental remediation costs, regulatory trends and decisions, market risks associated with our propane operations, the competitive position of the Company and other matters. It is important to understand that these forward-looking statements are not guarantees, but are subject to certain risks and uncertainties and other important factors that could cause actual results to differ materially from those in the forward-looking statements. The factors that could cause actual results to differ materially from the Company’s expectations include, but are not limited to those discussed in Item 1A “Risk Factors.”

### ITEM 1. BUSINESS.

#### (a) General Development of Business

Chesapeake is a diversified utility company engaged directly or through subsidiaries in natural gas distribution, transmission and marketing, propane distribution and wholesale marketing, advanced information services and other related businesses. Chesapeake is a Delaware corporation that was formed in 1947.

Chesapeake’s three natural gas distribution divisions serve approximately 59,100 residential, commercial and industrial customers in central and southern Delaware, Maryland’s Eastern Shore and parts of Florida. The Company’s natural gas transmission subsidiary, Eastern Shore Natural Gas Company (“Eastern Shore” or “ESNG”), operates a 366-mile interstate pipeline system that transports gas from various points in Pennsylvania to the Company’s Delaware and Maryland distribution divisions, as well as to other utilities and industrial customers in southern Pennsylvania, Delaware and on the Eastern Shore of Maryland. Our propane distribution operation serves approximately 33,300 customers in central and southern Delaware, the Eastern Shore of Maryland and Virginia, southeastern Pennsylvania, and parts of Florida. The advanced information services segment provides domestic and international clients with information technology related business services and solutions for both enterprise and e-business applications.

#### (b) Financial Information about Industry Segments

Financial information by business segment is included in Item 8 under the heading “Notes to Consolidated Financial Statements — Note C.”

#### (c) Narrative Description of Business

Chesapeake is engaged in three primary business activities: natural gas distribution, transmission and marketing, propane distribution and wholesale marketing and advanced information services. In addition to the primary groups, Chesapeake has subsidiaries in other related businesses.

##### *(i) (a) Natural Gas Distribution, Transmission and Marketing*

###### **General**

Chesapeake distributes natural gas to residential, commercial and industrial customers in central and southern Delaware, the Salisbury and Cambridge, Maryland areas on Maryland’s Eastern Shore and parts of Florida. These activities are conducted through three utility divisions, one division in Delaware, another in Maryland and a third division in Florida. The Company also offers natural gas supply and supply management services in the state of Florida through its subsidiary, Peninsula Energy Services Company, Inc. (“PESCO”).

Delaware and Maryland. Chesapeake's Delaware and Maryland utility divisions serve approximately 45,400 customers, of which approximately 45,200 are residential and commercial customers purchasing gas primarily for heating purposes. The remaining customers are industrial. For the year 2006, residential and commercial customers accounted for approximately 77% of the volume delivered by the divisions and 75% of the divisions' revenue.

Florida. The Florida division distributes natural gas to approximately 13,630 residential and commercial and 100 industrial customers in the 13 Counties of Polk, Osceola, Hillsborough, Gadsden, Gilchrist, Union, Holmes, Jackson, Desoto, Suwannee, Liberty, Washington and Citrus. Currently, the industrial customers, which purchase and transport gas on a firm basis, account for approximately 92% of the volume delivered by the Florida division and 43% of the revenues. These customers are primarily engaged in the citrus and phosphate industries and in electric cogeneration.

PESCO provides natural gas supply and supply management services to commercial and industrial end users in Florida. During 2005, Chesapeake formed a wholly owned subsidiary, Peninsula Pipeline Company, Inc. to provide natural gas transportation services to industrial customers by an intra-state pipeline.

Eastern Shore. The Company's wholly owned transmission subsidiary, Eastern Shore, owns and operates an interstate natural gas pipeline and provides open access transportation services for affiliated and non-affiliated companies through an integrated gas pipeline extending from southeastern Pennsylvania through Delaware to its terminus on the Eastern Shore of Maryland. Eastern Shore also provides swing transportation service and contract storage services. Eastern Shore's rates and services are subject to regulation by the Federal Energy Regulatory Commission ("FERC").

#### **Adequacy of Resources**

General. The Delaware and Maryland divisions have both firm and interruptible contracts with four interstate "open access" pipelines including Eastern Shore. The divisions are directly interconnected with Eastern Shore and services upstream of Eastern Shore are contracted with Transcontinental Gas Pipeline Corporation ("Transco"), Columbia Gas Transmission Corporation ("Columbia") and Columbia Gulf Transmission Company ("Gulf"). None of the upstream service providers are affiliates of the Company. The divisions use their firm transportation supply resources to meet a significant percentage of their projected demand requirements. In order to meet the difference between firm supply and firm demand, the divisions purchase natural gas supply on the spot market from various suppliers. This gas is transported by the upstream pipelines and delivered to the divisions' interconnects with Eastern Shore. The divisions also have the capability to use propane-air peak-shaving to supplement or displace the spot market purchases. The Company believes that the availability of gas supply and transportation to the Delaware and Maryland divisions is adequate under existing arrangements to meet the anticipated needs of their customers.

Delaware. The Delaware division's contracts with Transco include: (a) firm transportation capacity of 9,029 dekatherms ("Dt") per day, with provisions to continue from year to year, subject to 180 days notice for termination; (b) firm transportation capacity of 311 Dt per day for December through February, with provisions to continue such contract on a year to year basis, subject to 180 days notice for termination; (c) firm transportation capacity of 174 Dt per day, which expires in 2008; (d) firm transportation capacity of 1,842 Dt, which expires in 2009; (e) firm storage service, providing a peak day entitlement of 1,680 Dt and a total capacity of 142,830 Dt, with provisions to continue such contract on a year to year basis, subject to 180 days notice for termination; and (f) firm storage service, providing a peak day entitlement of 1,786 Dt and a total capacity of 17,967 Dt, which expires in 2013.

The Delaware division's contracts with Columbia include: (a) firm transportation capacity of 880 Dt per day, which expires in 2014; (b) firm transportation capacity of 1,132 Dt per day, which expires in 2017; (c) firm transportation capacity of 549 Dt per day, which expires in 2018; (d) firm transportation capacity of 899 per day, which expires in 2019; (e) firm storage service providing a peak day entitlement of 6,193 Dt and a total capacity of 298,195 Dt, which expires in 2015; (f) firm storage service, providing a peak day entitlement of 635 Dt and a total capacity of 57,139

Dt, which expires in 2018; (g) firm storage service providing a peak day entitlement of 583 Dt and a total capacity of 52,460 Dt, which expires in 2019; (h) firm storage service providing a peak day entitlement of 583 Dt and a total capacity of 52,460 Dt, which expires in 2020; (i) firm storage service providing a peak day entitlement of 15 Dt and a total capacity of 1,350 Dt, which expires in 2018; and (j) firm storage service providing a peak day entitlement of 215 Dt and a total capacity of 10,646 Dt, which expires in 2010. Delaware's contracts with Columbia for storage-related transportation provide quantities that are equivalent to the peak day entitlement for the period of October through March and are equivalent to fifty percent (50%) of the peak day entitlement for the period of April through September. The terms of the storage-related transportation contracts mirror the storage services that they support.

The Delaware division's contract with Gulf, which expires in 2009, provides firm transportation capacity of 880 Dt per day for the period November through March and 809 Dt per day for the period April through October.

The Delaware division's contracts with Eastern Shore include: (a) firm transportation capacity of 53,637 Dt per day for the period December through February, 52,415 Dt per day for the months of November, March and April, and 43,339 Dt per day for the period May through October, with various expiration dates ranging from 2007 to 2017; (b) firm storage capacity providing a peak day entitlement of 2,655 Dt and a total capacity of 131,370 Dt, which expires in 2013; (c) firm storage capacity providing a peak day entitlement of 580 Dt and a total capacity of 29,000 Dt, which expires in 2013; (d) firm storage capacity providing a peak day entitlement of 911 Dt and a total capacity of 5,708 Dt, with provisions to continue such contract on a year to year basis, subject to 180 days notice for termination.

The Delaware division currently has contracts for the purchase of firm natural gas supply with several suppliers. These supply contracts provide the availability of a maximum firm daily entitlement of 37,500 Dt and delivered on Transco, Columbia, and/or Gulf systems to Eastern Shore for redelivery under firm transportation contracts. The gas purchase contracts have various expiration dates and daily quantities may vary from day to day and month to month.

Maryland. The Maryland division's contracts with Transco include: (a) firm transportation capacity of 4,738 Dt per day, with provisions to continue such contract on a year to year basis, subject to 180 days notice for termination; (b) firm transportation capacity of 155 Dt per day for December through February, with provisions to continue such contract on a year to year basis, subject to 180 days notice for termination; (c) firm transportation capacity of 973 Dt, which expires in 2009; (d) firm storage service providing a peak day entitlement of 390 Dt and a total capacity of 33,120 Dt, with provisions to continue such contract on a year to year basis, subject to 180 days notice for termination; and (e) firm storage service, providing a peak day entitlement of 546 Dt and a total capacity of 5,489 Dt, which expires in 2013.

The Maryland division's contracts with Columbia include: (a) firm transportation capacity of 442 Dt per day, which expires in 2014; (b) firm transportation capacity of 908 Dt per day, which expires in 2017; (c) firm transportation capacity of 350 Dt per day, which expires in 2018; (d) firm storage service providing a peak day entitlement of 3,142 Dt and a total capacity of 154,756 Dt, which expires in 2015; (e) firm storage service providing a peak day entitlement of 521 Dt and a total capacity of 46,881 Dt, which expires in 2018; and (f) firm transportation capacity of 1,832 Dt per day for the period April through September. The Maryland division's contracts with Columbia for storage-related transportation provide quantities that are equivalent to the peak day entitlement for the period October through March and are equivalent to fifty percent (50%) of the peak day entitlement for the period April through September. The terms of the storage-related transportation contracts mirror the storage services that they support.

The Maryland division's contract with Gulf, which expires in 2009, provides firm transportation capacity of 590 Dt per day for the period November through March and 543 Dt per day for the period April through October.

The Maryland division's contracts with Eastern Shore include: (a) firm transportation capacity of 18,982 Dt per day for the period December through February, 18,254 Dt per day for the months of November, March and April and

13,674 Dt per day for the period May through October, with various expiration dates ranging from 2007 to 2015; (b) firm storage capacity providing a peak day entitlement of 1,428 Dt and a total capacity of 70,665 Dt, which expires in 2013; (c) firm storage capacity providing a peak day entitlement of 309 Dt and a total capacity of 15,500 Dt, which expires in 2013; and (d) firm storage capacity providing a peak day entitlement of 569 Dt and a total capacity of 3,560 Dt, with provisions to continue such contract on a year to year basis, subject to 180 days notice for termination.

The Maryland division currently has contracts for the purchase of firm natural gas supply with several suppliers. These supply contracts provide the availability of a maximum firm daily entitlement of 11,500 Dt delivered on Transco, Columbia, and/or Gulf systems to Eastern Shore for redelivery under the Maryland division's transportation contracts. The gas purchase contracts have various expiration dates and daily quantities may vary from day to day and month to month.

Florida. The Florida division receives natural gas from Florida Gas Transmission Company ("FGT") and Gulfstream Natural Gas System ("Gulfstream"). The Florida division has firm transportation agreements with both of these interstate pipelines. All of the capacity under these agreements has been released to various third parties and PESCO, our natural gas marketing subsidiary. Under terms of these capacity release agreements, Chesapeake is contingently liable to FGT and Gulfstream should the party that acquired the capacity through release fail to pay for the service.

Chesapeake's contracts with FGT include transportation service for: (a) daily firm transportation capacity of 27,519 Dt in November through April; 21,123 Dt in May through September, and 27,105 Dt in October, which expires in 2010; and (b) daily firm transportation capacity of 1,000 Dt daily, which expires in 2015.

Chesapeake's contracts with Gulfstream include transportation service for daily firm transportation capacity of 10,000 Dt daily. The contract with Gulfstream expires May 31, 2022.

PESCO currently has contracts with Eagle Energy Partners and Prior Energy for the purchase of firm natural gas supply. The Eagle Energy Partners' contract provides the availability of a maximum firm daily entitlement of 10,000 MMBtus and has an expiration date of May 2007. The Prior Energy contract provides the availability of a maximum firm daily entitlement of 7,500 MMBtus and has an expiration date of May 2007.

Eastern Shore. Eastern Shore also has contracts with Transco for: (a) 7,046 Mcf of firm peak day storage entitlements and total storage capacity of 278,264 Mcf, which expires in 2013.

Eastern Shore has retained the firm transportation capacity and firm storage services described above in order to provide swing transportation service and storage service to those customers that requested such service.

### **Competition**

See discussion on competition in Item 7 under the heading "Management's Discussion and Analysis — Competition."

### **Rates and Regulation**

General. Chesapeake's natural gas distribution divisions are subject to regulation by the Delaware, Maryland and Florida Public Service Commissions with respect to various aspects of the business, including the rates for sales and transportation to all customers in each respective jurisdiction. All of Chesapeake's firm distribution sales rates are subject to gas cost recovery mechanisms, which match revenues with gas costs and normally allow eventual full recovery of gas costs. Adjustments under these mechanisms, which are limited to gas costs, require periodic filings and hearings with the relevant regulatory authority.

Eastern Shore is subject to regulation by the FERC as an interstate pipeline. The FERC regulates the provision of service, terms and conditions of service, and the rates Eastern Shore can charge for its transportation and storage services.

Management monitors the achieved rate of return in each jurisdiction in order to ensure the timely filing of rate cases.

### ***Regulatory Proceedings***

See discussion of regulatory activities in Item 7 under the heading “Management’s Discussion and Analysis — Regulatory Activities.”

### ***(i) (b) Propane Distribution and Wholesale Marketing***

#### ***General***

Chesapeake’s propane distribution group consists of (1) Sharp Energy, Inc. (“Sharp Energy”), a wholly owned subsidiary of Chesapeake, (2) Sharpgas, Inc. (“Sharpgas”), a wholly owned subsidiary of Sharp Energy, and (3) Tri-County Gas Co., Incorporated (“Tri-County”), a wholly owned subsidiary of Sharp Energy. The propane wholesale marketing group consists of Xeron, Inc. (“Xeron”), a wholly owned subsidiary of Chesapeake.

Propane is a form of liquefied petroleum gas, which is typically extracted from natural gas or separated during the crude oil refining process. Although propane is a gas at normal pressure, it is easily compressed into liquid form for storage and transportation. Propane is a clean-burning fuel, gaining increased recognition for its environmental superiority, safety, efficiency, transportability and ease of use relative to alternative forms of energy. Propane is sold primarily in suburban and rural areas, which are not served by natural gas distributors. Demand is typically much higher in the winter months and is significantly affected by seasonal variations, particularly the relative severity of winter temperatures, because of its use in residential and commercial heating.

During 2006, our propane distribution operations served approximately 33,300 propane customers on the Delmarva Peninsula, southeastern Pennsylvania and in Florida and delivered approximately 24.2 million retail and wholesale gallons of propane.

In May 1998, Chesapeake acquired Xeron, a natural gas liquids trading company located in Houston, Texas. Xeron markets propane to large independent and petrochemical companies, resellers and southeastern retail propane companies in the United States. Additional information on Xeron’s trading and wholesale marketing activities, market risks and the controls that limit and monitor the risks are included in Item 7 under the heading “Management’s Discussion and Analysis — Market Risk.”

The propane distribution business is affected by many factors, such as seasonality, the absence of price regulation, and competition among local providers. The propane wholesale marketing business is affected by wholesale price volatility and the supply and demand for propane at a wholesale level.

### ***Adequacy of Resources***

The Company’s propane distribution operations purchase propane primarily from suppliers, including major oil companies and independent producers of natural gas liquids. Supplies of propane from these and other sources are readily available for purchase by the Company. Supply contracts generally include minimum (not subject to take-or-pay premiums) and maximum purchase provisions.

The Company’s propane distribution operations use trucks and railroad cars to transport propane from refineries, natural gas processing plants or pipeline terminals to its bulk storage facilities. From these facilities, propane is delivered primarily by “bobtail” trucks, owned and operated by the Company, to tanks located at the customer’s premises.

Xeron does not own physical storage facilities or equipment to transport propane; however, it contracts for storage and pipeline capacity to facilitate the sale of propane on a wholesale basis.

**Competition**

See discussion on competition in Item 7 under the heading “Management’s Discussion and Analysis — Competition.”

**Rates and Regulation**

The propane distribution and wholesale marketing activities are not subject to any federal or state pricing regulation. Transport operations are subject to regulations concerning the transportation of hazardous materials promulgated under the Federal Motor Carrier Safety Act, which is administered by the United States Department of Transportation and enforced by the various states in which such operations take place. Propane distribution operations are also subject to state safety regulations relating to “hook-up” and placement of propane tanks.

The Company’s propane operations are subject to all operating hazards normally associated with the handling, storage and transportation of combustible liquids, such as the risk of personal injury and property damage caused by fire. The Company carries general liability insurance in the amount of \$35 million, but there is no assurance that such insurance will be adequate.

**(i) (c) Advanced Information Services**

**General**

Chesapeake’s advanced information services segment consists of BravePoint, Inc. (“BravePoint”), a wholly owned subsidiary of the Company. BravePoint, headquartered in Norcross, Georgia, provides domestic and international clients with information technology related business services and solutions for both enterprise and e-business applications.

**Competition**

See discussion on competition in Item 7 under the heading “Management’s Discussion and Analysis — Competition.”

**(i) (d) Other Subsidiaries**

Skipjack, Inc. (“Skipjack”), Eastern Shore Real Estate, Inc. and Chesapeake Investment Company are wholly owned subsidiaries of Chesapeake Service Company. Skipjack and Eastern Shore Real Estate, Inc. own and lease office buildings in Delaware and Maryland to affiliates of Chesapeake. Chesapeake Investment Company is a Delaware affiliated investment company. During 2004, Chesapeake formed a new company, OnSight Energy, LLC (“OnSight”), to provide distributed energy solutions to customers requiring reliable, uninterrupted energy sources and/or those wishing to reduce energy costs.

**(ii) Seasonal Nature of Business**

Revenues from the Company’s residential and commercial natural gas sales and from its propane distribution activities are affected by seasonal variations, since the majority of these sales are to customers using the fuels for heating purposes. Revenues from these customers are accordingly affected by the mildness or severity of the heating season.

**(iii) Capital Budget**

A discussion of capital expenditures by business segment and capital expenditures for environmental control facilities are included in Item 7 under the heading “Management Discussion and Analysis — Liquidity and Capital Resources.”

***(iv) Employees***

As of December 31, 2006, Chesapeake had 437 employees, including 193 in natural gas, 142 in propane and 70 in advanced information services. The remaining 32 employees are considered general and administrative and include officers of the Company, treasury, accounting, internal audit, information technology, human resources and other administrative personnel.

***(v) Executive Officers of the Registrant***

Information pertaining to the executive officers of the Company is as follows:

John R. Schimkaitis (age 59) Mr. Schimkaitis is President and Chief Executive Officer of Chesapeake and its subsidiaries. Mr. Schimkaitis assumed the role of Chief Executive Officer on January 1, 1999. He has served as President since 1997. Prior to this, Mr. Schimkaitis served as President and Chief Operating Officer, Executive Vice President, Senior Vice President, Chief Financial Officer, Vice President, Treasurer, Assistant Treasurer and Assistant Secretary of Chesapeake.

Michael P. McMasters (age 48) Mr. McMasters is Senior Vice President and Chief Financial Officer of Chesapeake Utilities Corporation. He was appointed Senior Vice President in 2004 and has served as Chief Financial Officer since December 1996. He has previously held the positions of Vice President, Treasurer, Director of Accounting and Rates, and Controller. From 1992 to May 1994, Mr. McMasters was employed as Director of Operations Planning for Equitable Gas Company.

Stephen C. Thompson (age 46) Mr. Thompson is President of Eastern Shore Natural Gas Company and Senior Vice President of Chesapeake Utilities Corporation. Prior to becoming Senior Vice President in 2004, he served as Vice President of Chesapeake since May 1997. He has also served as Vice President, Director of Gas Supply and Marketing, Superintendent of Eastern Shore and Regional Manager for the Florida distribution operations.

Beth W. Cooper (age 40) Ms. Cooper is Vice President, Treasurer and Corporate Secretary of Chesapeake Utilities Corporation. Ms. Cooper has served as Corporate Secretary since July 2005. She previously served as Assistant Treasurer and Assistant Secretary, Director of Internal Audit, Director of Strategic Planning, Planning Consultant, Accounting Manager for Non-regulated Operations and Treasury Analyst. Prior to joining Chesapeake, she was employed as an auditor with Ernst & Young's Entrepreneurial Services Group.

S. Robert Zola (age 54) Mr. Zola joined Sharp Energy in August of 2002 as President. Prior to joining Sharp Energy, Mr. Zola most recently served as Northeast Regional Manager of Synergy Gas, now Cornerstone MLP, in Philadelphia, PA. During his 26-year career in the propane industry, Mr. Zola also started Bluestreak Propane in Phoenix, AZ, which after successfully developing the business, was sold to Ferrell Gas.

***(vi) Financial Information about Geographic Areas***

All of the Company's material operations, customers, and assets occur and are located in the United States.

***(d) Available Information***

As a public company, Chesapeake files annual, quarterly and other reports, as well as its annual proxy statement and other information, with the Securities and Exchange Commission ("SEC"). The public may read and copy any materials that the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E. Washington, DC 20549-5546; and the public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an Internet site that contains reports, proxy and information statements and other information regarding the Company. The address of the SEC's Internet website is [www.sec.gov](http://www.sec.gov). Chesapeake makes available, free of charge, on its Internet website its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to those reports, as soon as reasonably practicable after such reports are electronically filed with or furnished to the SEC. The address of Chesapeake's Internet website is [www.chpk.com](http://www.chpk.com). The content of this website is not part of this report.

Chesapeake has a Business Code of Ethics and Conduct applicable to all employees, officers and directors and a Code of Ethics for Financial Officers. Copies of the Business Code of Ethics and Conduct and the Financial Officer Code of Ethics are available on its internet website. Chesapeake also adopted Corporate Governance Guidelines and Charters for the Audit Committee, Compensation Committee, and Governance Committee of the Board of Directors, each of which satisfies the regulatory requirements established by the Securities and Exchange Commission and the New York Stock Exchange ("NYSE"). The Board of Directors has also adopted "Corporate Governance Guidelines on Director Independence," which conform to the NYSE listing standards on director independence. Each of these documents also is available on Chesapeake's Internet website or may be obtained by writing to: Corporate Secretary; c/o Chesapeake Utilities Corporation; 909 Silver Lake Blvd.; Dover, DE 19904.

If Chesapeake makes any amendment to, or grants a waiver of, any provision of the Business Code of Ethics and Conduct or the Financial Officer Code of Ethics applicable to its principal executive officer, principal financial officer, principal accounting officer or controller, the amendment or waiver will be disclosed within five business days on the Company's Internet website.

#### **ITEM 1A. RISK FACTORS.**

The following is a discussion of the primary factors that may affect the operations and/or financial performance of the regulated and unregulated businesses of Chesapeake. Refer to the section entitled "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" under Item 7 of this report for an additional discussion of these and other related factors that affect the Company's operations and/or financial performance. The principal business, economic and other factors that affect the operations and/or financial performance of the Company include:

***Fluctuations in weather have the potential to adversely affect our results of operations, cash flows and financial condition.***

Our utility and propane distribution operations are sensitive to fluctuations in weather, and weather conditions directly influence the volume of natural gas and propane delivered by our utility and propane distribution operations to customers. A significant portion of our utility and propane distribution operations' revenues are derived from the delivery of natural gas and propane to residential and commercial heating customers during the five-month peak heating season of November through March. If the weather is warmer than normal, we deliver less natural gas and propane to customers, and earn less revenue. In addition, hurricanes or other extreme weather conditions could damage production or transportation facilities, which could result in decreased supplies of natural gas and propane, increased supply costs and higher prices for customers.

***Regulation of the Company, including changes in the regulatory environment in general, may adversely affect our results of operations, cash flows and financial condition.***

The state Public Service Commissions of Delaware, Maryland and Florida regulate our natural gas distribution operations. Eastern Shore, our natural gas transmission subsidiary, is regulated by the FERC. These regulatory agencies set the rates in their respective jurisdictions that we can charge customers for our rate-regulated services. Changes in these rates, as ordered by regulatory commissions, affect our financial performance. Our ability to obtain timely future rate increases and rate supplements to maintain current rates of return depends on regulatory discretion, and there can be no assurance that our divisions and Eastern Shore will be able to obtain rate increases or supplements or continue receiving currently authorized rates of return.

***The amount and availability of natural gas and propane supplies are difficult to predict, which may reduce our earnings.***

Natural gas and propane production can be impacted by factors outside of our control, such as weather and refinery closings. If we are unable to obtain sufficient natural gas and propane supplies to meet demand, our results of operations may be negatively impacted.



***We rely on having access to interstate pipelines' transportation and storage capacity. If these pipelines or storage facilities were not available, it may impair our ability to meet our customers' full requirements.***

We must acquire both sufficient natural gas supplies and interstate pipeline and storage capacity to meet customer requirements. We must contract for reliable and adequate delivery capacity for our distribution system, while considering the dynamics of the interstate pipeline and storage capacity market, our own on-system resources, as well as, the characteristics of our customer base. Local natural gas distribution companies, including us, and other participants in the energy industry, have raised concerns regarding the future availability of additional upstream interstate pipeline and storage capacity. Additional available pipeline and storage capacity is a business issue that must be managed by us, as our customer base grows.

***Natural gas and propane commodity price changes may affect the operating costs and competitive positions of our natural gas and propane distribution operations, which may adversely affect our results of operations, cash flows and financial condition.***

Natural Gas. Over the last four years, natural gas costs have increased significantly and become more volatile. In addition, the hurricane activity in 2005 reduced the natural gas available from the Gulf Coast region, further contributing to the volatility of natural gas prices. Higher natural gas prices can result in significant increases in the cost of gas billed to customers during the winter heating season. Under our regulated gas cost recovery mechanisms, we record cost of gas expense equal to the cost of gas recovered in revenues from customers. Therefore, an increase in the cost of gas due to an increase in the price of the natural gas commodity generally has no immediate effect on our revenues and net income. However, our net income may be reduced due to higher expenses that may be incurred for uncollectible customer accounts, as well as, lower volumes of natural gas deliveries to customers due to lower natural gas consumption caused by customer conservation. Increases in the price of natural gas also can affect our operating cash flows, as well as the competitiveness of natural gas as an energy source.

Propane. The level of profitability in the retail propane business is largely dependent on the difference between the cost of propane and the revenues derived from our sale of propane to our customers. Propane costs are subject to volatile changes as a result of product supply or other market conditions, including economic and political factors impacting crude oil and natural gas supply or pricing. Propane cost changes can occur rapidly over a short period of time and can impact profitability. There is no assurance that we will be able to pass on propane cost increases fully or immediately, particularly when propane costs increase or decrease rapidly. Therefore, average retail sales prices can vary significantly from year to year as product costs fluctuate with propane, fuel oil, crude oil and natural gas commodity market conditions. In addition, in periods of sustained higher commodity prices, retail sales volumes may be negatively impacted by customer conservation efforts and increased amounts of uncollectible accounts, which may adversely affect net income.

***We compete in a competitive environment and may be faced with losing customers to a competitor.***

We compete with third-party suppliers to sell gas to industrial customers. As it relates to transportation services, our competitors include the interstate pipelines if distribution customer is located close enough to the transmission company's pipeline to make a connection economically feasible.

Our propane distribution operations compete with several other propane distributors in their service territories, primarily on the basis of service and price, emphasizing reliability of service and responsiveness. Some of our competitors have significantly greater resources. The retail propane industry is mature, and we foresee only modest growth in total demand. Given this limited growth, we expect that year-to-year industry volumes will be principally affected by weather patterns. Therefore, our ability to grow the propane distribution business is contingent upon execution of our community gas systems strategy to capture market share and to employ service pricing programs that retain and grow our customer base. Any failure to retain and grow our customer base would have an adverse effect on our results.

The propane wholesale marketing operation competes against various marketers, many of which have significantly greater resources and are able to obtain price or volumetric advantages.

The advanced information services business faces significant competition from a number of larger competitors having substantially greater resources available to them to compete on the basis of technological expertise, reputation and price.

***Costs of compliance with environmental laws may be significant.***

We are subject to federal, state and local laws and regulations governing environmental quality and pollution control. These evolving laws and regulations may require expenditures over a long period of time to control environmental effects at current and former operating sites, including former manufactured gas plant sites that we have acquired from third parties. Compliance with these legal requirements requires us to commit capital toward environmental compliance. If we fail to comply with environmental laws and regulations, even if such failure is caused by factors beyond our control, we may be assessed civil or criminal penalties and fines.

To date, we have been able to recover through approved rate mechanisms the costs of recovery associated with the remediation of former manufactured gas plant sites. However, there is no guarantee that we will be able to recover future remediation costs in the same manner or at all. A change in our approved rate mechanisms for recovery of environmental remediation costs at former manufactured gas plant sites could adversely affect our results of operations, cash flows and financial condition.

Further, existing environmental laws and regulations may be revised or new laws and regulations seeking to protect the environment may be adopted or become applicable to us. Revised or additional laws and regulations could result in additional operating restrictions on our facilities or increased compliance costs which may not be fully recoverable by us.

***A change in the economic conditions and interest rates may adversely affect our results of operations and cash flows.***

A downturn in the economies of the regions in which we operate, which we cannot accurately predict, might adversely affect our ability to increase our customer base and other businesses at the same rate they have grown in the recent past. Further, an increase in interest rates, without the recovery of the higher cost of debt in the sales and/or transportation rates we charge our utility customers, could adversely affect future earnings. An increase in short-term interest rates would negatively affect our results of operations, which depend on short-term debt to finance accounts receivable, storage gas inventories, and to temporarily finance capital expenditures.

***Inflation may impact our results of operations, cash flows and financial position.***

Inflation affects the cost of supply, labor, products and services required for operations, maintenance and capital improvements. While the impact of inflation has remained low in recent years, natural gas and propane prices are subject to rapid fluctuations. To help cope with the effects of inflation on our capital investments and returns, we seek rate relief from regulatory commissions for regulated operations while monitoring the returns of our unregulated business operations. There can be no assurance that we will be able to obtain adequate and timely rate relief to offset the effects of inflation. To compensate for fluctuations in propane gas prices, we adjust our propane selling prices to the extent allowed by the market. However, there can be no assurance that we will be able to increase propane sales prices sufficiently to fully compensate for such fluctuations in the cost of propane gas to us.

***Changes in technology may adversely affect our advanced information services segment's results of operations, cash flows and financial condition.***

Our advanced information services segment participates in a market that is characterized by rapidly changing technology and accelerating product introduction cycles. The success of our advanced information services segment depends upon our ability to address the rapidly changing needs of our customers by developing and supplying high-quality, cost-effective products, product enhancements and services on a timely basis, and by keeping pace with technological developments and emerging industry standards. There can be no assurance that we will be able to keep up with technological advancements necessary to make our products competitive.

***Our energy marketing subsidiaries have credit risk and credit requirements that may adversely affect our results of operations, cash flows and financial condition.***

Xeron, our propane wholesale and marketing subsidiary, and PESCO, our natural gas marketing subsidiary in Florida, extend credit to counter-parties. While we believe Xeron and PESCO utilize prudent credit policies, each of these subsidiaries is exposed to the risk that it may not be able to collect amounts owed to it. If the counter-party to such a transaction fails to perform and any underlying collateral is inadequate, we could experience financial losses.

Xeron and PESCO are dependent upon the availability of credit to buy propane and natural gas for resale or to trade. If the financial condition of these subsidiaries declines, or if our financial condition declines, then the cost of credit available to these subsidiaries could increase. If credit is not available, or if credit is more costly, our results of operations, cash flows and financial condition may be adversely affected.

***Our use of derivative instruments may adversely affect our results of operations.***

Fluctuating commodity prices cause our earnings and financing costs to be impacted. Our propane distribution and wholesale marketing segment uses derivative instruments, including forwards, swaps and puts, to hedge price risk. In addition, we have utilized in the past, and may decide, after further evaluation, to continue to utilize derivative instruments to hedge price risk for our Delaware and Maryland divisions, as well as PESCO. While we have a risk management policy and operating procedures in place to control our exposure to risk, if we purchase derivative instruments that are not properly matched to our exposure, our results of operations, cash flows, and financial conditions may be adversely impacted.

***Inability to access the capital markets may impair our future growth.***

We rely on access to both short-term and longer-term capital markets as a significant source of liquidity for capital requirements not satisfied by the cash flow from our operations. Currently, \$55 million of the total \$80 million of short-term lines of credit utilized to satisfy our short-term financing requirements are discretionary, uncommitted lines of credit. We utilize discretionary lines of credit to reduce the cost associated with these short-term financing requirements. We are committed to maintaining a sound capital structure and strong credit ratings to provide the financial flexibility needed to access the capital markets when required. However, if we are not able to access capital at competitive rates, our ability to implement our strategic plan, undertake improvements and make other investments required for our future growth may be limited.

***We are dependent upon access to natural gas supply and the construction of new facilities to support future growth in earnings in our utilities and the interstate pipeline.***

Construction of these facilities is subject to various regulatory, development and operational risks, include but not limited to our ability to obtain necessary approvals and permits by regulatory agencies on a timely basis and on terms that are acceptable to us; potential changes in federal, state and local statutes and regulations, including environmental requirements, that prevent a project from proceeding or increase the anticipated cost of the project; impediments on our ability to acquire rights-of-way or land rights on a timely basis on terms that are acceptable to us; lack of anticipated future growth in natural gas supply; and lack of transportation or throughput commitments.

***We are subject to operating and litigation risks that may not be covered by insurance.***

Our operations are subject to the operating hazards and risks normally incidental to handling, storing, transporting and otherwise providing natural gas and propane to end users. As a result, we are sometimes a defendant in legal proceedings and litigation arising in the ordinary course of business. We maintain insurance policies with insurers in such amounts and with such coverages and deductibles as we believe are reasonable and prudent. There can be no assurance; however, that such insurance will be adequate to protect us from all material expenses related to potential future claims for personal injury and property damage or that such levels of insurance will be available in the future at economical prices.

**ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

## **ITEM 2. PROPERTIES**

### **(a) General**

The Company owns offices and operates facilities in the following locations: Pocomoke, Salisbury, Cambridge and Princess Anne, Maryland; Dover, Seaford, Laurel and Georgetown, Delaware; and Winter Haven, Florida. Chesapeake rents office space in Dover and Ocean View, Delaware; Jupiter and Lecanto, Florida; Chincoteague and Belle Haven, Virginia; Easton, and Salisbury, Maryland; Honey Brook and Allentown, Pennsylvania; Houston, Texas; and Norcross, Georgia. In general, the Company believes that its properties are adequate for the uses for which they are employed. Capacity and utilization of the Company's facilities can vary significantly due to the seasonal nature of the natural gas and propane distribution businesses.

### **(b) Natural Gas Distribution**

Chesapeake owns over 965 miles of natural gas distribution mains (together with related service lines, meters and regulators) located in its Delaware and Maryland service areas and 726 miles of natural gas distribution mains (and related equipment) in its central Florida service areas. Chesapeake also owns facilities in Delaware and Maryland for propane-air injection during periods of peak demand.

### **(c) Natural Gas Transmission**

Eastern Shore owns and operates approximately 366 miles of transmission pipelines extending from supply interconnects at Parkesburg, Pennsylvania; Daleville, Pennsylvania and Hockessin, Delaware to approximately 75 delivery points in southeastern Pennsylvania, Delaware and the eastern shore of Maryland.

### **(d) Propane Distribution and Wholesale Marketing**

The company's Delmarva-based propane distribution operation owns bulk propane storage facilities with an aggregate capacity of approximately 2.0 million gallons at 42 plant facilities in Delaware, Maryland and Virginia, located on real estate that is either owned or leased. The Company's Florida-based propane distribution operation owns three bulk propane storage facilities with a total capacity of 66,000 gallons. Xeron does not own physical storage facilities or equipment to transport propane; however, it leases propane storage capacity and pipeline capacity.

## **ITEM 3. LEGAL PROCEEDINGS**

### **(a) General**

The Company and its subsidiaries are involved in various legal actions and claims arising in the normal course of business. The Company is also involved in certain legal and administrative proceedings before various governmental agencies concerning rates. In the opinion of management, the ultimate disposition of these proceedings will not have a material effect on our consolidated financial position.

### **(b) Environmental**

See discussion of environmental commitments and contingencies in Item 8 under the heading "Notes to Consolidated Financial Statements — Note M."

## **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

None

## **PART II**

## **ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

**(a) Common Stock Price Ranges, Common Stock Dividends and Shareholder Information:**

The Company's Common Stock is listed on the New York Stock Exchange under the symbol "CPK." The high, low and closing prices of Chesapeake's Common Stock and dividends declared per share for each calendar quarter during the years 2006 and 2005 were as follows:

|             | Quarter Ended | High     | Low      | Close    | Dividends Declared Per Share |
|-------------|---------------|----------|----------|----------|------------------------------|
| <b>2006</b> |               |          |          |          |                              |
|             | March 31      | \$ 32.47 | \$ 29.97 | \$ 31.24 | \$ 0.285                     |
|             | June 30       | 31.20    | 27.90    | 30.08    | 0.290                        |
|             | September 30  | 35.65    | 29.51    | 30.05    | 0.290                        |
|             | December 31   | 31.31    | 29.10    | 30.65    | 0.290                        |
| <b>2005</b> |               |          |          |          |                              |
|             | March 31      | \$27.59  | \$25.83  | \$26.60  | \$ 0.280                     |
|             | June 30       | \$30.95  | \$23.60  | \$30.58  | 0.285                        |
|             | September 30  | \$35.60  | \$29.50  | \$35.16  | 0.285                        |
|             | December 31   | \$35.78  | \$30.32  | \$30.80  | 0.285                        |

Dividend payments are payable at the discretion of our Board of Directors. Future payment of dividends, and the amount of these dividends, will depend on our financial condition, results of operations, capital requirements, and other factors. We sold no securities during the year 2006 that were not registered under the Securities Act of 1933, as amended.

Indentures to the long-term debt of the Company contain various restrictions. The most stringent restrictions state that the Company must maintain equity of at least 40 percent of total capitalization and the pro-forma fixed charge coverage ratio must be at least 1.5 times. The Company was in compliance with these restrictions and the other debt covenants during 2006.

At December 31, 2006, there were 1,978 shareholders of record of the Common Stock.

**(b) Purchases of Equity Securities by the Issuer**

The following table sets forth information on purchases by or on behalf of Chesapeake of shares of its Common Stock during the quarter ended December 31, 2006.

| Period                                       | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2) | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (2) |
|--|----------------------------------|------------------------------|--|--|
| October 1, 2006 through October 31, 2006 (1) | 463                              | \$29.92                      | 0  | 0  |
| November 1, 2006 through November 30, 2006   | 0                                | \$0.00                       | 0  | 0  |
| December 1, 2006 through December 31, 2006   | 0                                | \$0.00                       | 0  | 0  |
| Total  | 463                              | \$29.92                      | 0  | 0  |

(1) Chesapeake purchased shares of stock on the open market for the purpose of reinvesting the dividend on shares held in Rabbi Trust accounts for certain Senior Executives. During the quarter, 463 shares were purchased through executive dividend deferrals.

(2) Except for the purpose described in Footnote (1), Chesapeake has no publicly announced plans or programs to repurchase its shares.

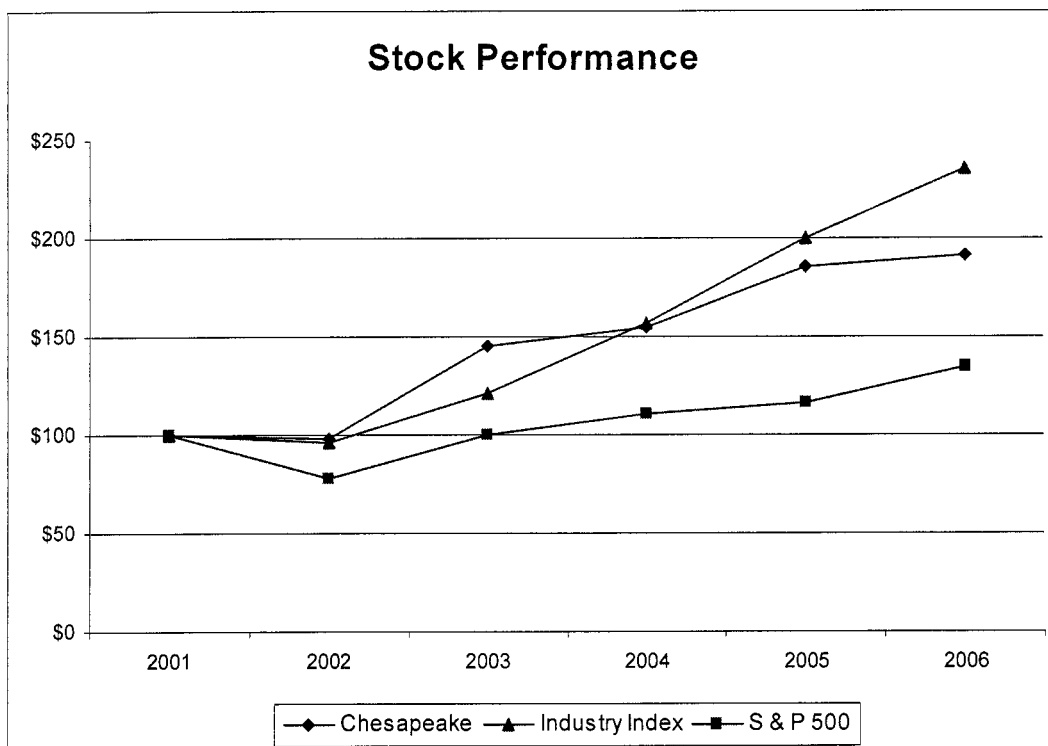
Discussion on compensation plans of Chesapeake and its subsidiaries for which shares of Chesapeake common stock are authorized for issuance is incorporated herein by reference to the portion of the Proxy Statement captioned "Equity Compensation Plan Information" to be filed not later than March 31, 2007 in connection with the Company's Annual Meeting to be held on May 2, 2007.

**(c) Chesapeake Utilities Corporation Common Stock Performance Graph**

The following Performance Graph compares the yearly percentage change in cumulative total shareholder return on the Company's common stock during the five fiscal years ended December 31, 2006, with the cumulative return on (i) the S&P 500 Index and (ii) an industry index consisting of 30 Natural Gas Distribution and Integrated Natural Gas Companies as published by C.A Turner Utility Reports.

The thirty companies in the C.A. Turner industry index are as follows: AGL Resources, Inc., Atmos Energy Corporation, Cascade Natural Gas Corporation, Chesapeake Utilities Corporation, Delta Natural Gas Company, Inc., El Paso Corporation, Energen Corporation, Energy West, Inc., EnergySouth, Inc., Equitable Resources, Inc., KeySpan Corporation, Kinder Morgan, Inc., The Laclede Group, Inc., National Fuel Gas Company, New Jersey Resources Corporation, NICOR, Inc., Northwest Natural Gas Company, ONEOK, Inc., Peoples Energy Corporation, Piedmont Natural Gas Co., Inc., Questar Corporation, RGC Resources, Inc., SEMCO Energy, Inc., South Jersey Industries, Inc., Southern Union Company, Southwest Gas Corporation, Southwest Energy Company, UGI Corporation, WGL Holdings, Inc., and The Williams Companies, Inc.

The comparison assumes \$100 was invested on December 31, 2001 in the Company's common stock and in each of the foregoing indices and assumes reinvested dividends. The comparisons in the Graph below are based on historical data and are not intended to forecast the possible future performance of the Company's Common Stock.



| Cumulative Total Stockholder Return |       |      |       |       |       |       |  |
|-------------------------------------|-------|------|-------|-------|-------|-------|--|
|                                     | 2001  | 2002 | 2003  | 2004  | 2005  | 2006  |  |
| <b>Chesapeake</b>                   | \$100 | \$98 | \$145 | \$155 | \$186 | \$192 |  |
| <b>Industry Index</b>               | \$100 | \$96 | \$121 | \$156 | \$200 | \$236 |  |
| <b>S &amp; P 500</b>                | \$100 | \$78 | \$100 | \$111 | \$116 | \$134 |  |

**ITEM 6. SELECTED FINANCIAL DATA**

| <b>For the Years Ended December 31,</b>                          | <b>2006 <sup>(3)</sup></b> | <b>2005</b>      | <b>2004</b>      |
|--|----------------------------|------------------|------------------|
| <b><u>Operating (in thousands of dollars) <sup>(1)</sup></u></b> |                            |                  |                  |
| Revenues   |                            |                  |                  |
| Natural gas  | \$170,374                  | \$166,582        | \$124,246        |
| Propane  | 48,576                     | 48,976           | 41,500           |
| Advanced informations systems                                    | 12,568                     | 14,140           | 12,427           |
| Other and eliminations   | (317)                      | (68)             | (218)            |
| <b>Total revenues</b>  | <b>\$231,201</b>           | <b>\$229,630</b> | <b>\$177,955</b> |
| Operating income   |                            |                  |                  |
| Natural gas  | \$19,733                   | \$17,236         | \$17,091         |
| Propane  | 2,534                      | 3,209            | 2,364            |
| Advanced informations systems                                    | 767                        | 1,197            | 387              |
| Other and eliminations   | (103)                      | (112)            | 128              |
| <b>Total operating income</b>                                    | <b>\$22,931</b>            | <b>\$21,530</b>  | <b>\$19,970</b>  |
| <b>Net income from continuing operations</b>                     | <b>\$10,507</b>            | <b>\$10,468</b>  | <b>\$9,550</b>   |
| <b><u>Assets (in thousands of dollars)</u></b>                   |                            |                  |                  |
| Gross property, plant and equipment                              | \$325,836                  | \$280,345        | \$250,267        |
| Net property, plant and equipment <sup>(2)</sup>                 | \$240,825                  | \$201,504        | \$177,053        |
| Total assets <sup>(2)</sup>                                      | \$324,994                  | \$295,980        | \$241,938        |
| Capital expenditures <sup>(1)</sup>                              | \$48,969                   | \$33,423         | \$17,830         |
| <b><u>Capitalization (in thousands of dollars)</u></b>           |                            |                  |                  |
| Stockholders' equity   | \$111,152                  | \$84,757         | \$77,962         |
| Long-term debt, net of current maturities                        | 71,050                     | 58,991           | 66,190           |
| <b>Total capitalization</b>                                      | <b>\$182,202</b>           | <b>\$143,748</b> | <b>\$144,152</b> |
| Current portion of long-term debt                                | \$7,656                    | \$4,929          | \$2,909          |
| Short-term debt  | 27,554                     | 35,482           | 5,002            |
| <b>Total capitalization and short-term financing</b>             | <b>\$217,412</b>           | <b>\$184,159</b> | <b>\$152,063</b> |

<sup>(1)</sup> These amounts exclude the results of water services due to their reclassification to discontinued operations. The assets of all of the water businesses were sold in 2004 and 2003.

<sup>(2)</sup> SFAS 143 was adopted in the year 2001; therefore, SFAS 143 was not applicable for the years prior to 2001.

<sup>(3)</sup> SFAS 123R and SFAS 158 were adopted in the year 2006; therefore, they were not applicable for the years prior to 2006.



| 2003      | 2002      | 2001      | 2000      | 1999      | 1998      | 1997      |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| \$110,247 | \$93,588  | \$107,418 | \$101,138 | \$75,637  | \$68,770  | \$88,108  |
| 41,029    | 29,238    | 35,742    | 31,780    | 25,199    | 23,377    | 28,614    |
| 12,578    | 12,764    | 14,104    | 12,390    | 13,531    | 10,331    | 7,786     |
| (286)     | (334)     | (113)     | (131)     | (14)      | (15)      | (182)     |
| \$163,568 | \$135,256 | \$157,151 | \$145,177 | \$114,353 | \$102,463 | \$124,326 |
| \$16,653  | \$14,973  | \$14,405  | \$12,798  | \$10,388  | \$8,820   | \$9,240   |
| 3,875     | 1,052     | 913       | 2,135     | 2,622     | 965       | 1,137     |
| 692       | 343       | 517       | 336       | 1,470     | 1,316     | 1,046     |
| 359       | 237       | 386       | 816       | 495       | 485       | 558       |
| \$21,579  | \$16,605  | \$16,221  | \$16,085  | \$14,975  | \$11,586  | \$11,981  |
| \$10,079  | \$7,535   | \$7,341   | \$7,665   | \$8,372   | \$5,329   | \$5,812   |
| \$234,919 | \$229,128 | \$216,903 | \$192,925 | \$172,068 | \$152,991 | \$144,251 |
| \$167,872 | \$166,846 | \$161,014 | \$131,466 | \$117,663 | \$104,266 | \$99,879  |
| \$222,058 | \$223,721 | \$222,229 | \$211,764 | \$166,958 | \$145,029 | \$145,719 |
| \$11,822  | \$13,836  | \$26,293  | \$22,057  | \$21,365  | \$12,516  | \$13,471  |
| \$72,939  | \$67,350  | \$67,517  | \$64,669  | \$60,714  | \$56,356  | \$53,656  |
| 69,416    | 73,408    | 48,409    | 50,921    | 33,777    | 37,597    | 38,226    |
| \$142,355 | \$140,758 | \$115,926 | \$115,590 | \$94,491  | \$93,953  | \$91,882  |
| \$3,665   | \$3,938   | \$2,686   | \$2,665   | \$2,665   | \$520     | \$1,051   |
| 3,515     | 10,900    | 42,100    | 25,400    | 23,000    | 11,600    | 7,600     |
| \$149,535 | \$155,596 | \$160,712 | \$143,655 | \$120,156 | \$106,073 | \$100,533 |

| For the Years Ended December 31,                                     | 2006 <sup>(3)</sup> | 2005      | 2004      |
|--|---------------------|-----------|-----------|
| <b>Common Stock Data and Ratios</b>                                  |                     |           |           |
| Basic earnings per share from continuing operations <sup>(1)</sup>   | \$1.74              | \$1.79    | \$1.66    |
| Diluted earnings per share from continuing operations <sup>(1)</sup> | \$1.72              | \$1.77    | \$1.64    |
| Return on average equity from continuing operations <sup>(1)</sup>   | 10.7%               | 12.9%     | 12.7%     |
| Common equity / total capitalization                                 | 61.0%               | 59.0%     | 54.1%     |
| Common equity / total capitalization and short-term financing        | 51.1%               | 46.0%     | 51.3%     |
| Book value per share   | \$16.62             | \$14.41   | \$13.49   |
| Market price:  |                     |           |           |
| High   | \$35.650            | \$35.780  | \$27.550  |
| Low  | \$27.900            | \$23.600  | \$20.420  |
| Close  | \$30.650            | \$30.800  | \$26.700  |
| Average number of shares outstanding                                 | 6,032,462           | 5,836,463 | 5,735,405 |
| Shares outstanding at year-end                                       | 6,688,084           | 5,883,099 | 5,778,976 |
| Registered common shareholders                                       | 1,978               | 2,026     | 2,026     |
| Cash dividends declared per share                                    | \$1.16              | \$1.14    | \$1.12    |
| Dividend yield (annualized) <sup>(2)</sup>                           | 3.8%                | 3.7%      | 4.2%      |
| Payout ratio from continuing operations <sup>(1) (4)</sup>           | 66.7%               | 63.7%     | 67.5%     |
| <b>Additional Data</b>   |                     |           |           |
| Customers  |                     |           |           |
| Natural gas distribution and transmission                            | 59,132              | 54,786    | 50,878    |
| Propane distribution   | 33,282              | 32,117    | 34,888    |
| Volumes  |                     |           |           |
| Natural gas distribution and transmission deliveries (in MMCF)       | 34,321              | 34,981    | 31,430    |
| Propane distribution (in thousands of gallons)                       | 24,243              | 26,178    | 24,979    |
| Heating degree-days (Delmarva Peninsula)                             |                     |           |           |
| Actual HDD   | 3,931               | 4,792     | 4,553     |
| 10 -year average HDD (normal)  | 4,372               | 4,436     | 4,389     |
| Propane bulk storage capacity (in thousands of gallons)              | 2,315               | 2,315     | 2,045     |
| Total employees <sup>(1)</sup>                                       | 437                 | 423       | 426       |

<sup>(1)</sup> These amounts exclude the results of water services due to their reclassification to discontinued operations. The assets of all of the water businesses were sold in 2004 and 2003.

<sup>(2)</sup> Dividend yield (annualized) is calculated by multiplying the fourth quarter dividend by four (4), then dividing that amount by the closing common stock price at December 31.

<sup>(3)</sup> SFAS 123R and SFAS 158 were adopted in the year 2006; therefore, they were not applicable for the years prior to 2006.

<sup>(4)</sup> The payout ratio from continuing operations is calculated by dividing cash dividends declared per share (for the year) by basic earnings per share from continuing operations.

| 2003      | 2002      | 2001      | 2000      | 1999      | 1998      | 1997      |
|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| \$1.80    | \$1.37    | \$1.37    | \$1.46    | \$1.63    | \$1.05    | \$1.17    |
| \$1.76    | \$1.37    | \$1.35    | \$1.43    | \$1.59    | \$1.04    | \$1.15    |
| 14.4%     | 11.2%     | 11.1%     | 12.2%     | 14.3%     | 9.7%      | 11.1%     |
| 51.2%     | 47.8%     | 58.2%     | 55.9%     | 64.3%     | 60.0%     | 58.4%     |
| 48.8%     | 43.3%     | 42.0%     | 45.0%     | 50.5%     | 53.1%     | 53.4%     |
| \$12.89   | \$12.16   | \$12.45   | \$12.21   | \$11.71   | \$11.06   | \$10.72   |
| \$26.700  | \$21.990  | \$19.900  | \$18.875  | \$19.813  | \$20.500  | \$21.750  |
| \$18.400  | \$16.500  | \$17.375  | \$16.250  | \$14.875  | \$16.500  | \$16.250  |
| \$26.050  | \$18.300  | \$19.800  | \$18.625  | \$18.375  | \$18.313  | \$20.500  |
| 5,610,592 | 5,489,424 | 5,367,433 | 5,249,439 | 5,144,449 | 5,060,328 | 4,972,086 |
| 5,660,594 | 5,537,710 | 5,424,962 | 5,297,443 | 5,186,546 | 5,093,788 | 5,004,078 |
| 2,069     | 2,130     | 2,171     | 2,166     | 2,212     | 2,271     | 2,178     |
| \$1.10    | \$1.10    | \$1.10    | \$1.07    | \$1.03    | \$1.00    | \$0.97    |
| 4.2%      | 6.0%      | 5.6%      | 5.8%      | 5.7%      | 5.5%      | 4.7%      |
| 61.1%     | 80.3%     | 80.3%     | 73.3%     | 63.2%     | 95.2%     | 82.9%     |
| 47,649    | 45,133    | 42,741    | 40,854    | 39,029    | 37,128    | 35,797    |
| 34,894    | 34,566    | 35,530    | 35,563    | 35,267    | 34,113    | 33,123    |
| 29,375    | 27,935    | 27,264    | 30,830    | 27,383    | 21,400    | 23,297    |
| 25,147    | 21,185    | 23,080    | 28,469    | 27,788    | 25,979    | 26,682    |
| 4,715     | 4,161     | 4,368     | 4,730     | 4,082     | 3,704     | 4,430     |
| 4,409     | 4,393     | 4,446     | 4,356     | 4,409     | 4,493     | 4,574     |
| 2,195     | 2,151     | 1,958     | 1,928     | 1,926     | 1,890     | 1,866     |
| 439       | 455       | 458       | 471       | 466       | 431       | 397       |

## Management's Discussion and Analysis

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### INTRODUCTION

This section provides management's discussion of Chesapeake Utilities Corporation and its consolidated subsidiaries with specific information on results of operations and liquidity and capital resources. It includes management's interpretation of our financial results, the factors affecting these results, the major factors expected to affect future operating results and future investment and financing plans. This discussion should be read in conjunction with our consolidated financial statements and notes thereto.

Several factors exist that could influence our future financial performance, some of which are described in Item 1A above, "Risk Factors". They should be considered in connection with evaluating forward-looking statements contained in this report or otherwise made by or on behalf of us since these factors could cause actual results and conditions to differ materially from those set out in such forward-looking statements.

#### EXECUTIVE OVERVIEW

Chesapeake is a diversified utility company engaged directly or through subsidiaries in natural gas distribution, transmission and marketing, propane distribution and wholesale marketing, advanced information services and other related businesses.

The Company's strategy is focused on growing earnings from a stable utility foundation and investing in related businesses and services that provide opportunities for returns greater than traditional utility returns. The key elements of this strategy include:

- Executing a capital investment program in pursuit of organic growth opportunities that generate returns equal to or greater than our cost of capital.
- Expanding the natural gas distribution and transmission business through expansion into new geographic areas in our current service territories.
- Expanding the propane distribution business in existing and new markets through leveraging our community gas system services and our bulk delivery capabilities.
- Utilizing the Company's expertise across our various businesses to improve overall performance.
- Enhancing marketing channels to attract new customers and providing reliable and responsive customer service to retain existing customers.
- Maintaining a capital structure that enables the Company to access capital as needed.
- Maintaining a consistent and competitive dividend.

In 2006, the Company earned \$10,507,000 in net income, or \$1.72 per share (diluted), in spite of weather that was the second warmest in the last thirty years. In 2005, net income was \$10,468,000, or \$1.77 per diluted share. Overall, operating income in 2006 increased \$1,401,000, or 6.5 percent from 2005, despite weather that was 18 percent warmer than in 2005. However, the increase in operating income was offset by a decline of \$194,000, or 51 percent, in other income, net of other expenses, and increases in interest expense of \$644,000, or 12.5 percent, and income taxes of \$525,000, or 8.3 percent. The net result was that net income was up by only \$39,000, or 0.4 percent.

*The following discussions and those later in the document on operating income and segment results include use of the term "gross margin." Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for natural gas and propane and the cost of labor spent on direct revenue-producing activities. Gross margin should not be considered an alternative to operating income or net income, which are determined in accordance with Generally Accepted Accounting Principles ("GAAP"). Chesapeake believes that gross margin, although a non-GAAP measure, is useful and meaningful to investors as a basis for making investment decisions. It provides investors with information that demonstrates the profitability achieved by the Company under its allowed rates for regulated operations and under its competitive pricing structure for non-regulated segments. Chesapeake's*

*management uses gross margin in measuring its business units' performance and has historically analyzed and reported gross margin information publicly. Other companies may calculate gross margin in a different manner.*

#### Operating Income

The year 2006 reflects the strong year-over-year operating income growth experienced by the Company's natural gas operations of \$2,497,000, or 14.5 percent. This growth was offset by reductions in operating income from propane and advanced information services. In 2006, both natural gas and propane segments were negatively impacted by weather that was 18 percent warmer than in 2005. The Company estimates that the warmer weather reduced gross margin by \$3.4 million in 2006. The natural gas segment was able to overcome the weather impact and show an increase in operating income due to its growth and cost containment efforts. However, as the propane segment is more weather sensitive and is not experiencing the high level of growth of our natural gas segment, its operating income declined when compared to 2005.

Advanced information services experienced a decrease in operating income in 2006 as compared to the prior year due in part to the gain on the sale of Lightweight Association Management Processing System ("LAMPS™") during the fourth quarter of 2005. The LAMPS product was internally developed software that was developed and marketed specifically for REALTOR® Associations.

Key financial and operational highlights for fiscal year 2006 include the following:

- Customer growth in the natural gas and propane businesses remained strong, with the Delmarva and Florida natural gas distribution operations registering 9 and 8 percent increases in residential customers, respectively; and the Delmarva Community Gas Systems ("CGS") generating a 34 percent increase in propane distribution customers.
- In June 2006, Eastern Shore Natural Gas announced that it had received approval from the Federal Energy Regulatory Commission ("FERC") to expand its pipeline system in the years 2006, 2007 and 2008. The entire project represents an investment of \$33.6 million, with expected annualized revenue of \$6.7 million after the full build-out of the facilities.
- On September 26, 2006, the Company received approval for a base rate increase from the Maryland Public Service Commission ("PSC") for our Maryland natural gas operations, with the new base rates effective October 1, 2006. The base rate adjustment results in an increase in base rates of approximately \$780,000, which would result in an average increase in revenues of approximately 4.5 percent for the Company's firm residential, commercial and industrial customers in Maryland. The PSC also approved the Company's proposal to implement a revenue normalization mechanism for its residential heating and smaller commercial heating customers, reducing the Company's future risk due to weather and usage changes.
- In November 2006, the Company completed a public offering of 600,300 shares of its common stock at a price per share of \$30.10. Additionally, in November 2006, the Company completed the sale of 90,045 additional shares of its common stock, pursuant to the over-allotment option granted to the Underwriters by the Company. The net proceeds of approximately \$19.7 million, after the deduction of underwriting commissions and expenses from the sale of the common stock, were added to the Company's general funds and primarily used to repay a portion of the Company's short-term debt.
- Total capitalization, including short-term borrowing, increased \$33.3 million at December 31, 2006 compared with December 31, 2005. The increased capitalization was obtained to fund the \$39.3 million increase in net plant and for other working capital needs.
- For the year ended December 31, 2006, the Company generated \$30.1 million in operating cash flow compared with \$13.6 million for the year ended December 31, 2005. The higher cost of natural gas and propane in 2005 had an adverse impact on working capital in 2005.
- Net property, plant and equipment increased to \$240.8 million at December 31, 2006 from \$201.5 million at December 31, 2005, primarily reflecting continued capital investment to support customer growth.

## Management's Discussion and Analysis

- In June 2006, Eastern Shore announced the Bay Crossing Project for which it plans to develop, construct and operate new pipeline facilities that would transport natural gas from Calvert County, Maryland, cross under the Chesapeake Bay into Dorchester and Caroline Counties, Maryland, to points on the Delmarva Peninsula where such facilities would interconnect with its existing facilities in Sussex County, Delaware. If completed, the project will expand the capacity of its interstate pipeline system by approximately 33 percent. We still have significant obstacles to overcome on this project to make it a reality. In 2007, Eastern Shore will initiate the processes required to obtain the FERC and other federal, state and local permits required to construct the project. Eastern Shore received approval from the FERC in August 2006 to recover the pre-service costs associated with this pipeline project through its rates from two of its customers. As of December 31, 2006, the Company had deferred a total of \$409,000 of pre-service costs associated with the project.

The Company's financial performance is discussed in greater detail below in Results of Operations.

### Critical Accounting Policies

Chesapeake's reported financial condition and results of operations are affected by the accounting methods, assumptions and estimates that are used in the preparation of the Company's financial statements. Because most of Chesapeake's businesses are regulated, the accounting methods used by Chesapeake must comply with the requirements of the regulatory bodies; therefore, the choices available are limited by these regulatory requirements. Management believes that the following policies require significant estimates or other judgments of matters that are inherently uncertain. These policies and their application have been discussed with Chesapeake's Audit Committee.

#### ***Regulatory Assets and Liabilities***

Chesapeake records certain assets and liabilities in accordance with Statement of Financial Accounting Standards ("SFAS") No. 71 "Accounting for the Effects of Certain Types of Regulation." Costs are deferred when there is a probable expectation that they will be recovered in future revenues as a result of the regulatory process. At December 31, 2006, Chesapeake had recorded regulatory assets of \$3.0 million, including \$1.1 million for under-recovered purchased gas costs, \$1.3 million for tax-related regulatory assets, \$139,000 for defined postretirement benefits, and \$122,000 for environmental cost recovery. The Company has recorded regulatory liabilities totaling \$23.8 million, including \$18.4 million for accrued asset removal cost, \$2.4 million for over-recovered purchased gas costs, \$1.2 million for self-insurance, \$1.2 million for cash in/cash out, and \$349,000 for over-collected environmental costs at December 31, 2006. If the Company were required to terminate application of SFAS No. 71, it would be required to recognize all such deferred amounts as a charge to earnings, net of applicable income taxes. Such a charge could have a material adverse effect on the Company's results of operations.

#### ***Valuation of Environmental Assets and Liabilities***

As more fully described in Note M to the Financial Statements, Chesapeake has completed its responsibilities related to one environmental site and is currently participating in the investigation, assessment or remediation of three other former manufactured gas plant sites. Amounts have been recorded as environmental liabilities and associated environmental regulatory assets based on estimates of future costs provided by independent consultants. There is uncertainty in these amounts because the Environmental Protection Agency ("EPA") or applicable state environmental authority may not have selected the final remediation methods. Additionally, there is uncertainty due to the outcome of legal remedies sought from other potentially responsible parties. At December 31, 2006, Chesapeake had recorded environmental regulatory assets of \$122,000 and a regulatory liability of \$350,000 for over-collections and an additional liability of \$212,000 for environmental costs.

#### ***Propane Wholesale Marketing Contracts***

Chesapeake's propane wholesale marketing operation enters into forward and futures contracts that are considered derivatives under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." In accordance with the pronouncement, open positions are marked to market prices at the end of each reporting period and unrealized gains or losses are recorded in the Consolidated Statement of Income as revenue. The contracts all mature

within one year, and are almost exclusively for propane commodities with delivery points of Mt. Belvieu, Texas, Conway, Kansas and Hattiesburg, Mississippi. Management estimates the market valuation based on references to exchange-traded futures prices, historical differentials and actual trading activity at the end of the reporting period. At December 31, 2006, these contracts had net unrealized gains of \$8,500 that was recorded in the financial statements. At December 31, 2005, these contracts had net unrealized gains of \$46,000 that were recorded in the financial statements.

### **Operating Revenues**

Revenues for the natural gas distribution operations of the Company are based on rates approved by the public service commissions ("PSC") of the jurisdictions in which we operate. The natural gas transmission operation's revenues are based on rates approved by the FERC. Customers' base rates may not be changed without formal approval by these commissions. However, the regulatory authorities have granted the Company's regulated natural gas distribution operations the ability to negotiate rates with customers that have competitive alternatives using approved methodologies. In addition, the natural gas transmission operation can negotiate rates above or below the FERC approved tariff rates.

Chesapeake's natural gas distribution operations in Delaware and Maryland each have a gas cost recovery mechanism that provides for the adjustment of rates charged to customers as gas costs fluctuate. These amounts are collected or refunded through adjustments to rates in subsequent periods.

The Company charges flexible rates to the natural gas distribution's industrial interruptible customers to make them competitive with alternative types of fuel. Based on pricing, these customers can choose natural gas or alternative types of supply. Neither the Company nor the interruptible customer is contractually obligated to deliver or receive natural gas.

The propane wholesale marketing operation records trading activity, on a net mark-to-market basis in the Company's income statement, for open contracts. The natural gas segment recognizes revenue on an accrual basis. The propane distribution, advanced information services and other segments record revenue in the period the products are delivered and/or services are rendered.

## **Results of Operations**

### **Net Income & Diluted Earnings Per Share Summary**

| For the Years Ended December 31,  | 2006     | 2005     | Increase<br>(decrease) | 2005     | 2004    | Increase<br>(decrease) |
|-----------------------------------|----------|----------|------------------------|----------|---------|------------------------|
| <b>Net Income *</b>               |          |          |                        |          |         |                        |
| Continuing operations             | \$10,507 | \$10,468 | \$39                   | \$10,468 | \$9,550 | \$918                  |
| Discontinued operations           | -        | -        | -                      | -        | (121)   | 121                    |
| Total Net Income                  | \$10,507 | \$10,468 | \$39                   | \$10,468 | \$9,429 | \$1,039                |
| <b>Diluted Earnings Per Share</b> |          |          |                        |          |         |                        |
| Continuing operations             | \$1.72   | \$1.77   | (\$0.05)               | \$1.77   | \$1.64  | \$0.13                 |
| Discontinued operations           | -        | -        | -                      | -        | (0.02)  | 0.02                   |
| Total Earnings Per Share          | \$1.72   | \$1.77   | (\$0.05)               | \$1.77   | \$1.62  | \$0.15                 |

\* Dollars in thousands.

The Company's net income from continuing operations increased \$39,000 in 2006 when compared to 2005. Net income was \$10.50 million, or \$1.72 per share (diluted), for 2006, compared to a net income of \$10.47 million, or \$1.77 per share (diluted).

The Company's net income from continuing operations increased \$918,000, or 10 percent, in 2005 compared to 2004. Net income from continuing operations was \$10.5 million, or \$1.77 per share (diluted), compared to a net income from continuing operations of \$9.6 million, or \$1.64 per share (diluted) for 2004.

## Management's Discussion and Analysis

During 2003, Chesapeake decided to exit the water services business and had sold the assets of six of seven dealerships by December 31, 2003. The remaining operation was sold in 2004. The results of water services were classified as discontinued operations for year 2004. Discontinued operations experienced losses of \$0.02 per share (diluted) for 2004.

### Operating Income Summary (in thousands)

| For the Years Ended December 31, | 2006            | 2005            | Increase<br>(decrease) | 2005            | 2004            | Increase<br>(decrease) |
|----------------------------------|-----------------|-----------------|------------------------|-----------------|-----------------|------------------------|
| <b>Business Segment:</b>         |                 |                 |                        |                 |                 |                        |
| Natural gas                      | \$19,733        | \$17,236        | \$2,497                | \$17,236        | \$17,091        | \$145                  |
| Propane                          | 2,534           | 3,209           | (675)                  | 3,209           | 2,364           | 845                    |
| Advanced information services    | 767             | 1,197           | (430)                  | 1,197           | 387             | 810                    |
| Other & eliminations             | (103)           | (112)           | 9                      | (112)           | 128             | (240)                  |
| <b>Total Operating Income</b>    | <b>\$22,931</b> | <b>\$21,530</b> | <b>\$1,401</b>         | <b>\$21,530</b> | <b>\$19,970</b> | <b>\$1,560</b>         |

### 2006 Compared to 2005

Operating income in 2006 increased \$1.4 million, or 6.5 percent, greater than 2005, despite adverse weather, which when measured in terms of heating degree-days, was 18 percent warmer. The improved 2006 results of operations when compared to 2005 were impacted by:

- Weather on the Delmarva Peninsula was 18 percent warmer in 2006 than 2005, which the Company estimates to have cost approximately \$3.4 million in gross margin for its Delmarva natural gas and propane distribution operations.
- Strong residential customer growth of 9 percent and 8 percent, respectively, for the Delmarva and Florida natural gas distribution operations in 2006.
- The natural gas transmission operation achieved gross margin growth of \$1.8 million, or 11 percent, due to additional capacity contracts that went into effect in November 2005 and November 2006.
- A 67 percent increase in the number of customers for the Company's natural gas marketing operation.
- Gross margin for the Delmarva propane distribution operations decreased \$834,000, primarily from the warmer weather in 2006.
- The Delmarva Community Gas Systems continue to experience strong customer growth as the number of customers increased 34 percent in 2006 compared to 2005.
- Operating income for the advanced information services segment decreased \$430,000 in 2006. Although revenues from consulting increased \$749,000 in 2006, the 2005 results contained \$993,000 of operating income for the LAMPS™ product, which was sold in the fourth quarter 2005.

### 2005 Compared to 2004

The improvement in results for 2005 versus 2004 was primarily driven by:

- The LAMPS™ product, including the sale of its property rights, contributed \$622,000 to operating income in 2005 for the Company's advanced information services segment.
- The Delmarva and Florida natural gas distribution operations experienced strong residential customer growth of 9 percent and 7 percent, respectively, in 2005.
- Temperatures on the Delmarva Peninsula were 5 percent colder than 2004, which led to increased contributions from the Company's natural gas and propane distribution operations. This increase was offset by conservation efforts by customers.
- The natural gas transmission operation achieved gross margin growth of 9 percent due to additional transportation capacity contracts that went into effect in November 2004.
- A 100 percent increase in the number of customers for the Company's natural gas marketing operation.
- An increase of 1.1 million gallons sold by the Delmarva propane distribution operation.



### ***Natural Gas Distribution, Transmission, and Marketing***

The natural gas segment earned operating income of \$19.7 million for 2006, \$17.2 million for 2005, and \$17.1 million for 2004, resulting in increases of \$2.5 million, or 14.5 percent, for 2006 and \$145,000, or 1.0 percent, for 2005.

#### ***Natural Gas Distribution, Transmission, and Marketing (in thousands)***

| <b>For the Years Ended December 31,</b> | <b>2006</b>     | <b>2005</b>     | <b>Increase<br/>(decrease)</b> | <b>2005</b>     | <b>2004</b>     | <b>Increase<br/>(decrease)</b> |
|---|-----------------|-----------------|--------------------------------|-----------------|-----------------|--------------------------------|
| Revenue                                 | \$170,374       | \$166,582       | \$3,792                        | \$166,582       | \$124,246       | \$42,336                       |
| Cost of gas                             | 117,948         | 116,178         | 1,770                          | 116,178         | 77,456          | 38,722                         |
| Gross margin                            | 52,426          | 50,404          | 2,022                          | 50,404          | 46,790          | 3,614                          |
| Operations & maintenance                | 22,673          | 23,874          | (1,201)                        | 23,874          | 21,129          | 2,745                          |
| Depreciation & amortization             | 6,312           | 5,682           | 630                            | 5,682           | 5,418           | 264                            |
| Other taxes                             | 3,708           | 3,612           | 96                             | 3,612           | 3,152           | 460                            |
| Other operating expenses                | 32,693          | 33,168          | (475)                          | 33,168          | 29,699          | 3,469                          |
| <b>Total Operating Income</b>           | <b>\$19,733</b> | <b>\$17,236</b> | <b>\$2,497</b>                 | <b>\$17,236</b> | <b>\$17,091</b> | <b>\$145</b>                   |

#### ***Heating Degree-Day (HDD) and Customer Analysis***

| <b>For the Years Ended December 31,</b>                  | <b>2006</b>   | <b>2005</b>   | <b>Increase<br/>(decrease)</b> | <b>2005</b>   | <b>2004</b>   | <b>Increase<br/>(decrease)</b> |
|--|---------------|---------------|--------------------------------|---------------|---------------|--------------------------------|
| <b>Heating degree-day data — Delmarva</b>                |               |               |                                |               |               |                                |
| Actual HDD   | 3,931         | 4,792         | (861)                          | 4,792         | 4,553         | 239                            |
| 10-year average HDD                                      | 4,372         | 4,436         | (64)                           | 4,436         | 4,383         | 53                             |
| Estimated gross margin per HDD                           | \$2,013       | \$2,234       | (\$221)                        | \$2,234       | \$1,800       | \$434                          |
| <b>Estimated dollars per residential customer added:</b> |               |               |                                |               |               |                                |
| Gross margin   | \$372         | \$372         | \$0                            | \$372         | \$372         | \$0                            |
| Other operating expenses                                 | \$111         | \$106         | \$5                            | \$106         | \$104         | \$2                            |
| <b>Average number of residential customers</b>           |               |               |                                |               |               |                                |
| Delmarva   | 40,535        | 37,346        | 3,189                          | 37,346        | 34,352        | 2,994                          |
| Florida  | 12,663        | 11,717        | 946                            | 11,717        | 10,910        | 807                            |
| <b>Total</b>   | <b>53,198</b> | <b>49,063</b> | <b>4,135</b>                   | <b>49,063</b> | <b>45,262</b> | <b>3,801</b>                   |

### **2006 Compared to 2005**

Gross margin for the Company's natural gas segment increased \$2.0 million, or 4 percent, and other operating expenses decreased \$475,000, or 1 percent, in 2006 compared to 2005. The gross margin increases of \$1.8 million for the natural gas transmission operation, \$395,000 for the Florida natural gas distribution operation and \$75,000 for the natural gas marketing operation were partially offset by lower gross margin of \$210,000 for the Delmarva natural gas distribution operations.

### **Natural Gas Transmission**

The natural gas transmission operation achieved gross margin growth of \$1.8 million, or 11 percent. Of the \$1.8 million increase, \$1.1 million was attributed to new transportation capacity contracts implemented in November 2005 and \$612,000 due to new transportation capacity contracts implemented in November 2006. In 2007, the new transportation capacity contracts implemented in November 2006 are expected to generate an additional gross margin of \$3.3 million above and beyond 2006 gross margins. An increase of \$416,000 in other operating expenses partially offset the increased gross margin. The factors contributing to the increased expenses are as follow:

- Payroll costs and incentive compensation increased \$108,000 to serve the additional growth experienced by the operation.
- Higher depreciation and asset removal costs of \$558,000 and increased property taxes of \$109,000 due to an increase in the level of capital investment.

## Management's Discussion and Analysis

- A reduction of \$376,000 as a result of the operation receiving approval from the FERC to recover certain pre-service costs associated with the Bay Crossing Project. Please refer to the Regulatory Matters section under Other Matters within Item 2 of the Management's Discussion and Analysis for additional details. As a result of this approval, the Company is deferring the pre-service costs that it incurs. In 2006, the Company deferred \$188,000 of costs previously incurred and expensed in 2005. As a result of this deferral, the amounts recognized in the Company's income statement have declined from 2005 by \$376,000.
- There was an increase of approximately \$17,000 in other operating expenses relating to various minor items.

### Natural Gas Marketing

Gross margin for the natural gas marketing operation increased \$75,000 for 2006 compared to 2005. The increase was attained primarily from an increase in the number of customers to which it provides supply management services. Other operating expenses decreased \$78,000 for the operation due to lower levels of consulting services, partially offset by an increase in the allowance for uncollectible accounts.

### Natural Gas Distribution

Gross margin for the Florida distribution operation increased by \$395,000. The impact of an 8 percent growth in residential customers contributed \$230,000 to gross margin. In addition to residential customer growth, new commercial and industrial customers contributed \$91,000 to gross margin in 2006. The remaining \$74,000 increase in gross margin is attributed to various factors, including turn-on revenue.

The Delmarva distribution operations experienced a decrease of \$210,000 in gross margin. Weather significantly impacted gross margin in 2006 compared to 2005 as temperatures on the Delmarva Peninsula were 18 percent warmer in 2006. The Company estimates that the warmer temperatures in 2006 led to a decrease in gross margin of approximately \$1.7 million when compared to 2005. This decrease was partially offset by continued residential customer growth. The average number of residential customers on the Delmarva Peninsula increased 3,189, or 9 percent, for 2006 compared to 2005 and the Company estimates these additional residential customers contributed approximately \$1.2 million to gross margin. The remaining \$190,000 increase in gross margin can be attributed to various factors, including an increase in the number of commercial customers and decrease of interruptible sales.

Other operating expense for the natural gas distribution operations decreased \$814,000 in 2006 compared to 2005. Some of the key components of the decrease in other operating expenses in 2006, compared to 2005, include the following:

- Health care costs decreased by \$313,000 as a result of the Company changing health care service providers in November 2005 and has subsequently experienced lower costs related to claims.
- Allowance for uncollectible accounts decreased by \$289,000 in 2006 compared to 2005 due to lower revenues and increased collection efforts. Revenues are down due to lower prices and warmer temperatures.
- Incentive compensation decreased \$177,000 in 2006 to reflect lower than expected earnings
- Lower corporate costs due to lower payroll and related expenses.
- Depreciation and amortization expense and asset removal cost increased \$132,000 and \$186,000, respectively, as a result of the Company's continued capital investments.
- Merchant payment fees increased \$136,000 in 2006 compared to 2005 as the Company experienced more customers making payments with the use of credit cards.
- In addition, there is an increase of approximately \$55,000 in other operating expenses relating to various minor items.

### 2005 Compared to 2004

Gross margin for the Company's natural gas segment increased \$3.6 million, or 8 percent, which was partially offset by higher other operating expenses of \$3.5 million in 2005 compared to 2004. Each of the natural gas operations

experienced year-over-year increases in gross margin in 2005, primarily from customer growth, colder temperatures, and changes in rate design.

#### Natural Gas Transmission

The natural gas transmission operation achieved gross margin growth of \$1.4 million, or 9 percent, primarily due to additional contracts signed in November 2004 for transportation capacity provided to its firm customers. In addition, the Company's capital investments enabled the natural gas transmission operations to execute additional transportation capacity contracts in November 2005. An increase of \$980,000 in other operating expenses partially offset the increased gross margin. The factors contributing to the increased expenses were associated with continued economic growth, as well as higher depreciation and property taxes due to an increase in the level of capital investments.

#### Natural Gas Marketing

Gross margin for the natural gas marketing operation increased \$506,000, or 39 percent, for 2005 compared to 2004 as the number of customers to which it provides supply management services increased 100 percent. The increase in gross margin was partially offset by an increase of \$352,000 in other operating expenses due to higher levels of staff and other operating costs necessary to support the increase in business.

#### Natural Gas Distribution

Gross margin for the Delaware and Maryland distribution divisions increased \$1.2 million, as temperatures in 2005 were 5 percent colder than 2004 and the number of residential customers increased 8.7 percent. An increase in gross margin from the colder weather of \$534,000 was offset by a decrease of \$651,000 in gas deliveries to customers as a result of conservation efforts in response to the higher gas prices. Gross margin for the Florida distribution operations increased \$579,000, primarily due to changes in the customer rate design and a 7.4 percent increase in the number of residential customers served. The Company estimates the rate design changes contributed \$322,000 in additional gross margin and resulted in the Florida division collecting a greater percentage of revenues from fixed charges, rather than variable charges based upon consumption. Other operating expense for the natural gas distribution operations increased \$2.1 million in 2005. Some of the key components of the increase in other operating expenses in 2005, compared to 2004, include the following:

- The incremental operating and maintenance cost of supporting the residential customers added by the Delmarva and Florida distribution operations was approximately \$403,000.
- In response to higher natural gas prices, the Company increased its allowance for uncollectible accounts by \$98,000.
- The cost of providing health care for our employees increased \$180,000.
- Costs of line location activities increased \$177,000.
- With the additional capital investments, depreciation expense, asset removal cost and property taxes increased \$225,000, \$130,000 and \$319,000, respectively.

#### **Propane**

The propane segment experienced a decrease of \$675,000 in operating income in 2006 compared to 2005, reflecting a gross margin decrease of \$1.1 million, which was partially offset by a decrease in operating expenses of \$464,000. During 2005, the propane segment increased operating income by \$845,000, or 36 percent, over 2004. Gross margin in 2005 increased \$2.6 million over 2004, which more than offset the increase of \$1.7 million of operating expenses.

## Management's Discussion and Analysis

### Propane (in thousands)

| For the Years Ended December 31, | 2006           | 2005           | Increase       |                | Increase       |              |
|----------------------------------|----------------|----------------|----------------|----------------|----------------|--------------|
|                                  |                |                | (decrease)     | 2005           | 2004           | (decrease)   |
| Revenue                          | \$48,576       | \$48,976       | (\$400)        | \$48,976       | \$41,500       | \$7,476      |
| Cost of sales                    | 30,780         | 30,041         | 739            | 30,041         | 25,155         | 4,886        |
| Gross margin                     | 17,796         | 18,935         | (1,139)        | 18,935         | 16,345         | 2,590        |
| Operations & maintenance         | 12,823         | 13,355         | (532)          | 13,355         | 11,718         | 1,637        |
| Depreciation & amortization      | 1,659          | 1,574          | 85             | 1,574          | 1,524          | 50           |
| Other taxes                      | 780            | 797            | (17)           | 797            | 739            | 58           |
| Other operating expenses         | 15,262         | 15,726         | (464)          | 15,726         | 13,981         | 1,745        |
| <b>Total Operating Income</b>    | <b>\$2,534</b> | <b>\$3,209</b> | <b>(\$675)</b> | <b>\$3,209</b> | <b>\$2,364</b> | <b>\$845</b> |

### Propane Heating Degree-Day (HDD) Analysis — Delmarva

| For the Years Ended December 31, | 2006    | 2005    | Increase   |         | Increase |            |
|----------------------------------|---------|---------|------------|---------|----------|------------|
|                                  |         |         | (decrease) | 2005    | 2004     | (decrease) |
| Heating degree-days              |         |         |            |         |          |            |
| Actual                           | 3,931   | 4,792   | (861)      | 4,792   | 4,553    | 239        |
| 10-year average                  | 4,372   | 4,436   | (64)       | 4,436   | 4,383    | 53         |
| Estimated gross margin per HDD   | \$1,743 | \$1,743 | \$0        | \$1,743 | \$1,691  | \$52       |

### 2006 Compared to 2005

Operating income for the propane segment decreased \$675,000, or 21 percent, to \$2.5 million for 2006 compared to 2005. This decrease was due primarily to warmer weather on the Delmarva Peninsula in 2006, which resulted in reduced customer consumption. Gross margin in the Delmarva propane distribution operations was lower when compared to 2005 by \$834,000, primarily due to warmer weather. Gross margin also decreased in the Florida propane distribution operation and the Company's wholesale propane marketing operation by \$146,000 and \$159,000, respectively.

#### Delmarva Propane Distribution

The Delmarva propane distribution operation's decrease in gross margin of \$834,000 resulted from the following items:

- Volumes sold in 2006 decreased 1.9 million gallons, or 8 percent, primarily from temperatures on the Delmarva Peninsula being 18 percent warmer during 2006 when compared to 2005. The Company estimates that the warmer temperatures resulted in a decrease in gross margin of approximately \$1.7 million when compared to 2005.
- Gross margin increased \$956,000 from an increase of \$0.0302 in the average gross margin per retail gallon in 2006 compared to 2005.
- Gross margin for the Delmarva CGS increased \$155,000 when compared to the prior period, primarily from an increase in the average number of customers. The average number of customers increased by approximately 1,000 to a total count of approximately 3,900, or a 34 percent increase, when compared to 2005. The Company expects the growth of its CGS operation to continue as the number of systems currently under construction or under contract is anticipated to provide for an additional 7,700 customers.
- Gross margin was adversely impacted by a \$272,000 write-down of propane inventory to reflect the lower of cost or market.
- The remaining gross margin decrease of \$29,000 is attributed primarily to customer conservation and changes in the timing of deliveries to customers.

Other operating expenses decreased \$335,000 for the Delmarva operations in 2006, compared to 2005. The significant items contributing to the decrease are explained below.

- The Company recovered \$387,000 in fixed costs from one of its propane suppliers in response to a propane contamination incident that occurred in March 2006. The Company identified that approximately 75,000 gallons of propane that it purchased from the supplier contained above-normal levels of petroleum byproducts.
- Health care costs decreased by \$324,000. The Company changed health care service providers in November 2005 and has subsequently experienced lower costs related to claims.
- In addition, there is a decrease of approximately \$39,000 in other operating expenses relating to various minor items.
- These lower costs were partially offset by increased costs of \$176,000 for one of the Pennsylvania start-ups, which began operation in July 2005, increased payroll costs of \$165,000 and higher costs of \$74,000 associated with vehicle fuel.

#### Florida Propane Distribution

The Florida propane distribution operation experienced a decrease in gross margin of \$146,000, or 12 percent, when compared to the same period in 2005. The lower gross margin reflects a decrease of \$208,000 for in-house piping sales as the operation exited the house piping service, which was partially offset by an increase in gross margin of \$62,000 from propane sales. The increase in gross margin from propane sales was attained primarily from an increase in the average gross margin per retail gallon, partially offset by a 1 percent decrease in the volumes sold in 2006. Florida propane experienced a decrease in other operating expenses in 2006 compared to 2005 of \$49,000 attributed to lower payroll and benefits costs due to vacant positions during the year, partially offset by higher expenses related to leak testing and depreciation expense.

#### Propane Wholesale and Marketing

Gross margin for the Company's propane wholesale marketing operation decreased by \$159,000 in 2006 compared to 2005. This decrease from the 2005 results reflects the increased market opportunities that rose in 2005 due to the extreme price volatility in the propane wholesale market from rising propane prices following the hurricanes in the Gulf of Mexico area. The same level of price fluctuations was not experienced in 2006. The decrease in gross margin was partially offset by lower other operating expenses of \$79,000 attributed primarily to lower incentive compensation as a result of the lower earnings in 2006.

#### 2005 Compared to 2004

Operating income for the propane segment increased \$846,000, or 36 percent, to \$3.2 million for 2005 compared to 2004. Gross margin in the Delmarva propane distribution operations was higher when compared to 2004 by \$1.8 million, primarily due to colder weather. Gross margin also increased in the Florida propane distribution operation and the Company's wholesale propane marketing operation by \$385,000 and \$445,000, respectively.

#### Delmarva Propane Distribution

The gross margin increase for the propane segment was due primarily to an increase of \$1.8 million for the Delmarva distribution operations. Volumes sold in 2005 increased 1.1 million gallons or 5 percent. Temperatures in 2005 were 5 percent colder than 2004, causing an estimated gross margin increase of \$417,000. Additionally, the gross margin per retail gallon improved by \$0.0342 in 2005 compared to 2004. Gross margin per gallon increased as a result of market prices rising greater than the Company's inventory price per gallon. This trend reverses when market prices decrease and move closer to the Company's inventory price per gallon. The gross margin increase was partially offset by increased other operating expenses of \$1.5 million. The higher other operating costs were attributable to the Pennsylvania start-up costs and expenses related to higher earnings, such as incentive compensation and other taxes, employee benefits, insurance, vehicle fuel and maintenance expenses, and a non-recurring credit of \$100,000 for vehicle insurance audits in 2004. The Pennsylvania start-up costs accounted for \$722,000, or approximately 49 percent, of the increase in operating expenses.

## Management's Discussion and Analysis

### Florida Propane Distribution

Gross margin for the Florida propane distribution operations increased \$385,000, or 45 percent, in 2005 compared to 2004. The increase in gross margin was attained from an increase of 27% in the average number of customers, which contributed to the \$267,000 in propane sales gross margin, and an increase of \$118,000 in house-piping sales. Florida propane also experienced an increase in other operating expenses of \$147,000 attributed to business growth, such as payroll, vehicle fuel and maintenance, insurance, and depreciation expense.

### Propane Wholesale and Marketing

The Company's propane wholesale marketing operation experienced an increase in gross margin of \$445,000 and an increase of \$121,000 in other operating expenses, leading to an improvement of \$323,000 in operating income over 2004. Wholesale price volatility created trading opportunities during the third and fourth quarters of the year; however, these were partially offset by reduced trading activities particularly in the first half of the year when the wholesale marketing operation followed a conservative marketing strategy, which lowered risk and earnings, in light of continued high wholesale price levels.

### **Advanced Information Services**

The advanced information services segment provides domestic and international clients with information technology related business services and solutions for both enterprise and e-business applications. The advanced information services business contributed operating income of \$767,000 for 2006, \$1.2 million for 2005, and \$387,000 for 2004.

#### **Advanced Information Services (in thousands)**

| <b>For the Years Ended December 31,</b> | <b>2006</b>  | <b>2005</b>    | <b>Increase<br/>(decrease)</b> | <b>2005</b>    | <b>2004</b>  | <b>Increase<br/>(decrease)</b> |
|---|--------------|----------------|--------------------------------|----------------|--------------|--------------------------------|
| Revenue                                 | \$12,568     | \$14,140       | (\$1,572)                      | \$14,140       | \$12,427     | \$1,713                        |
| Cost of sales                           | 7,082        | 7,181          | (99)                           | 7,181          | 7,015        | 166                            |
| Gross margin                            | 5,486        | 6,959          | (1,473)                        | 6,959          | 5,412        | 1,547                          |
| Operations & maintenance                | 4,119        | 5,129          | (1,010)                        | 5,129          | 4,405        | 724                            |
| Depreciation & amortization             | 113          | 123            | (10)                           | 123            | 138          | (15)                           |
| Other taxes                             | 487          | 510            | (23)                           | 510            | 482          | 28                             |
| Other operating expenses                | 4,719        | 5,762          | (1,043)                        | 5,762          | 5,025        | 737                            |
| <b>Total Operating Income</b>           | <b>\$767</b> | <b>\$1,197</b> | <b>(\$430)</b>                 | <b>\$1,197</b> | <b>\$387</b> | <b>\$810</b>                   |

### **2006 Compared to 2005**

Operating income for advanced information services business decreased \$430,000 to \$767,000 for 2006 compared to \$1.2 million in 2005. The operating income for 2005 included operating income of \$993,000 for LAMPS™, inclusive of a \$924,000 pre-tax gain on the sale of the product. The LAMPS™ product was sold to Fidelity National Information Solutions, Inc., a subsidiary of Fidelity National Financial, Inc., in October 2005.

Revenues for the period decreased \$1.6 million compared to 2005, due primarily to elimination of \$1.9 million of revenue generated by the LAMPS™ product in 2005. Consulting revenues increased \$749,000 in 2006 when compared to 2005, primarily from offering a new service, Managed Database Administration ("MDBA"), to its customers in 2006 and an increase of 7.6 percent in the average hourly billing rate, while the number of billable hours remained at the same level of 2005. The MDBA service provides third parties with professional database monitoring and support solutions during business hours or around the clock. The MDBA service contributed \$470,000 to consulting revenues. Partially offsetting the increase in consulting revenues were decreases of \$128,000 and \$244,000 from training and product sales and other revenues, respectively.

Cost of sales for 2006 decreased \$99,000 to \$7.08 million, compared to 2005. The 2005 cost of sales of \$7.18 million included \$401,000 related to LAMPS™. Absent the cost of sales associated with the LAMPS™ product, cost of sales increased in 2006 compared to 2005 to support the higher revenues.

Other operating expenses decreased \$1.0 million in 2006 to \$4.7 million, when compared to 2005. The reduction in expenses primarily reflects expenses of \$554,000 in 2005 associated with LAMPS™ and lower benefits costs, rent expense and consulting costs.

#### **2005 Compared to 2004**

The advanced information services segment had operating income of \$1.2 million and \$387,000 for years 2005 and 2004, respectively. The results for 2005 and 2004 include revenues and costs related to the LAMPS™ product that was sold in October 2005, which resulted in a \$924,000 pre-tax gain.

Revenues for 2005 increased \$1.7 million to \$14.1 million compared to revenues of \$12.4 million for 2004. The 2005 and 2004 revenue figures include \$2.4 million and \$149,000 of revenue relating to the LAMPS™ product for those respective years. Decreases in consulting revenues for the eBusiness group of \$793,000 and lower sales of Progress software licenses of \$285,000 accounted for the decrease in revenue when compared to 2004. This decrease was partially offset by the performance revenue of \$238,000 received in the third quarter 2005 and an increase of \$317,000 in consulting revenues for the Enterprise Solutions group. The performance revenue was related to the sale of the webproEX software that took place in 2003. As part of the sale agreement, Chesapeake received a percentage of revenues after certain annual revenue and performance targets were reached.

Cost of sales for 2005 increased \$165,000 to \$7.2 million, compared to \$7.0 million for 2004. The increase in cost of sales was attributed to the LAMPS™ product. The 2005 and 2004 cost of sales figures included \$511,000 and \$345,000 of cost for the LAMPS™ product. Other operating expenses increased \$738,000 in 2005 to \$5.8 million, compared to \$5.0 million in 2004. The increase in other operating cost was attributed to the increase of costs relating to the LAMPS™ product. The costs associated with the LAMPS™ product for 2005 and 2004 were \$1.2 million and \$575,000 respectively. The remaining increase was primarily due to health care claims and office rent, which were offset by cost containment measures implemented in the second quarter of 2005 to reduce operating expenses.

#### ***Other Operations and Eliminations***

Other operations consist primarily of subsidiaries that own real estate leased to other Company subsidiaries and the results of operations for OnSight Energy, LLC ("OnSight"). Eliminations are entries required to eliminate activities between business segments from the consolidated results. Other operations and eliminating entries generated an operating loss of \$103,000 for 2006 compared to an operating loss of \$112,000 for 2005. The operating loss in both 2006 and 2005 is attributed to results of OnSight.

The Company formed OnSight in 2004 to provide distributed energy services. Distributed energy refers to a variety of small, modular power generating technologies that may be combined with heating and/or cooling systems. For 2006, OnSight had an operating loss of \$401,000 compared to an operating loss of \$390,000 for 2005. The higher operating loss in 2006 when compared to 2005 is the result of:

- In the third quarter of 2006, actions were taken to reduce operating expenses going forward, which resulted in a charge of \$65,000 to other operating expenses associated with staff reductions.
- The 2005 results of operation includes the impact of OnSight completing its first and only contract to date, which occurred in the second quarter of 2005.

## Management's Discussion and Analysis

### Other Operations & Eliminations (in thousands)

| For the Years Ended December 31,     | 2006           | 2005           | Increase<br>(decrease) | 2005           | 2004         | Increase<br>(decrease) |
|--------------------------------------|----------------|----------------|------------------------|----------------|--------------|------------------------|
| Revenue                              | \$620          | \$763          | (\$143)                | \$763          | \$647        | \$116                  |
| Cost of sales                        | 1              | 116            | (115)                  | 116            | -            | 116                    |
| Gross margin                         | 619            | 647            | (28)                   | 647            | 647          | -                      |
| Operations & maintenance             | 479            | 472            | 7                      | 472            | 278          | 194                    |
| Depreciation & amortization          | 163            | 220            | (57)                   | 220            | 210          | 10                     |
| Other taxes                          | 83             | 97             | (14)                   | 97             | 63           | 34                     |
| Other operating expenses             | 725            | 789            | (64)                   | 789            | 551          | 238                    |
| Operating Income — Other             | (\$106)        | (\$142)        | \$36                   | (\$142)        | \$96         | (\$238)                |
| Operating Income — Eliminations      | \$3            | \$30           | (\$27)                 | \$30           | \$32         | (\$2)                  |
| <b>Total Operating Income (Loss)</b> | <b>(\$103)</b> | <b>(\$112)</b> | <b>\$9</b>             | <b>(\$112)</b> | <b>\$128</b> | <b>(\$240)</b>         |

### Discontinued Operations

In 2003, Chesapeake decided to exit the water services business. Six of seven water dealerships were sold during 2003 and the remaining operation was sold in October 2004. The results of the water companies' operations, for all periods presented in the consolidated income statements, have been reclassified to discontinued operations and shown net of tax. For 2004, the discontinued operations experienced a net loss of \$121,000. The Company did not have any discontinued operations in 2006 and 2005.

### Income Taxes

Income tax expense for 2006 was \$6.8 million compared to \$6.3 million for 2005. Income taxes increased in 2006 compared to 2005, due primarily to increased taxable income. Income taxes increased in 2005 compared to 2004, due to increased income. The effective current federal income tax rate for 2006 and 2005 was 35 percent, whereas the rate for 2004 was 34 percent. During 2006, 2005, and 2004, the Company realized benefit of \$220,000, \$223,000, and \$205,000, respectively, from a change in the tax law that allows tax deductions for dividends paid on Company stock held in Employee Stock Ownership Plans ("ESOP").

### Other Income

Other income was \$189,000, \$383,000, and \$549,000 for the years 2006, 2005, and 2004, respectively. The other income amounts for the years 2006 and 2005 consist of interest income, compared to interest income and gains from the sale of assets for the year 2004.

### Interest Expense

Total interest expense for 2006 increased approximately \$644,000, or 12.5 percent, compared to 2005. The increase reflects the increase in the average short-term debt balance and higher short-term interest rates in 2006 compared to 2005. The average short-term borrowing balance increased \$21.2 million in 2006 to \$26.9 million compared to \$5.7 million in 2005. The large year-over-year increase in the average short-term borrowing balance was primarily to finance the \$39.3 million of net property, plant, and equipment added in 2006. The weighted average interest rate for short-term borrowing increased from 4.47 percent for 2005 to 5.47 percent for 2006. The average long-term debt balance during 2006 was \$67.2 million with a weighted average interest rate of 6.98 percent, compared to \$67.4 million with a weighted average interest rate of 7.18 percent for 2005. The Company also capitalized \$586,000 of interest as part of capital project costs during 2006.

Total interest expense for 2005 decreased approximately \$135,000, or 2.6 percent, compared to 2004. The decrease reflects the decrease in the average long-term debt balance. The average long-term debt balance during 2005 was \$67.4 million with a weighted average interest rate of 7.18 percent, compared to \$71.3 million with a weighted average interest rate of 7.17 percent in 2004. The average short-term borrowing balance in 2005 was \$5.7 million, an increase from



\$870,000 in 2004. The weighted average interest rate for short-term borrowing increased from 3.72 percent for 2004 to 4.47 percent for 2005. The Company also capitalized \$136,000 of interest as part of capital project costs during 2005.

### **Liquidity and Capital Resources**

Chesapeake's capital requirements reflect the capital-intensive nature of its business and are principally attributable to its investment in new plant and equipment and the retirement of outstanding debt. The Company relies on cash generated from operations, short-term borrowing, and other sources to meet normal working capital requirements and to finance capital expenditures. During 2006, net cash provided by operating activities was \$30.1 million, cash used by investing activities was \$48.9 million and cash provided by financing activities was \$20.7 million.

During 2005, net cash provided by operating activities was \$13.6 million, cash used by investing activities was \$33.1 million and cash provided by financing activities was \$20.4 million.

As of December 31, 2006, the Board of Directors ("Board") has authorized the Company to borrow up to \$55.0 million of short-term debt from various banks and trust companies under short-term lines of credit. During 2006, the Board authorized increases in the Company's borrowing authority up to \$75 million to fund the 2006 capital budget and working capital. The \$75 million limit was subsequently reduced to its current level by the Board on November 7, 2006, following the placement on October 12, 2006 of \$20 million 5.50 percent Senior Notes.

On December 31, 2006, the Company had four unsecured bank lines of credit with two financial institutions, totaling \$80.0 million, none of which required compensating balances. These bank lines provide funds for the Company's short-term cash needs to meet seasonal working capital requirements and to temporarily fund portions of its capital expenditures. Two of the bank lines, totaling \$15.0 million, are committed. The other two lines are subject to the banks' availability of funds. The outstanding balances of short-term debt at December 31, 2006 and 2005 were \$27.6 million and \$35.5 million, respectively. The level of short-term debt was reduced with funds provided from the placement of \$20 million of 5.5 percent Senior Notes in October 2006 and from the proceeds of the issuance of 600,300 shares of common stock in November 2006.

Chesapeake has budgeted \$45.5 million for capital expenditures during 2007. This amount includes \$20.2 million for natural gas distribution, \$16.5 million for natural gas transmission, \$7.5 million for propane distribution and wholesale marketing, \$154,000 for advanced information services and \$915,000 million for other operations. The natural gas distribution and transmission expenditures are for expansion and improvement of facilities. The propane expenditures are to support customer growth and for the replacement of equipment. The advanced information services expenditures are for computer hardware, software and related equipment. The other category includes general plant, computer software and hardware. Financing for the 2007 capital expenditure program is expected from short-term borrowing, cash provided by operating activities, and other sources. The capital expenditure program is subject to continuous review and modification. Actual capital requirements may vary from the above estimates due to a number of factors, including acquisition opportunities, changing economic conditions, customer growth in existing areas, regulation, new growth opportunities and availability of capital.

Chesapeake expects to incur approximately \$75,000 in 2007 and 2008 for environmental-related expenditures. Additional expenditures may be required in future years (see Note M to the Consolidated Financial Statements). Management does not expect financing of future environmental-related expenditures to have a material adverse effect on the financial position or capital resources of the Company.

#### ***Cash Flows Provided by Operating Activities***

Our cash flows provided by (used in) operating activities were as follows:

## Management's Discussion and Analysis

| For the Years Ended December 31,          | 2006                | 2005                | 2004                |
|---|---------------------|---------------------|---------------------|
| Net income                                | \$10,506,525        | \$10,467,614        | \$9,428,767         |
| Non-cash adjustments to net income        | 11,186,418          | 13,059,678          | 16,342,116          |
| Changes in working capital                | 8,424,055           | (9,927,351)         | (3,767,730)         |
| <b>Net cash from operating activities</b> | <b>\$30,116,998</b> | <b>\$13,599,941</b> | <b>\$22,003,153</b> |

Year-over-year changes in our cash flows from operating activities are attributable primarily to net income, depreciation and working capital changes. The changes in working capital are impacted by weather, the price of natural gas and propane, the timing of customer collections, payments of natural gas and propane purchases, and deferred gas cost recoveries.

The Company generates a large portion of its annual net income and subsequent increases in our accounts receivable in the first and fourth quarters of each year due to significant volumes of natural gas and propane delivered by our Delmarva natural gas and propane distribution operations to our customers during the peak heating season. In addition, our natural gas and propane inventories, which usually peak in the fall months, are largely drawn down in the heating season and provide a source of cash as the inventory is used to satisfy winter sales demand.

During this period, our accounts payable increased to reflect payments due to providers of the natural gas, propane commodities and pipeline capacity. The value of the natural gas and propane can vary significantly from one period to the next as a result of volatility in the prices of these commodities. Our natural gas costs and deferred purchased natural gas costs due from, or to, our customers represent the difference between natural gas costs that we have paid to suppliers in the past and amounts that we have collected from customers. These natural gas costs can cause significant variations in cash flows from period to period.

In 2006, our net cash flow provided by operating activities was \$30.1 million, an increase of \$16.5 million from the same period of 2005. The increase was primarily a result of the recovery of working capital during 2006 that was deployed in 2005 due to the significantly higher commodity prices and the amount of working capital required for operations. Contributing to this increase was a decrease in the amount of natural gas and propane purchased for inventory of \$6.1 million as a result of mild weather in the prior heating season and therefore higher inventory balances for the current heating season.

In 2005, our net cash flow provided by operating activities was \$13.6 million, a decrease of \$8.4 million from the same period of 2004. The decrease was primarily a result of increased working capital requirements including increased spending of \$5.7 million for seasonal natural gas and propane inventories in advance of the winter sales demand. We spent more on these inventories in 2005 primarily because of higher natural gas and propane prices due to the effects of the hurricanes in the Gulf Coast region. The Company also used \$1.2 million of cash to purchase investments for the Rabbi Trust associated with the Company's Supplemental Executive Retirement Savings Plan. See Note E on Investments in Item 8 under the heading "Financial Statements and Supplemental Data."

### **Cash Flows Used in Investing Activities**

Net cash flows used in investing activities totaled \$48.9 million, \$33.1 million, and \$15.5 million during fiscal years 2006, 2005, and 2004, respectively. In fiscal years 2006, 2005, and 2004, \$48.8 million, \$33.3 million, and \$16.4 million, respectively, of cash were utilized for capital expenditures. Additions to property, plant and equipment in 2006 were primarily for natural gas transmission (\$28.0 million), natural gas distribution (\$16.1 million) and propane distribution (\$4.3 million). In both 2006 and 2005, the natural gas distribution expenditures were used primarily to fund expansion and facilities improvements. Natural gas transmission capital expenditures related primarily to expanding the Company's transmission system.

### **Cash Flows Provided by Financing Activities**

Cash flows provided by financing activities totaled \$20.7 million during 2006, \$20.4 million during 2005 and cash flows used by financing activities was \$8.0 million for 2004. Our significant financing activities for the years 2006, 2005, and 2004 are summarized as follow:

- In November 2006, the Company sold 600,300 shares of common stock, including the underwriter's exercise of their over-allotment option of 90,045 shares, pursuant to a shelf registration statement declared effective in November 2006, generating net proceeds of \$19.7 million.
- In October 2006, the Company placed \$20 million of 5.5 percent Senior Notes ("Notes") to three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company). The original note agreement was executed on October 18, 2005 and provided for the Company to sell the Notes at any time prior to January 15, 2007.
- The Company repaid \$4.9 million of long-term debt during 2006 compared with \$4.8 million during 2005 and \$3.7 million during 2004.
- During 2006, the Company reduced short-term debt by \$8.0 million. During 2005 and 2004, net borrowing of short-term debt increased by \$29.6 million and \$1.2 million, respectively, primarily to support our capital investment.
- During 2006, the Company paid \$6.0 million in cash dividends compared with dividend payments of \$5.8 million and \$5.6 million for years 2005 and 2004, respectively. The increase in dividends paid over prior year reflects the increase in the dividend rate from \$1.14 per share during 2005 to \$1.16 per share during 2006 and the issuance of additional shares of common stock.
- In August 2006, the Company paid cash of \$435,000, in lieu of issuing shares of the Company's common stock for the 30,000 stock warrants outstanding at December 31, 2005.

### **Capital Structure**

The following presents our capitalization as of December 31, 2006 and 2005:

|  | <b>December 31,</b>                       |             |             |      |
|--|---|-------------|-------------|------|
|  | <b>2006</b>                               |             | <b>2005</b> |      |
|  | <i>(In thousands, except percentages)</i> |             |             |      |
| Long-term debt, net of current maturities              | <b>\$71,050</b>                           | <b>39%</b>  | \$58,990    | 41%  |
| Shareholders' equity                                   | <b>\$111,152</b>                          | <b>61%</b>  | \$84,757    | 59%  |
| <b>Total capitalization, excluding short-term debt</b> | <b>\$182,202</b>                          | <b>100%</b> | \$143,747   | 100% |

The Company increased its capitalization by \$38.5 million in 2006 compared to 2005. The increased capitalization was primarily used to fund the \$39.3 million of net property, plant, and equipment added in 2006 and for working capital.

As of December 31, 2006, common equity represented 61 percent of total capitalization, compared to 59 percent in 2005.

## Management's Discussion and Analysis

The following presents our capitalization as of December 31, 2006 and 2005 if short-term borrowing and current portion of long-term debt were included in capitalization:

|  | December 31,                       |             |                  |             |
|--|------------------------------------|-------------|------------------|-------------|
|  | 2006                               |             | 2005             |             |
|  | (In thousands, except percentages) |             |                  |             |
| Short-term debt  | \$27,554                           | 13%         | \$35,482         | 19%         |
| Long-term debt, including current maturities           | \$78,706                           | 36%         | \$63,919         | 35%         |
| Shareholders' equity                                   | \$111,152                          | 51%         | \$84,757         | 46%         |
| <b>Total capitalization, including short-term debt</b> | <b>\$217,412</b>                   | <b>100%</b> | <b>\$184,158</b> | <b>100%</b> |

If short-term borrowing and current portion of long-term debt were included in capitalization, total capitalization increased by \$33.3 million in 2006 compared to 2005. The increased capitalization was primarily used to fund a portion of the \$39.3 million of net property, plant, and equipment added in 2006 and for other general working capital. In addition, if short-term borrowing and the current portion of long-term debt were included in total capitalization, the equity component of the Company's capitalization would have been 51 percent and 46 percent for 2006 and 2005, respectively.

Total debt as a percentage of total capitalization, including short-term debt, was 49 percent and 54 percent at December 31, 2006 and 2005, respectively. The decrease in the debt-to-capitalization ratio in 2006 was primarily attributed to the following:

- The Company sold 600,300 additional shares of common stock pursuant to a shelf registration declared effective by the SEC in November 2006. The sale of these additional shares increased total shareholder's equity by approximately \$19.7 million.
- The outstanding long-term debt balance increased \$14.8 million. Contributing to the increase was the placement of \$20 million of 5.5 percent Senior Notes in October 2006, partially offset by scheduled principal payments.
- The outstanding short-term debt balance decreased \$7.9 million. The Company reduced its outstanding short-term debt with funds received from the sale of additional shares of common stock and the placement of the Senior Notes.

Chesapeake remains committed to maintaining a sound capital structure and strong credit ratings to provide the financial flexibility needed to access the capital markets when required. This commitment, along with adequate and timely rate relief for the Company's regulated operations, is intended to ensure that Chesapeake will be able to attract capital from outside sources at a reasonable cost. The Company believes that the achievement of these objectives will provide benefits to customers and creditors, as well as to the Company's investors.

### Shelf Registration

In July 2006, the Company filed a registration statement on Form S-3 with the SEC to issue up to \$40.0 million in new common stock and/or debt securities. The registration statement was declared effective by the SEC in November 2006. In November 2006, we sold 600,300 shares of common stock, including the underwriter's exercise of their over-allotment option of 90,045 shares, under this registration statement, generating net proceeds of \$19.7 million. The net proceeds from the sale were used for general corporate purposes, including financing of capital expenditures, repayment of short-term debt, and general working capital purposes. At December 31, 2006, the Company had approximately \$20.0 million remaining under this registration statement.

## Contractual Obligations

We have the following contractual obligations and other commercial commitments as of December 31, 2006:

| Contractual Obligations                             | Payments Due by Period |                     |                     |                     | Total                |
|---|------------------------|---------------------|---------------------|---------------------|----------------------|
|   | Less than 1 year       | 1 - 3 years         | 3 - 5 years         | More than 5 years   |                      |
| Long-term debt <sup>(1)</sup>                       | \$7,656,364            | \$14,312,727        | \$14,403,636        | \$42,333,636        | \$78,706,363         |
| Operating leases <sup>(2)</sup>                     | 649,659                | 919,216             | 652,026             | 3,769,640           | 5,990,541            |
| Purchase obligations <sup>(3)</sup>                 |                        |                     |                     |                     |                      |
| Transmission capacity                               | 7,182,746              | 12,413,145          | 8,154,556           | 23,523,355          | 51,273,802           |
| Storage — Natural Gas                               | 1,363,488              | 2,698,742           | 2,666,955           | 5,163,488           | 11,892,673           |
| Commodities   | 17,862,123             |                     |                     |                     | 17,862,123           |
| Forward purchase contracts — Propane <sup>(4)</sup> | 13,868,391             |                     |                     |                     | 13,868,391           |
| Unfunded benefits <sup>(5)</sup>                    | 292,445                | 588,705             | 614,043             | 2,710,528           | 4,205,721            |
| Funded benefits <sup>(6)</sup>                      | 323,500                | 148,364             | 117,732             | 1,419,046           | 2,008,642            |
| <b>Total Contractual Obligations</b>                | <b>\$49,198,716</b>    | <b>\$31,080,899</b> | <b>\$26,608,948</b> | <b>\$78,919,693</b> | <b>\$185,808,256</b> |

<sup>(1)</sup> Principal payments on long-term debt, see Note H, "Long-Term Debt," in the Notes to the Consolidated Financial Statements for additional discussion of this item. The expected interest payments on long-term debt are \$5.2 million, \$8.8 million, \$6.9 million and \$10.0 million, respectively, for the periods indicated above. Expected interest payments for all periods total \$ 30.9 million.

<sup>(2)</sup> See Note J, "Lease Obligations," in the Notes to the Consolidated Financial Statements for additional discussion of this item.

<sup>(3)</sup> See Note N, "Other Commitments and Contingencies," in the Notes to the Consolidated Financial Statements for further information.

<sup>(4)</sup> The Company has also entered into forward sale contracts. See "Market Risk" of the Management's Discussion and Analysis for further information.

<sup>(5)</sup> The Company has recorded long-term liabilities of \$4.2 million at December 31, 2006 for unfunded post-retirement benefit plans. The amounts specified in the table are based on expected payments to current retirees and assumes a retirement age of 65 for currently active employees. There are many factors that would cause actual payments to differ from these amounts, including early retirement, future health care costs that differ from past experience and discount rates implicit in calculations.

<sup>(6)</sup> The Company has recorded long-term liabilities of \$2.0 million at December 31, 2006 for funded benefits. These liabilities have been funded using a Rabbi Trust and an asset in the same amount is recorded under Investments on the Balance Sheet. The defined benefit pension plan was closed to new participants on January 1, 1999 and participants in the plan on that date were given the option to leave the plan. See Note K, "Employee Benefit Plans," in the Notes to the Consolidated Financial Statements for further information on the plan. Since the plan modification, no additional funding has been required from the Company and none is expected for the next five years, based on factors in effect at December 31, 2006. However, this is subject to change based on the actual return earned by the plan assets and other actuarial assumptions, such as the discount rate and long-term expected rate of return on plan assets.

## Off-Balance Sheet Arrangements

The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its natural gas supply and management subsidiary, and propane distribution subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases in the event of the subsidiaries' default. The liabilities for these purchases are recorded in the Consolidated Financial Statements. The aggregate amount guaranteed at December 31, 2006, totaled \$21.4 million, with the guarantees expiring on various dates in 2007.

In addition to the corporate guarantees, the Company has issued a letter of credit to its primary insurance company for \$775,000, which expires on May 31, 2007. The letter of credit is provided as security for claims amounts to satisfy the deductibles on the Company's policies. The current letter of credit was renewed during the second quarter of 2006 when the insurance policies were renewed.

## Regulatory Activities

The Company's natural gas distribution operations are subject to regulation by the Delaware, Maryland and Florida Public Service Commissions. Eastern Shore Natural Gas ("Eastern Shore"). The Company's natural gas transmission operation is subject to regulation by the FERC.

## Management's Discussion and Analysis

Delaware. On September 1, 2006, the Delaware division filed its annual Gas Sales Service Rates ("GSR") application that was effective for service rendered on and after November 1, 2006 with the Delaware Public Service Commission ("Delaware PSC"). On October 3, 2006, the Delaware PSC approved the GSR charges, subject to full evidentiary hearings and a final decision. The Delaware division expects a final decision during the first half of 2007.

On September 2, 2005, the Delaware division filed an application with the Delaware PSC requesting approval of an alternative rate design and rate structure in order to provide natural gas service to prospective customers in eastern Sussex County. While Chesapeake does provide natural gas service to residents and businesses in portions of Sussex County, under the Company's current tariff, natural gas distribution lines have not been extended to a large portion of the State of Delaware's recently targeted growth areas in eastern Sussex County. In April 2002, Governor Ruth Ann Minner established the Delaware Energy Task Force ("Task Force"), whose mission was to address the State of Delaware's long-term and short-term energy challenges. In September 2003, the Task Force issued its final report to the Governor that included a strategy related to enhancing the availability of natural gas within the State by evaluating possible incentives for expanding residential and commercial natural gas service. Chesapeake believes its current proposal to implement a rate design that will enable the Company to provide natural gas as a viable energy choice to a broad number of prospective customers within eastern Sussex County is consistent with the Task Force recommendation. While the Company cannot predict the outcome of its application at this time, the Company anticipates a final decision from the Delaware PSC regarding its application in 2007.

On October 16, 2006, the Delaware division filed an application with the Delaware PSC requesting approval for the issuance of up to \$40,000,000 of common stock and/or debt securities as contained in the shelf registration statement filed with the SEC in July 2006. The Delaware PSC granted approval of the issuance at its regularly scheduled meeting on October 31, 2006.

On November 1, 2006, the Delaware division filed with the Delaware PSC its annual Environmental Rider ("ER") rate application to become effective for service rendered on and after December 1, 2006. The Delaware PSC granted approval of the ER rate at its regularly scheduled meeting on November 21, 2006, subject to full evidentiary hearings and a final decision. The Delaware PSC granted final approval of the ER rate at its regulatory scheduled meeting on January 23, 2007.

On November 9, 2006, the Delaware division filed two applications with the Delaware PSC requesting approval for a Town of Millsboro Franchise Fee Rider and a Town of Georgetown Franchise Fee Rider. These Riders will allow the Delaware division to charge all respective natural gas customers within town limits the franchise fee paid by the Delaware division to the Towns of Millsboro and Georgetown as a condition to providing natural gas service. The Delaware PSC granted approval of both of the Riders at its regularly scheduled meeting on January 23, 2007.

On December 14, 2006, the Delaware division filed an application with the Delaware PSC requesting approval to change its base delivery service rates in order to recover a 1 mill increase in the assessment factor, which had been approved by the state legislature. The Delaware PSC granted approval of the application at its regularly scheduled meeting on December 19, 2006.

Maryland. On May 1, 2006, the Maryland division filed a base rate application with the Maryland Public Service Commission ("Maryland PSC") requesting an overall increase in base rates of approximately \$1,137,000 annually, based on a proposed overall rate of return of 9.7 percent and a return on equity of 11.5 percent. On September 26, 2006, the Maryland PSC approved a base rate increase of approximately \$780,000 annually, based on an overall rate of return of 9.03 percent and a return on equity of 10.75 percent. This increase will result in an average increase in revenues of approximately 4.5 percent for the Maryland division's firm residential, commercial and industrial customers. The PSC also approved the Company's proposal to implement a revenue normalization mechanism for its residential heating and smaller commercial heating customers, reducing the Company's risk due to weather and usage changes.

On December 14, 2006, the Maryland PSC held an evidentiary hearing to determine the reasonableness of the Maryland division's four quarterly gas cost recovery filings during the twelve months ended September 30, 2006. On December 15, 2006, the Hearing Examiner issued proposed findings approving the quarterly gas cost recovery rates as filed by the Maryland division, permitting complete recovery of its purchased gas costs for the period under review. No appeals or written exceptions to the proposed findings were made and a final order approving the quarterly gas cost recovery rates as filed was issued by the Maryland PSC on January 17, 2007.

Florida. On March 22, 2006, the Florida division filed a petition with the Florida Public Service Commission ("Florida PSC") seeking approval of special contracts to provide Delivery Point Operator ("DPO") services. Under the proposed contracts, the DPO services would be provided to an affiliate company, Peninsula Energy Services Company, Inc. The Florida PSC approved the petition on July 7, 2006, ordering that the special contracts be effective June 20, 2006.

On May 16, 2005, the Florida division filed a request with the Florida PSC for approval of a Special Contract with the Department of Management Services, an agency of the State of Florida, for service to the Washington Correction Institution ("WCI"). The Florida PSC approved the Company's request on July 19, 2005, and service to the existing WCI facility began in February 2006. WCI is located in Washington County in the Florida panhandle and is the thirteenth county served by the Company's Florida division.

On September 2, 2005, the Florida division filed a petition for a Declaratory Statement with the Florida PSC for a determination that Peninsula Pipeline Company, Inc. ("PPC"), a wholly owned subsidiary of the Company, qualifies as a natural gas transmission company under the Natural Gas Transmission Pipeline Intrastate Regulatory Act. The Florida PSC approved this Petition at its December 20, 2005 agenda conference, and a final order was issued on January 9, 2006. The determination that PPC qualifies as a natural gas transmission company provides opportunities for investment by PPC to provide natural gas transmission service to industrial customers in Florida by an intrastate pipeline.

On September 15, 2006, the Florida division filed a petition with the Florida PSC for approval of its Energy Conservation Cost Recovery Factors for the year 2007. Approved on November 30<sup>th</sup> by the Florida PSC, the new factors went into effect on January 1, 2007.

On October 10, 2006, the Florida division filed a petition with the Florida PSC for authority to implement phase two of its experimental transitional transportation service ("TTS") pilot program, and for approval of a new tariff to reflect the division's transportation service environment. When approved, the implementation of phase two of the TTS program for residential and certain small commercial consumers will expand the number of pool managers from one to two, and increase the gas supply pricing options available to these consumers. A decision is expected from the Florida PSC in March 2007.

On November 29, 2006, the Florida division filed a petition with the Florida PSC for authority to modify its energy conservation programs. In this petition the Florida division is seeking approval to increase the cash allowances paid within the Residential Homebuilder Program and the Residential Appliance Replacement Program, and to expand the scope of the Residential Water Heater Retention Program to add natural gas heating systems, cooking and clothes drying appliances. A decision is expected from the Florida PSC in March 2007.

Eastern Shore. During October 2002, Eastern Shore filed for recovery of gas supply realignment costs, which totaled \$196,000 (including interest), associated with the implementation of FERC Order No. 636. At that time, the FERC deferred review of the filing pending settlement of a related matter concerning another transmission company. Upon resolution of the issue with the other transmission company, Eastern Shore resubmitted its filing to the FERC, requesting authorization to recover a total of \$223,000 (including interest) of gas supply realignment costs. FERC approved Eastern Shore's filing by letter order dated July 14, 2006.

System Expansion 2006 – 2008. On January 20, 2006, Eastern Shore filed an application for a Certificate of Public Convenience and Necessity for its 2006-2008 system expansion project (the "2006 – 2008 Project") with

## Management's Discussion and Analysis

the FERC. The application requested authority to construct and operate approximately 55 miles of new pipeline facilities and two new metering and regulating station facilities to provide an additional 47,350 dekatherms per day ("dt/d") of firm transportation service in accordance with the phased-in customer requests of 26,200 dt/d in 2006, 10,300 dt/d in 2007, and 10,850 dt/d in 2008, at a total estimated cost of approximately \$33.6 million. The following table provides a breakdown for the additional amounts of firm capacity per day, the estimated capital investment required, and the estimated annual gross margin contribution for the new services that will become effective November 1<sup>st</sup> for each of the respective years of the project:

| Services implemented November 1,     | Year         |             |             |
|--------------------------------------|--------------|-------------|-------------|
|                                      | 2006         | 2007        | 2008        |
| Additional firm capacity per day     | 26,200       | 10,300      | 10,850      |
| Capital investment                   | \$17 million | \$8 million | \$8 million |
| Annualized gross margin contribution | \$3,670,000  | \$1,484,000 | \$1,595,000 |

A Scoping Meeting was held on March 29, 2006 at which the public and all other interested stakeholders were invited to attend to review the project. No opposition to the project was received. On June 13, 2006, the FERC issued a Certificate to Eastern Shore authorizing it to construct and operate the 2006-2008 Project as proposed. Eastern Shore has completed and placed in service the authorized Phase I facilities. Phase II and Phase III facilities are expected to be constructed in 2007 and 2008, respectively.

Bay Crossing Project. On May 31, 2006, Eastern Shore entered into Precedent Agreements with Delmarva Power & Light Company ("Delmarva") and Chesapeake, through its Delaware and Maryland Divisions to provide additional firm transportation services upon completion of its latest proposed pipeline project.

Under the Bay Crossing Project, Eastern Shore has proposed to develop, construct and operate approximately 63 miles of new pipeline facilities that would transport natural gas from Calvert County, Maryland, crossing under the Chesapeake Bay into Dorchester and Caroline Counties, Maryland, to points on the Delmarva Peninsula where such facilities would interconnect with its existing facilities in Sussex County, Delaware.

Chesapeake and Delmarva are currently parties to existing firm natural gas transportation service agreements with Eastern Shore and each desires firm transportation services under the Bay Crossing Project, as evidenced by the May 31 Precedent Agreements. Pursuant to these Precedent Agreements, the parties have agreed to proceed with the required initiatives to obtain the governmental and regulatory authorizations that are necessary for Eastern Shore to provide, and for Chesapeake and Delmarva to utilize, such firm transportation services under the Bay Crossing Project.

During the negotiations of the Precedent Agreements, Eastern Shore and each of the participating customers entered into Letter Agreements which provide that, in the event that the Bay Crossing Project is not certified and placed in service, the participating customers will each pay their proportionate share of certain pre-certification costs by means of a negotiated surcharge of up to \$2 million, over a period of no less than 20 years.

In connection with the Bay Crossing Project, on June 27, 2006 Eastern Shore submitted a petition to the FERC for approval of the uncontested Settlement Agreement. The Settlement Agreement provides Eastern Shore and all customers utilizing Eastern Shore's system with benefits, including but not limited to the following: (1) advancement of a necessary infrastructure project to meet the growing demand for natural gas on the Delmarva Peninsula; (2) sharing of project development costs by the participating customers in the project; and (3) no development cost risk for non-participating customers. On August 1, 2006, the FERC granted approval of the uncontested Settlement Agreement. On September 6, 2006, Eastern Shore submitted to FERC proposed tariff sheets to implement the provisions of the above-referenced Settlement Agreement. By Letter Order dated



October 6, 2006, the FERC accepted the tariff sheets effective September 7, 2006. Eastern Shore anticipates entering into a pre-filing process at the FERC during the first half of 2007 with the ultimate goal of obtaining FERC approval to construct the Proposed Project. Eastern Shore will also be required to obtain permits from other federal, state and local agencies prior to proceeding with construction. It is not until the Company obtains the appropriate approvals and permits that a majority of the total estimated cost of \$93 million for the Bay Crossing Project is estimated to be spent. This estimated cost will depend upon the final size and route of the pipeline, as well as construction materials and labor costs.

Rate Matters. On September 19, 2006, Eastern Shore submitted its Annual Charge Adjustment (“ACA”) compliance filing to reflect the most current ACA surcharge rate as established by the FERC. The compliance filing was accepted by the FERC and the revised ACA surcharge rate became effective on October 1, 2006.

On October 31, 2006 Eastern Shore filed a Section 4 base rate proceeding in compliance with Article IX of the Stipulation & Agreement approved in its prior base rate proceeding in Docket No.RP02-34-000. Eastern Shore’s filed rates, proposed to be effective November 1, 2006, reflect an annual increase of \$5,589,000 over its current rates. The proposed rate increase reflects increases in operating and maintenance expenses, depreciation expense, taxes other than income taxes, and return on new gas plant facilities that are expected to be placed into service before March 31, 2007. Eastern Shore proposed a return on equity of 14.875 percent utilizing a capital structure of 39 percent debt and 61 percent equity.

On November 30, 2006 the FERC issued its *Order Accepting and Suspending Tariff Sheets Subject to Refund and Establishing a Hearing*. The FERC accepted and suspended the effectiveness of Eastern Shore’s rate increase until May 1, 2007, subject to refund and the outcome of the hearing established in the order.

On December 5, 2006 the FERC’s Chief Judge issued an order stating this proceeding is subject to a Track Three procedural schedule. Track Three denotes an exceptionally complex case and provides for a total of 63 weeks within which a formal hearing will be conducted and an Initial Decision issued. The Chief Judge’s order also designated the Presiding Administrative Law Judge (“ALJ”).

On December 19, 2006 the ALJ issued an *Order Establishing Procedural Schedule* as agreed upon by the participants and the Judge at a pre-hearing conference held that same day. The procedural schedule specifies that an Initial Decision shall be issued on February 19, 2008. The ALJ also strongly encouraged the participants in this proceeding to pursue a negotiated settlement through the Commission’s settlement process, thus eliminating the need for a formal hearing.

### **Environmental Matters**

The Company continues to work with federal and state environmental agencies to assess the environmental impact and explore corrective action at three environmental sites (see Note M to the Consolidated Financial Statements). The Company believes that future costs associated with these sites will be recoverable in rates or through sharing arrangements with, or contributions by, other responsible parties.

### **Market Risk**

Market risk represents the potential loss arising from adverse changes in market rates and prices. Long-term debt is subject to potential losses based on the change in interest rates. The Company’s long-term debt consists of senior notes and convertible debentures (see Note H to the Consolidated Financial Statements for annual maturities of consolidated long-term debt). All of Chesapeake’s long-term debt is fixed-rate debt. The carrying value of the Company’s long-term debt, including current maturities, was \$78.7 million at December 31, 2006 as compared to a fair value of \$81.4 million, based mainly on current market prices or discounted cash flows using current rates for similar issues with similar terms and remaining maturities. The Company evaluates whether to refinance existing debt or permanently finance existing short-term borrowing based in part on the fluctuation in interest rates.

## Management's Discussion and Analysis

The Company's propane distribution business is exposed to market risk as a result of propane storage activities and entering into fixed price contracts for supply. The Company can store up to approximately four million gallons of propane (including leased storage and rail cars) during the winter season to meet its customers' peak requirements and to serve metered customers. Decreases in the wholesale price of propane may cause the value of stored propane to decline. To mitigate the impact of price fluctuations, the Company has adopted a Risk Management Policy that allows the propane distribution operation to enter into fair value hedges of its inventory. At December 31, 2006, the propane distribution operation had entered into a swap agreement to protect the Company from the impact of price increases on our price-cap plan that we offer to customers. The Company considers this agreement to be an economic hedge and does not qualify for hedge accounting as described in SFAS 133. At the end of the period, the market price of propane dropped below the unit price within the swap agreement. As a result of the price drop, the Company marked the agreement to market, which resulted in an unrealized loss of \$84,000.

The propane wholesale marketing operation is a party to natural gas liquids ("NGL") forward contracts, primarily propane contracts, with various third parties. These contracts require that the propane wholesale marketing operation purchase or sell NGL at a fixed price at fixed future dates. At expiration, the contracts are settled by the delivery of NGL to the Company or the counterparty or booking out the transaction (booking out is a procedure for financially settling a contract in lieu of the physical delivery of energy). The propane wholesale marketing operation also enters into futures contracts that are traded on the New York Mercantile Exchange. In certain cases, the futures contracts are settled by the payment of a net amount equal to the difference between the current market price of the futures contract and the original contract price.

The forward and futures contracts are entered into for trading and wholesale marketing purposes. The propane wholesale marketing operation is subject to commodity price risk on its open positions to the extent that market prices for NGL deviate from fixed contract settlement amounts. Market risk associated with the trading of futures and forward contracts are monitored daily for compliance with Chesapeake's Risk Management Policy, which includes volumetric limits for open positions. To manage exposures to changing market prices, open positions are marked up or down to market prices and reviewed by oversight officials on a daily basis. Additionally, the Risk Management Committee reviews periodic reports on market and credit risk, approves any exceptions to the Risk Management Policy (within the limits established by the Board of Directors) and authorizes the use of any new types of contracts. Quantitative information on the forward and futures contracts at December 31, 2006 and 2005 is shown in the following charts.

| <b>At December 31, 2006</b> | <b>Quantity<br/>in gallons</b> | <b>Estimated<br/>Market Prices</b> | <b>Weighted Average<br/>Contract Prices</b> |
|-----------------------------|--------------------------------|------------------------------------|---|
| <b>Forward Contracts</b>    |                                |                                    |   |
| Sale                        | 13,797,000                     | \$0.9250 — \$1.2100                | \$1.0107                                    |
| Purchase                    | 13,733,800                     | \$0.9250 — \$1.2200                | \$1.0098                                    |

*Estimated market prices and weighted average contract prices are in dollars per gallon.  
All contracts expire in 2007.*

| <b>At December 31, 2005</b> | <b>Quantity<br/>in gallons</b> | <b>Estimated<br/>Market Prices</b> | <b>Weighted Average<br/>Contract Prices</b> |
|-----------------------------|--------------------------------|------------------------------------|---|
| <b>Forward Contracts</b>    |                                |                                    |   |
| Sale                        | 20,794,200                     | \$1.0350 — \$1.1013                | \$1.0718                                    |
| Purchase                    | 20,202,000                     | \$1.0100 — \$1.0450                | \$1.0703                                    |

*Estimated market prices and weighted average contract prices are in dollars per gallon.  
All contracts expired in 2006.*

The Company's natural gas distribution and marketing operations have entered into agreements with natural gas suppliers to purchase natural gas for resale to their customers. Purchases under these contracts either do not meet the definition of derivatives in SFAS No. 133 or are considered "normal purchases and sales" under SFAS No. 138 and are not marked to market.

## **Competition**

The Company's natural gas operations compete with other forms of energy including electricity, oil and propane. The principal competitive factors are price, and to a lesser extent, accessibility. The Company's natural gas distribution operations have several large volume industrial customers that have the capacity to use fuel oil as an alternative to natural gas. When oil prices decline, these interruptible customers convert to oil to satisfy their fuel requirements. Lower levels in interruptible sales occur when oil prices are lower relative to the price of natural gas. Oil prices, as well as the prices of electricity and other fuels, are subject to fluctuation for a variety of reasons; therefore, future competitive conditions are not predictable. To address this uncertainty, the Company uses flexible pricing arrangements on both the supply and sales side of this business to maximize sales volumes. As a result of the transmission business' conversion to open access and the Florida division's restructuring of its services, their businesses have shifted from providing competitive sales service to providing transportation and contract storage services.

The Company's natural gas distribution operations located in Delaware, Maryland and Florida offer transportation services to certain commercial and industrial customers. In 2002, the Florida operation extended transportation service to residential customers. With transportation service available on the Company's distribution systems, the Company is competing with third-party suppliers to sell gas to industrial customers. As it relates to transportation services, the Company's competitors include the interstate transmission company if the distribution customer is located close enough to the transmission company's pipeline to make a connection economically feasible. The customers at risk are usually large volume commercial and industrial customers with the financial resources and capability to bypass the distribution operations in this manner. In certain situations, the distribution operations may adjust services and rates for these customers to retain their business. The Company expects to continue to expand the availability of transportation service to additional classes of distribution customers in the future. The Company established a natural gas sales and supply operation in Florida to compete for customers eligible for transportation services. The Company also provides sales service in Delaware.

The Company's propane distribution operations compete with several other propane distributors in their service territories, primarily on the basis of service and price, emphasizing reliability of service and responsiveness. Competition is generally from local outlets of national distribution companies and local businesses, because distributors located in close proximity to customers incur lower costs of providing service. Propane competes with electricity as an energy source, because it is typically less expensive than electricity, based on equivalent BTU value. Propane also competes with home heating oil as an energy source. Since natural gas has historically been less expensive than propane, propane is generally not distributed in geographic areas serviced by natural gas pipeline or distribution systems.

The propane wholesale marketing operation competes against various marketers, many of which have significantly greater resources and are able to obtain price or volumetric advantages.

The advanced information services business faces significant competition from a number of larger competitors having substantially greater resources available to them than does the Company. In addition, changes in the advanced information services business are occurring rapidly, which could adversely impact the markets for the products and services offered by these businesses. This segment competes on the basis of technological expertise, reputation and price.

## **Inflation**

Inflation affects the cost of labor, products and services required for operation, maintenance and capital improvements. While the impact of inflation has remained low in recent years, natural gas and propane prices are subject to rapid fluctuations. Fluctuations in natural gas prices are passed on to customers through the gas cost recovery mechanism in the Company's tariffs. To help cope with the effects of inflation on its capital investments and returns, the Company seeks rate relief from regulatory commissions for regulated operations while monitoring the returns of its unregulated business operations. To compensate for fluctuations in propane gas prices, Chesapeake adjusts its propane selling prices to the extent allowed by the market.

## Management's Discussion and Analysis

### Cautionary Statement

Chesapeake has made statements in this report that are considered to be forward-looking statements. These statements are not matters of historical fact. Sometimes they contain words such as "believes," "expects," "intends," "plans," "will" or "may," and other similar words of a predictive nature. These statements relate to matters such as customer growth, changes in revenues or gross margin, capital expenditures, environmental remediation costs, regulatory approvals, market risks associated with the Company's propane wholesale marketing operation, competition, inflation and other matters. It is important to understand that these forward-looking statements are not guarantees but are subject to certain risks and uncertainties and other important factors that could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things:

- the temperature sensitivity of the natural gas and propane businesses;
- the effect of spot, forward and futures market prices on the Company's distribution, wholesale marketing and energy trading businesses;
- amount and availability of natural gas and propane supplies and the access to interstate pipelines' transportation and storage capacity;
- the effects of natural gas and propane commodity price changes may affect the operating costs and competitive positions of our natural gas and propane distribution operations;
- the effects of competition on the Company's unregulated and regulated businesses;
- the effect of changes in federal, state or local regulatory and tax requirements, including deregulation;
- the effect of changes in technology on the Company's advanced information services segment;
- the effects of credit risk and credit requirements on the Company's energy marketing subsidiaries;
- the effect of accounting changes;
- the effect of changes in benefit plan assumptions;
- the effect of compliance with environmental regulations or the remediation of environmental damage;
- the effects of general economic conditions and including interest rates on the Company and its customers;
- the ability of the Company's new and planned facilities and acquisitions to generate expected revenues;
- the Company's ability to obtain the rate relief and cost recovery requested from utility regulators and the timing of the requested regulatory actions; and
- the Company's ability to obtain necessary approvals and permits by regulatory agencies on a timely basis.

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

Information concerning quantitative and qualitative disclosure about market risk is included in Item 7 under the heading "Management's Discussion and Analysis — Market Risk."

#### **ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

##### **Management's Report on Internal Control Over Financial Reporting**

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Under the supervision and with the participation of management, including the principal executive officer and principal financial officer, Chesapeake's management conducted an evaluation of the effectiveness of its internal control over financial reporting based on the criteria established in a report entitled "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. Chesapeake's management has evaluated and concluded that Chesapeake's internal control over financial reporting was effective as of December 31, 2006.

Management's assessment of the effectiveness of Chesapeake's internal control over financial reporting as of December 31, 2006 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which is included herein.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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To the Board of Directors and Stockholders  
of Chesapeake Utilities Corporation

We have completed integrated audits of Chesapeake Utilities Corporation's consolidated financial statements and of its internal control over financial reporting as of December 31, 2006, in accordance with the standards of the Public Company Accounting Oversight Board (United States). Our opinions, based on our audits, are presented below.

### Consolidated financial statements and financial statement schedule

In our opinion, the consolidated financial statements listed in the index appearing under Item 15(a)(1) present fairly, in all material respects, the financial position of Chesapeake Utilities Corporation and its subsidiaries at December 31, 2006 and 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index appearing under Item 15(a)(2) presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note K to the consolidated financial statements, the Company changed the manner in which it accounts for defined benefit pension and other postretirement plans, effective December 31, 2006.


### Internal control over financial reporting

Also, in our opinion, management's assessment, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 8, that the Company maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is fairly stated, in all material respects, based on those criteria. Furthermore, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in *Internal Control - Integrated Framework* issued by the COSO. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express opinions on management's assessment and on the effectiveness of the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies

and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The image shows a handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PRICEWATERHOUSECOOPERS LLP  
Boston, MA  
March 13, 2007

## Consolidated Statements of Income

| For the Years Ended December 31,   | 2006                 | 2005                 | 2004                 |
|--|----------------------|----------------------|----------------------|
| <b>Operating Revenues</b>  | <b>\$231,200,591</b> | <b>\$229,629,736</b> | <b>\$177,955,441</b> |
| <b>Operating Expenses</b>  |                      |                      |                      |
| Cost of sales, excluding costs below   | 155,810,622          | 153,514,739          | 109,626,377          |
| Operations   | 37,053,223           | 40,181,648           | 35,146,595           |
| Maintenance  | 2,103,562            | 1,818,981            | 1,518,774            |
| Depreciation and amortization  | 8,243,715            | 7,568,209            | 7,257,538            |
| Other taxes  | 5,058,158            | 5,015,660            | 4,436,411            |
| <b>Total operating expenses</b>  | <b>208,269,280</b>   | <b>208,099,237</b>   | <b>157,985,695</b>   |
| <b>Operating Income</b>  | <b>22,931,311</b>    | <b>21,530,499</b>    | <b>19,969,746</b>    |
| Other income net of other expenses   | 189,112              | 382,626              | 549,156              |
| Interest charges   | 5,777,336            | 5,133,495            | 5,268,145            |
| <b>Income Before Income Taxes</b>  | <b>17,343,087</b>    | <b>16,779,630</b>    | <b>15,250,757</b>    |
| Income taxes   | 6,836,562            | 6,312,016            | 5,701,090            |
| <b>Net Income from Continuing Operations</b>                                   | <b>10,506,525</b>    | <b>10,467,614</b>    | <b>9,549,667</b>     |
| Loss from discontinued operations, net of tax benefit of \$0, \$0 and \$59,751 | -                    | -                    | (120,900)            |
| <b>Net Income</b>  | <b>\$10,506,525</b>  | <b>\$10,467,614</b>  | <b>\$9,428,767</b>   |
| <b>Earnings Per Share of Common Stock:</b>                                     |                      |                      |                      |
| <u>Basic</u>   |                      |                      |                      |
| From continuing operations   | \$1.74               | \$1.79               | \$1.66               |
| From discontinued operations   | -                    | -                    | (0.02)               |
| <b>Net Income</b>  | <b>\$1.74</b>        | <b>\$1.79</b>        | <b>\$1.64</b>        |
| <u>Diluted</u>   |                      |                      |                      |
| From continuing operations   | \$1.72               | \$1.77               | \$1.64               |
| From discontinued operations   | -                    | -                    | (0.02)               |
| <b>Net Income</b>  | <b>\$1.72</b>        | <b>\$1.77</b>        | <b>\$1.62</b>        |

*The accompanying notes are an integral part of the financial statements.*



## Consolidated Statements of Cash Flows

| For the Years Ended December 31,   | 2006               | 2005               | 2004               |
|--|--------------------|--------------------|--------------------|
| <b>Operating Activities</b>  |                    |                    |                    |
| Net Income   | \$10,506,525       | \$10,467,614       | \$9,428,767        |
| Adjustments to reconcile net income to net operating cash:                         |                    |                    |                    |
| Depreciation and amortization  | 8,243,715          | 7,568,209          | 7,257,538          |
| Depreciation and accretion included in other costs                                 | 3,102,066          | 2,705,620          | 2,611,779          |
| Deferred income taxes, net   | (408,533)          | 1,510,777          | 4,559,207          |
| Unrealized gain (loss) on commodity contracts                                      | 37,110             | (227,193)          | 353,183            |
| Unrealized loss on investments   | (151,952)          | (56,650)           | (43,256)           |
| Employee benefits and compensation   | 382,608            | 1,621,607          | 1,536,586          |
| Other, net   | (18,596)           | (62,692)           | 67,079             |
| Changes in assets and liabilities:   |                    |                    |                    |
| Sale (purchase) of investments   | (177,990)          | (1,242,563)        | 43,354             |
| Accounts receivable and accrued revenue  | 9,705,860          | (16,831,751)       | (11,723,505)       |
| Propane inventory, storage gas and other inventory                                 | 354,764            | (5,704,040)        | (1,741,941)        |
| Regulatory assets  | 2,498,954          | (1,719,184)        | 428,516            |
| Prepaid expenses and other current assets  | (271,438)          | 36,704             | (221,137)          |
| Other deferred charges   | (231,822)          | (102,561)          | (168,898)          |
| Long-term receivables  | 137,101            | 247,600            | 428,964            |
| Accounts payable and other accrued liabilities                                     | (11,434,370)       | 15,569,924         | 9,731,360          |
| Income taxes receivable (payable)  | 1,800,913          | (2,006,762)        | (229,237)          |
| Accrued interest   | 273,672            | (42,376)           | (51,272)           |
| Customer deposits and refunds  | 2,361,265          | 462,781            | 665,549            |
| Accrued compensation   | (542,512)          | 875,342            | (794,194)          |
| Regulatory liabilities   | 2,824,068          | 144,501            | (191,266)          |
| Other liabilities  | 1,125,590          | 385,034            | 55,977             |
| Net cash provided by operating activities  | 30,116,998         | 13,599,941         | 22,003,153         |
| <b>Investing Activities</b>  |                    |                    |                    |
| Property, plant and equipment expenditures   | (48,845,828)       | (33,319,613)       | (16,435,938)       |
| Sale of investments  | -                  | -                  | 135,170            |
| Sale of discontinued operations  | -                  | -                  | 415,707            |
| Environmental recoveries (expenditures)  | (15,549)           | 240,336            | 369,719            |
| Net cash used by investing activities  | (48,861,377)       | (33,079,277)       | (15,515,342)       |
| <b>Financing Activities</b>  |                    |                    |                    |
| Common stock dividends   | (5,982,531)        | (5,789,180)        | (5,560,535)        |
| Issuance of stock for Dividend Reinvestment Plan                                   | 321,865            | 458,757            | 200,551            |
| Stock issuance   | 19,698,509         | -                  | -                  |
| Cash settlement of warrants  | (434,782)          | -                  | -                  |
| Change in cash overdrafts due to outstanding checks                                | 49,047             | 874,083            | (143,720)          |
| Net borrowing (repayment) under line of credit agreements                          | (7,977,347)        | 29,606,400         | 1,184,742          |
| Proceeds from issuance of long-term debt   | 20,000,000         | -                  | -                  |
| Repayment of long-term debt  | (4,929,674)        | (4,794,827)        | (3,665,589)        |
| Net cash provided (used) by financing activities                                   | 20,745,087         | 20,355,233         | (7,984,551)        |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>                        | <b>2,000,708</b>   | <b>875,897</b>     | <b>(1,496,740)</b> |
| <b>Cash and Cash Equivalents — Beginning of Period</b>                             | <b>2,487,658</b>   | <b>1,611,761</b>   | <b>3,108,501</b>   |
| <b>Cash and Cash Equivalents — End of Period</b>                                   | <b>\$4,488,366</b> | <b>\$2,487,658</b> | <b>\$1,611,761</b> |
| <b>Supplemental Disclosures of Non-Cash Investing Activities:</b>                  |                    |                    |                    |
| Capital property and equipment acquired on account, but not paid as of December 31 | \$1,490,890        | \$1,367,348        | \$1,678,724        |
| <b>Supplemental Disclosure of Cash Flow information</b>                            |                    |                    |                    |
| Cash paid for interest   | \$5,334,477        | \$5,052,013        | \$5,280,299        |
| Cash paid for income taxes   | \$6,285,272        | \$6,342,476        | \$1,977,223        |

The accompanying notes are an integral part of the financial statements.

## Consolidated Balance Sheets

| <b>Assets</b>  |                      |                      |
|--|----------------------|----------------------|
| <b>At December 31,</b>   | <b>2006</b>          | <b>2005</b>          |
| <b>Property, Plant and Equipment</b>   |                      |                      |
| Natural gas distribution and transmission  | \$269,012,516        | \$220,685,461        |
| Propane  | 44,791,552           | 41,563,810           |
| Advanced information services  | 1,054,368            | 1,221,177            |
| Other plant  | 9,147,500            | 9,275,729            |
| Total property, plant and equipment  | 324,005,936          | 272,746,177          |
| Less: Accumulated depreciation and amortization  | (85,010,472)         | (78,840,413)         |
| Plus: Construction work in progress  | 1,829,948            | 7,598,531            |
| Net property, plant and equipment  | 240,825,412          | 201,504,295          |
| <b>Investments</b>   | <b>2,015,577</b>     | <b>1,685,635</b>     |
| <b>Current Assets</b>  |                      |                      |
| Cash and cash equivalents  | 4,488,366            | 2,487,658            |
| Accounts receivable (less allowance for uncollectible accounts of \$661,597 and \$861,378, respectively) | 44,969,182           | 54,284,011           |
| Accrued revenue  | 4,325,351            | 4,716,383            |
| Propane inventory, at average cost   | 7,187,035            | 6,332,956            |
| Other inventory, at average cost   | 1,564,937            | 1,538,936            |
| Regulatory assets  | 1,275,653            | 4,434,828            |
| Storage gas prepayments  | 7,393,335            | 8,628,179            |
| Income taxes receivable  | 1,078,882            | 2,725,840            |
| Deferred income taxes  | 1,365,316            | -                    |
| Prepaid expenses   | 2,280,900            | 2,021,164            |
| Other current assets   | 1,553,284            | 1,596,797            |
| Total current assets   | 77,482,241           | 88,766,752           |
| <b>Deferred Charges and Other Assets</b>   |                      |                      |
| Goodwill   | 674,451              | 674,451              |
| Other intangible assets, net   | 191,878              | 205,683              |
| Long-term receivables  | 824,333              | 961,434              |
| Other regulatory assets  | 1,765,088            | 1,178,232            |
| Other deferred charges   | 1,215,004            | 1,003,393            |
| Total deferred charges and other assets  | 4,670,754            | 4,023,193            |
| <b>Total Assets</b>  | <b>\$324,993,984</b> | <b>\$295,979,875</b> |

*The accompanying notes are an integral part of the financial statements.*

## Capitalization and Liabilities

| At December 31,  | 2006                 | 2005                 |
|--|----------------------|----------------------|
| <b>Capitalization</b>  |                      |                      |
| Stockholders' equity   |                      |                      |
| Common Stock, par value \$0.4867 per share<br>(authorized 12,000,000 shares) (1) | \$3,254,998          | \$2,863,212          |
| Additional paid-in capital   | 61,960,220           | 39,619,849           |
| Retained earnings  | 46,270,884           | 42,854,894           |
| Accumulated other comprehensive income   | (334,550)            | (578,151)            |
| Deferred compensation obligation   | 1,118,509            | 794,535              |
| Treasury stock   | (1,118,509)          | (797,156)            |
| <b>Total stockholders' equity</b>  | <b>111,151,552</b>   | <b>84,757,183</b>    |
| <b>Long-term debt, net of current maturities</b>                                 | <b>71,050,000</b>    | <b>58,990,363</b>    |
| <b>Total capitalization</b>  | <b>182,201,552</b>   | <b>143,747,546</b>   |
| <b>Current Liabilities</b>   |                      |                      |
| Current portion of long-term debt  | 7,656,364            | 4,929,091            |
| Short-term borrowing   | 27,553,941           | 35,482,241           |
| Accounts payable   | 33,870,552           | 45,645,228           |
| Customer deposits and refunds  | 7,502,265            | 5,140,999            |
| Accrued interest   | 832,392              | 558,719              |
| Dividends payable  | 1,939,482            | 1,676,398            |
| Income taxes payable   | -                    | -                    |
| Deferred income taxes  | -                    | 1,150,828            |
| Accrued compensation   | 2,901,053            | 3,793,244            |
| Regulatory liabilities   | 4,199,147            | 550,546              |
| Other accrued liabilities  | 4,005,795            | 3,560,055            |
| <b>Total current liabilities</b>   | <b>90,460,991</b>    | <b>102,487,349</b>   |
| <b>Deferred Credits and Other Liabilities</b>                                    |                      |                      |
| Deferred income taxes  | 26,517,098           | 24,248,624           |
| Deferred investment tax credits  | 328,277              | 367,085              |
| Other regulatory liabilities   | 1,236,254            | 2,008,779            |
| Environmental liabilities  | 211,581              | 352,504              |
| Accrued pension costs  | 1,608,311            | 3,099,882            |
| Accrued asset removal cost   | 18,410,992           | 16,727,268           |
| Other liabilities  | 4,018,928            | 2,940,838            |
| <b>Total deferred credits and other liabilities</b>                              | <b>52,331,441</b>    | <b>49,744,980</b>    |
| <b>Other Commitments and Contingencies (Note N)</b>                              |                      |                      |
| <b>Total Capitalization and Liabilities</b>                                      | <b>\$324,993,984</b> | <b>\$295,979,875</b> |

(1) Shares issued were 6,688,084 and 5,883,099 for 2006 and 2005, respectively.

Shares outstanding were 6,688,084 and 5,883,002 for 2006 and 2005, respectively.

*The accompanying notes are an integral part of the financial statements.*

## Consolidated Statements of Stockholders' Equity

| For the Years Ended December 31,                            | 2006                 | 2005                | 2004                |
|---|----------------------|---------------------|---------------------|
| <b>Common Stock</b>   |                      |                     |                     |
| Balance — beginning of year                                 | \$2,863,212          | \$2,812,538         | \$2,754,748         |
| Dividend Reinvestment Plan                                  | 18,685               | 20,038              | 20,125              |
| Retirement Savings Plan                                     | 14,457               | 10,255              | 19,058              |
| Conversion of debentures                                    | 8,117                | 11,004              | 9,060               |
| Performance shares and options exercised <sup>(1)</sup>     | 14,536               | 9,377               | 9,547               |
| Stock issuance  | 335,991              | -                   | -                   |
| Balance — end of year                                       | 3,254,998            | 2,863,212           | 2,812,538           |
| <b>Additional Paid-in Capital</b>                           |                      |                     |                     |
| Balance — beginning of year                                 | 39,619,849           | 36,854,717          | 34,176,361          |
| Dividend Reinvestment Plan                                  | 1,148,100            | 1,224,874           | 996,715             |
| Retirement Savings Plan                                     | 900,354              | 682,829             | 946,319             |
| Conversion of debentures                                    | 275,300              | 373,259             | 307,940             |
| Performance shares and options exercised <sup>(1)</sup>     | 887,426              | 484,170             | 427,382             |
| Stock issuance  | 19,362,518           | -                   | -                   |
| Exercise warrants, net of tax                               | (233,327)            | -                   | -                   |
| Balance — end of year                                       | 61,960,220           | 39,619,849          | 36,854,717          |
| <b>Retained Earnings</b>                                    |                      |                     |                     |
| Balance — beginning of year                                 | 42,854,894           | 39,015,087          | 36,008,246          |
| Net income  | 10,506,525           | 10,467,614          | 9,428,767           |
| Cash dividends <sup>(2)</sup>                               | (7,090,535)          | (6,627,807)         | (6,403,450)         |
| Loss on issuance of treasury stock                          | -                    | -                   | (18,476)            |
| Balance — end of year                                       | 46,270,884           | 42,854,894          | 39,015,087          |
| <b>Accumulated Other Comprehensive Income</b>               |                      |                     |                     |
| Balance — beginning of year                                 | (578,151)            | (527,246)           | -                   |
| Minimum pension liability adjustment, net of tax            | 74,036               | (50,905)            | (527,246)           |
| Gain on funded status of Employee Benefit Plans, net of tax | 169,565              | -                   | -                   |
| Balance — end of year                                       | (334,550)            | (578,151)           | (527,246)           |
| <b>Deferred Compensation Obligation</b>                     |                      |                     |                     |
| Balance — beginning of year                                 | 794,535              | 816,044             | 913,689             |
| New deferrals   | 323,974              | 130,426             | 296,790             |
| Payout of deferred compensation                             | -                    | (151,935)           | (394,435)           |
| Balance — end of year                                       | 1,118,509            | 794,535             | 816,044             |
| <b>Treasury Stock</b>                                       |                      |                     |                     |
| Balance — beginning of year                                 | (797,156)            | (1,008,696)         | (913,689)           |
| New deferrals related to compensation obligation            | (323,974)            | (130,426)           | (296,790)           |
| Purchase of treasury stock                                  | (51,572)             | (182,292)           | (344,753)           |
| Sale and distribution of treasury stock                     | 54,193               | 524,258             | 546,536             |
| Balance — end of year                                       | (1,118,509)          | (797,156)           | (1,008,696)         |
| <b>Total Stockholders' Equity</b>                           | <b>\$111,151,552</b> | <b>\$84,757,183</b> | <b>\$77,962,444</b> |

<sup>(1)</sup> Includes amounts for shares issued for Directors' compensation.

<sup>(2)</sup> Cash dividends declared per share for 2006, 2005 and 2004 were \$1.16, \$1.14 and \$1.12, respectively.

## Consolidated Statements of Comprehensive Income

|   |                     |                     |                    |
|---|---------------------|---------------------|--------------------|
| Net income  | \$10,506,525        | \$10,467,614        | \$9,428,767        |
| Pension liability adjustment, net of tax of<br>\$48,889, \$33,615 and \$347,726, respectively | 74,036              | (50,905)            | (527,246)          |
| <b>Comprehensive Income</b>   | <b>\$10,580,561</b> | <b>\$10,416,709</b> | <b>\$8,901,521</b> |

*The accompanying notes are an integral part of the financial statements.*

## Consolidated Statements of Income Taxes

| For the Years Ended December 31,                    | 2006               | 2005               | 2004               |
|---|--------------------|--------------------|--------------------|
| <b>Current Income Tax Expense</b>                   |                    |                    |                    |
| Federal   | \$5,994,296        | \$3,687,800        | \$1,221,155        |
| State   | 1,424,485          | 789,233            | 618,916            |
| Investment tax credit adjustments, net              | (54,816)           | (54,816)           | (54,816)           |
| <b>Total current income tax expense</b>             | <b>7,363,965</b>   | <b>4,422,217</b>   | <b>1,785,255</b>   |
| <b>Deferred Income Tax Expense <sup>(1)</sup></b>   |                    |                    |                    |
| Property, plant and equipment                       | 1,697,024          | 1,380,628          | 4,230,650          |
| Deferred gas costs                                  | (2,085,066)        | 1,064,310          | 283,547            |
| Pensions and other employee benefits                | (97,436)           | (340,987)          | (49,620)           |
| Environmental expenditures                          | (5,580)            | (98,229)           | (150,864)          |
| Other   | (36,345)           | (115,923)          | (397,878)          |
| <b>Total deferred income tax expense</b>            | <b>(527,403)</b>   | <b>1,889,799</b>   | <b>3,915,835</b>   |
| <b>Total Income Tax Expense</b>                     | <b>\$6,836,562</b> | <b>\$6,312,016</b> | <b>\$5,701,090</b> |
| <b>Reconciliation of Effective Income Tax Rates</b> |                    |                    |                    |
| Federal income tax expense <sup>(2)</sup>           | \$6,070,080        | \$5,872,871        | \$5,185,257        |
| State income taxes, net of federal benefit          | 804,988            | 708,192            | 736,176            |
| Other   | (38,506)           | (269,047)          | (220,343)          |
| <b>Total Income Tax Expense</b>                     | <b>\$6,836,562</b> | <b>\$6,312,016</b> | <b>\$5,701,090</b> |
| <b>Effective income tax rate</b>                    | <b>39.4%</b>       | <b>37.6%</b>       | <b>37.4%</b>       |

| At December 31,   | 2006                | 2005                |
|---|---------------------|---------------------|
| <b>Deferred Income Taxes</b>                                |                     |                     |
| <b>Deferred income tax liabilities:</b>                     |                     |                     |
| Property, plant and equipment                               | \$27,997,744        | \$26,795,452        |
| Environmental costs   | 204,149             | -                   |
| Deferred gas costs  | -                   | 1,664,252           |
| Other   | 870,424             | 612,943             |
| <b>Total deferred income tax liabilities</b>                | <b>29,072,317</b>   | <b>29,072,647</b>   |
| <b>Deferred income tax assets:</b>                          |                     |                     |
| Pension and other employee benefits                         | 2,225,944           | 2,289,370           |
| Self insurance  | 468,922             | 575,303             |
| Environmental costs   | -                   | 181,734             |
| Deferred gas costs  | 528,814             | -                   |
| Other   | 696,855             | 626,788             |
| <b>Total deferred income tax assets</b>                     | <b>3,920,535</b>    | <b>3,673,195</b>    |
| <b>Deferred Income Taxes Per Consolidated Balance Sheet</b> | <b>\$25,151,782</b> | <b>\$25,399,452</b> |

(1) Includes (\$54,000), \$146,000 and \$386,000 of deferred state income taxes for the years 2006, 2005 and 2004, respectively.

(2) Federal income taxes were recorded at 35% for the years 2006 and 2005. They were recorded at 34% in 2004.

*The accompanying notes are an integral part of the financial statements.*

## Notes to the Consolidated Financial Statements

### A. SUMMARY OF ACCOUNTING POLICIES

#### ***Nature of Business***

Chesapeake Utilities Corporation (“Chesapeake” or “the Company”) is engaged in natural gas distribution to approximately 59,100 customers located in central and southern Delaware, Maryland’s Eastern Shore and Florida. The Company’s natural gas transmission subsidiary operates an intrastate pipeline from various points in Pennsylvania and northern Delaware to the Company’s Delaware and Maryland distribution divisions, as well as other utility and industrial customers in Pennsylvania, Delaware and the Eastern Shore of Maryland. The Company’s propane distribution and wholesale marketing segment provides distribution service to approximately 33,300 customers in central and southern Delaware, the Eastern Shore of Maryland, southeastern Pennsylvania, central Florida and the Eastern Shore of Virginia, and markets propane to wholesale customers including large independent oil and petrochemical companies, resellers and propane distribution companies in the southeastern United States. The advanced information services segment provides domestic and international clients with information technology related business services and solutions for both enterprise and e-business applications.

#### ***Principles of Consolidation***

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. The Company does not have any ownership interests in investments accounted for using the equity method or any variable interests in a variable interest entity. All intercompany transactions have been eliminated in consolidation.

#### ***System of Accounts***

The natural gas distribution divisions of the Company located in Delaware, Maryland and Florida are subject to regulation by their respective Public Service Commissions with respect to their rates for service, maintenance of their accounting records and various other matters. Eastern Shore Natural Gas Company is an open access pipeline and is subject to regulation by the Federal Energy Regulatory Commission (“FERC”). Our financial statements are prepared in accordance with generally accepted accounting principles, which give appropriate recognition to the ratemaking and accounting practices and policies of the various commissions. The propane, advanced information services and other business segments are not subject to regulation with respect to rates or maintenance of accounting records.

#### ***Property, Plant, Equipment and Depreciation***

Utility and non-utility property is stated at original cost. The costs of repairs and minor replacements are charged against income as incurred and the costs of major renewals and betterments are capitalized. Upon retirement or disposition of non-utility property, the gain or loss, net of salvage value, is charged to income. Upon retirement or disposition of utility property, the gain or loss, net of salvage value, is charged to accumulated depreciation. The provision for depreciation is computed using the straight-line method at rates that amortize the unrecovered cost of depreciable property over the estimated remaining useful life of the asset. Depreciation and amortization expenses are provided at an annual rate for each segment. The three-year average rates were 3 percent for natural gas distribution and transmission, 5 percent for propane, 11 percent for advanced information services and 7 percent for general plant.

| At December 31,                           | 2006          | 2005          | Useful Life <sup>(1)</sup>                       |
|---|---------------|---------------|--|
| Plant in service                          |               |               |  |
| Mains                                     | \$151,890,304 | \$113,111,408 | 24-37 years                                      |
| Services — utility                        | 32,334,145    | 29,010,008    | 14-28 years                                      |
| Compressor station equipment              | 24,921,976    | 23,853,871    | 28 years   |
| Liquefied petroleum gas equipment         | 24,627,398    | 22,162,867    | 30-39 years                                      |
| Meters and meter installations            | 16,093,737    | 15,165,212    | Propane 15-33 years, Natural gas 17-49 years     |
| Measuring and regulating station equipmer | 13,272,201    | 12,219,964    | 17-37 years                                      |
| Office furniture and equipment            | 10,114,101    | 9,572,926     | Non-regulated 3-10 years, Regulated 3-20 years   |
| Transportation equipment                  | 10,686,259    | 9,822,272     | 2-11 years                                       |
| Structures and improvements               | 9,538,345     | 9,161,696     | 5-44 years <sup>(2)</sup>                        |
| Land and land rights                      | 7,386,268     | 5,646,852     | Not depreciable, except certain regulated assets |
| Propane bulk plants and tanks             | 5,301,457     | 6,097,036     | 15 - 40 years                                    |
| Various                                   | 17,839,745    | 16,922,065    | Various  |
| Total plant in service                    | 324,005,936   | 272,746,177   |  |
| Plus construction work in progress        | 1,829,948     | 7,598,531     |  |
| Less accumulated depreciation             | (85,010,472)  | (78,840,413)  |  |
| Net property, plant and equipment         | \$240,825,412 | \$201,504,295 |  |

<sup>(1)</sup> Certain immaterial account balances may fall outside this range.

The regulated operations compute depreciation in accordance with rates approved by either the state Public Service Commission or the FERC. These rates are based on depreciation studies and may change periodically upon receiving approval from the appropriate regulatory body. The depreciation rates shown above are based on the remaining useful lives of the assets at the time of the depreciation study, rather than their original lives. The depreciation rates are composite, straight-line rates applied to the average investment for each class of depreciable property and are adjusted for anticipated cost of removal less salvage value.

The non-regulated operations compute depreciation using the straight-line method over the estimated useful life of the asset.

<sup>(2)</sup> Includes buildings, structures used in connection with natural gas and propane operations, improvements to those facilities and leasehold improvements.

### **Cash and Cash Equivalents**

The Company's policy is to invest cash in excess of operating requirements in overnight income producing accounts. Such amounts are stated at cost, which approximates market value. Investments with an original maturity of three months or less when purchased are considered cash equivalents.

### **Inventories**

The Company uses the average cost method to value propane and materials and supplies inventory. If the market prices drop below cost, inventory balances that are subject to price risk are adjusted to market values.

### **Regulatory Assets, Liabilities and Expenditures**

The Company accounts for its regulated operations in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation." This standard includes accounting principles for companies whose rates are determined by independent third-party regulators. When setting rates, regulators often make decisions, the economics of which require companies to defer costs or revenues in different periods than may be appropriate for unregulated enterprises. When this situation occurs, the regulated utility defers the associated costs as assets (regulatory assets) on the balance sheet, and records them as expense on the income statement as it collects revenues. Further, regulators can also impose liabilities upon a company for amounts previously collected from customers, and for recovery of costs that are expected to be incurred in the future (regulatory liabilities).

At December 31, 2006 and 2005, the regulated utility operations had recorded the following regulatory assets and liabilities on the Balance Sheets. These assets and liabilities will be recognized as revenues and expenses in future periods as they are reflected in customers' rates.

## Notes to the Consolidated Financial Statements

| At December 31,                                  | 2006                | 2005                |
|--|---------------------|---------------------|
| <b>Regulatory Assets</b>                         |                     |                     |
| <b>Current</b>                                   |                     |                     |
| Underrecovered purchased gas costs               | \$1,076,921         | \$4,016,522         |
| Conservation cost recovery                       | 51,408              | 303,930             |
| Swing transportation imbalances                  | -                   | 454                 |
| PSC Assessment                                   | 22,290              | -                   |
| Flex rate asset                                  | 81,926              | 113,922             |
| Other  | 43,108              | -                   |
| <b>Total current</b>                             | <b>1,275,653</b>    | <b>4,434,828</b>    |
| <b>Non-Current</b>                               |                     |                     |
| Income tax related amounts due from customers    | 1,300,544           | 711,961             |
| Deferred regulatory and other expenses           | 188,686             | 89,258              |
| Deferred gas supply                              | 15,201              | 15,201              |
| Deferred post retirement benefits                | 138,949             | 166,739             |
| Environmental regulatory assets and expenditures | 121,708             | 195,073             |
| <b>Total non-current</b>                         | <b>1,765,088</b>    | <b>1,178,232</b>    |
| <b>Total Regulatory Assets</b>                   | <b>\$3,040,741</b>  | <b>\$5,613,060</b>  |
| <b>Regulatory Liabilities</b>                    |                     |                     |
| <b>Current</b>                                   |                     |                     |
| Self insurance — current                         | \$568,897           | \$44,221            |
| Overrecovered purchased gas costs                | 2,351,553           | -                   |
| Shared interruptible margins                     | 100,355             | 3,039               |
| Operational flow order penalties                 | 7,831               | 7,831               |
| Swing transportation imbalances                  | 1,170,511           | 495,455             |
| <b>Total current</b>                             | <b>4,199,147</b>    | <b>550,546</b>      |
| <b>Non-Current</b>                               |                     |                     |
| Self insurance — long-term                       | 600,787             | 1,383,247           |
| Income tax related amounts due to customers      | 285,819             | 327,893             |
| Environmental overcollections                    | 349,648             | 297,639             |
| <b>Total non-current</b>                         | <b>1,236,254</b>    | <b>2,008,779</b>    |
| Accrued asset removal cost                       | 18,410,992          | 16,727,268          |
| <b>Total Regulatory Liabilities</b>              | <b>\$23,846,393</b> | <b>\$19,286,593</b> |

Included in the regulatory assets listed above are \$133,000 of which is accruing interest. Of the remaining regulatory assets, \$1.4 million will be collected in approximately one to two years, \$310,000 will be collected within approximately 3 to 10 years, and \$1.4 million are awaiting regulatory approval for recovery, but once approved are expected to be collected within 12 months.

As required by SFAS No. 71, the Company monitors its regulatory and competitive environment to determine whether the recovery of its regulatory assets continues to be probable. If the Company were to determine that recovery of these assets is no longer probable, it would write off the assets against earnings. The Company believes that SFAS No. 71 continues to apply to its regulated operations, and that the recovery of its regulatory assets is probable.

### **Goodwill and Other Intangible Assets**

The Company accounts for its goodwill and other intangibles under SFAS No. 142, "Goodwill and Other Intangible Assets." Under SFAS No. 142, goodwill is not amortized, but it is tested for impairment at least annually. In addition, goodwill of a reporting unit is tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. Other intangible assets are amortized on a straight-line basis over their estimated economic useful lives. Please refer to Note F "Goodwill and Other Intangible Assets" for additional discussions of this area.



**Other Deferred Charges**

Other deferred charges include discount, premium and issuance costs associated with long-term debt. Debt costs are deferred and then are amortized to interest expense over the original lives of the respective debt issuances. Deferred post-employment benefits are adjusted based on current age, the present value of the projected annual benefit received and estimated life expectancy.

**Income Taxes and Investment Tax Credit Adjustments**

The Company files a consolidated federal income tax return. Income tax expense allocated to the Company's subsidiaries is based upon their respective taxable incomes and tax credits.

Deferred tax assets and liabilities are recorded for the tax effect of temporary differences between the financial statements bases and tax bases of assets and liabilities and are measured using current effective income tax rates. The portions of the Company's deferred tax liabilities applicable to utility operations, which have not been reflected in current service rates, represent income taxes recoverable through future rates. Investment tax credits on utility property have been deferred and are allocated to income ratably over the lives of the subject property.

**Financial Instruments**

Xeron, Inc. ("Xeron"), the Company's propane wholesale marketing operation, engages in trading activities using forward and futures contracts which have been accounted for using the mark-to-market method of accounting. Under mark-to-market accounting, the Company's trading contracts are recorded at fair value, net of future servicing costs. The changes in market price are recognized as gains or losses in revenues on the income statement in the period of change. The resulting unrealized gains and losses are recorded as assets or liabilities, respectively. There were unrealized gains of \$8,500 and \$46,000 at December 31, 2006 and 2005, respectively. Trading liabilities are recorded in other accrued liabilities. Trading assets are recorded in prepaid expenses and other current assets.

The Company's natural gas and propane distribution operations have entered into agreements with natural gas and propane suppliers to purchase gas for resale to their customers. Purchases under these contracts either do not meet the definition of derivatives in SFAS No. 133 or are considered "normal purchases and sales" under SFAS No. 138 and are accounted for on an accrual basis.

The propane distribution operation has entered into a fair value hedge of its inventory, in order to mitigate the impact of wholesale price fluctuations. At December 31, 2006, the propane distribution operation had entered into a swap agreement to protect the Company from the impact of price increases on our price-cap plan that we offer to customers. The Company considers this agreement to be an economic hedge and does not qualify for hedge accounting as described in SFAS 133. At the end of the period, the market price of propane dropped below the unit price within the swap agreement. As a result of the price drop, the Company marked the agreement to market, which resulted in an unrealized loss of \$84,000.

## Notes to the Consolidated Financial Statements

### **Earnings Per Share**

The calculations of both basic and diluted earnings per share from continuing operations are presented in the following chart.

| For the Periods Ended December 31,                | 2006                | 2005                | 2004               |
|---|---------------------|---------------------|--------------------|
| <b>Calculation of Basic Earnings Per Share:</b>   |                     |                     |                    |
| Net Income  | \$10,506,525        | \$10,467,614        | \$9,549,667        |
| Weighted average shares outstanding               | 6,032,462           | 5,836,463           | 5,735,405          |
| <b>Basic Earnings Per Share</b>                   | <b>\$1.74</b>       | <b>\$1.79</b>       | <b>\$1.66</b>      |
| <b>Calculation of Diluted Earnings Per Share:</b> |                     |                     |                    |
| <b>Reconciliation of Numerator:</b>               |                     |                     |                    |
| Net Income — Basic                                | \$10,506,525        | \$10,467,614        | \$9,549,667        |
| Effect of 8.25% Convertible debentures            | 105,024             | 123,559             | 139,097            |
| <b>Adjusted numerator — Diluted</b>               | <b>\$10,611,549</b> | <b>\$10,591,173</b> | <b>\$9,688,764</b> |
| <b>Reconciliation of Denominator:</b>             |                     |                     |                    |
| Weighted shares outstanding — Basic               | 6,032,462           | 5,836,463           | 5,735,405          |
| Effect of dilutive securities                     |                     |                     |                    |
| Stock options                                     | -                   | -                   | 1,784              |
| Warrants  | -                   | 11,711              | 7,900              |
| 8.25% Convertible debentures                      | 122,669             | 144,378             | 162,466            |
| <b>Adjusted denominator — Diluted</b>             | <b>6,155,131</b>    | <b>5,992,552</b>    | <b>5,907,555</b>   |
| <b>Diluted Earnings Per Share</b>                 | <b>\$1.72</b>       | <b>\$1.77</b>       | <b>\$1.64</b>      |

### **Operating Revenues**

Revenues for the natural gas distribution operations of the Company are based on rates approved by the various public service commissions. The natural gas transmission operation's revenues are based on rates approved by the FERC. Customers' base rates may not be changed without formal approval by these commissions; however, the regulatory authorities have granted our regulated natural gas distribution operations the ability to negotiate rates with customers that have competitive alternatives using approved methodologies. In addition, the natural gas transmission operation can negotiate rates above or below the FERC-approved tariff rates.

Chesapeake's Maryland and Delaware natural gas distribution operations each have a gas cost recovery mechanism that provides for the adjustment of rates charged to customers as gas costs fluctuate. These amounts are collected or refunded through adjustments to rates in subsequent periods.

The Company charges flexible rates to the natural gas distribution's industrial interruptible customers to compete with alternative types of fuel. Based on pricing, these customers can choose natural gas or alternative types of supply. Neither the Company nor the interruptible customer is contractually obligated to deliver or receive natural gas.

The propane wholesale marketing operation records trading activity net on the Company's income statement, on a mark-to-market basis, for open contracts. The propane distribution, advanced information services and other segments record revenue in the period the products are delivered and/or services are rendered.

### **Certain Risks and Uncertainties**

The financial statements are prepared in conformity with generally accepted accounting principles that require management to make estimates in measuring assets and liabilities and related revenues and expenses (see Notes M and N to the Consolidated Financial Statements for significant estimates). These estimates involve judgments with respect to, among other things, various future economic factors that are difficult to predict and are beyond the control of the Company; therefore, actual results could differ from those estimates.

The Company records certain assets and liabilities in accordance with SFAS No. 71. If the Company were required to terminate application of SFAS No. 71 for its regulated operations, all such deferred amounts would be recognized in the

income statement at that time. This could result in a charge to earnings, net of applicable income taxes, which could be material.

#### ***FASB Statements and Other Authoritative Pronouncements***

In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 123 (Revised 2004), “Share-Based Payment” (“SFAS No. 123(R)”). SFAS No. 123(R) is effective for annual reporting periods beginning after June 15, 2005. The Company was required to adopt SFAS No. 123(R) in the first quarter of 2006. The Company is required to measure the cost of all employee share-based payments to employees, including grants of employee stock options, using a fair-value-based method. The pro forma disclosures previously permitted under SFAS No. 123 no longer will be an alternative to financial statement recognition. The adoption of SFAS No. 123(R) did not have a material impact on the financial statements

In May 2005, the FASB issued SFAS No. 154, “Accounting Changes and Error Corrections”. This statement applies to all voluntary changes in accounting principle. It also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This statement requires retrospective application to prior periods’ financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement was effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company was required to adopt SFAS No. 154 in the first quarter of 2006. The implementation of this statement did not have a material impact on Chesapeake’s financial statements.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans”. This statement improves financial reporting by requiring an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. The Company is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. The Company adopted SFAS No. 158 as of December 31, 2006. Based on the fair value of plan assets and their related funded status at December 31, 2006, the adoption of SFAS 158 resulted in an increase in total assets by approximately \$282,000, an increase in total liabilities by approximately \$112,000 and an increase to total shareholders equity by approximately \$170,000. Please refer to Note K “Employee Benefit Plans,” for details of each of the Company’s benefit plans.

In June 2006, the FASB issued FASB Interpretation (“FIN”) No. 48, “Employers’ Accounting for Uncertainty in Income Taxes”. This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS No. 109, “Accounting for Income Taxes”. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. Chesapeake is required to adopt FIN No. 48 in the first quarter of 2007. The Company is currently evaluating the impact that this interpretation will have on our financial statements.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements”. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Chesapeake will be required to adopt SFAS No. 157 in the first quarter of 2008. The Company has not yet evaluated the impact that this statement will have on our financial statements.

## **Notes to the Consolidated Financial Statements**

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, which expresses the SEC's views regarding the process of quantifying financial statement misstatements. The application of the guidance in this bulletin is applicable at December 31, 2006. The implementation of this bulletin did not have any impact on the Company's financial statements.

### ***Reclassification of Prior Years' Amounts***

Certain prior years' amounts have been reclassified to conform to the current year's presentation.

## **B. BUSINESS DISPOSITIONS AND DISCONTINUED OPERATIONS**

During 2003, Chesapeake decided to exit the water services business and sold six of its seven operations. The remaining operation was sold in October 2004. At December 31, 2006, all property and assets of the water subsidiary have been sold. The results of operations for all water service businesses have been reclassified to discontinued operations for all periods presented. Operating revenues for discontinued operations was \$1.1 million and operating losses for discontinued operations was \$94,000 for 2004. A loss of \$52,000, net of tax, was recorded for 2004 on the sale of the water operations. The Company did not have any discontinued operations in 2006 and 2005.

## C. SEGMENT INFORMATION

The following table presents information about the Company's reportable segments. The table excludes discontinued operations.

| For the Years Ended December 31,                        | 2006                 | 2005                 | 2004                 |
|---|----------------------|----------------------|----------------------|
| <b>Operating Revenues, Unaffiliated Customers</b>       |                      |                      |                      |
| Natural gas distribution, transmission and marketing    | \$170,114,514        | \$166,388,562        | \$124,073,939        |
| Propane   | 48,575,976           | 48,975,349           | 41,499,687           |
| Advanced information services                           | 12,509,077           | 14,121,441           | 12,381,815           |
| Other   | 1,024                | 144,384              | -                    |
| <b>Total operating revenues, unaffiliated customers</b> | <b>\$231,200,591</b> | <b>\$229,629,736</b> | <b>\$177,955,441</b> |
| <b>Intersegment Revenues <sup>(1)</sup></b>             |                      |                      |                      |
| Natural gas distribution, transmission and marketing    | \$259,969            | \$193,404            | \$172,427            |
| Propane   | -                    | 668                  | -                    |
| Advanced information services                           | 58,532               | 18,123               | 45,266               |
| Other   | 618,493              | 618,492              | 647,378              |
| <b>Total intersegment revenues</b>                      | <b>\$936,994</b>     | <b>\$830,687</b>     | <b>\$865,071</b>     |
| <b>Operating Income</b>                                 |                      |                      |                      |
| Natural gas distribution, transmission and marketing    | \$19,733,487         | \$17,235,810         | \$17,091,360         |
| Propane   | 2,534,035            | 3,209,388            | 2,363,884            |
| Advanced information services                           | 767,160              | 1,196,544            | 387,193              |
| Other and eliminations                                  | (103,371)            | (111,243)            | 127,309              |
| <b>Total operating income</b>                           | <b>\$22,931,311</b>  | <b>\$21,530,499</b>  | <b>\$19,969,746</b>  |
| <b>Depreciation and Amortization</b>                    |                      |                      |                      |
| Natural gas distribution, transmission and marketing    | \$6,312,277          | \$5,682,137          | \$5,418,007          |
| Propane   | 1,658,554            | 1,574,357            | 1,524,016            |
| Advanced information services                           | 112,729              | 122,569              | 138,007              |
| Other and eliminations                                  | 160,155              | 189,146              | 177,508              |
| <b>Total depreciation and amortization</b>              | <b>\$8,243,715</b>   | <b>\$7,568,209</b>   | <b>\$7,257,538</b>   |
| <b>Capital Expenditures</b>                             |                      |                      |                      |
| Natural gas distribution, transmission and marketing    | \$43,894,614         | \$28,433,671         | \$13,945,214         |
| Propane   | 4,778,891            | 3,955,799            | 3,395,190            |
| Advanced information services                           | 159,402              | 294,792              | 84,185               |
| Other   | 321,204              | 739,079              | 404,941              |
| <b>Total capital expenditures</b>                       | <b>\$49,154,111</b>  | <b>\$33,423,341</b>  | <b>\$17,829,530</b>  |

<sup>(1)</sup> All significant intersegment revenues are billed at market rates and have been eliminated from consolidated revenues.

| At December 31,                                      | 2006                 | 2005                 | 2004                 |
|--|----------------------|----------------------|----------------------|
| <b>Identifiable Assets</b>                           |                      |                      |                      |
| Natural gas distribution, transmission and marketing | \$252,292,600        | \$225,667,049        | \$184,412,301        |
| Propane  | 60,170,200           | 57,344,859           | 47,531,106           |
| Advanced information services                        | 2,573,810            | 2,062,902            | 2,387,440            |
| Other  | 9,957,374            | 10,905,065           | 7,379,794            |
| <b>Total identifiable assets</b>                     | <b>\$324,993,984</b> | <b>\$295,979,875</b> | <b>\$241,710,641</b> |

Chesapeake uses the management approach to identify operating segments. Chesapeake organizes its business around differences in products or services and the operating results of each segment are regularly reviewed by the Company's

## **Notes to the Consolidated Financial Statements**

chief operating decision maker in order to make decisions about resources and to assess performance. The segments are evaluated based on their pre-tax operating income.

The Company's operations are all domestic. The advanced information services segment has infrequent transactions with foreign companies, located primarily in Canada, which are denominated and paid in U.S. dollars. These transactions are immaterial to the consolidated revenues.

### **D. FAIR VALUE OF FINANCIAL INSTRUMENTS**

Various items within the balance sheet are considered to be financial instruments because they are cash or are to be settled in cash. The carrying values of these items generally approximate their fair value (see Note E to the Consolidated Financial Statements for disclosure of fair value of investments). The Company's open forward and futures contracts at December 31, 2006 had a gain in fair value of \$8,500 and at December 31, 2005 had a gain in fair value of \$46,000 based on market rates. The fair value of the Company's long-term debt is estimated using a discounted cash flow methodology. The Company's long-term debt at December 31, 2006, including current maturities, had an estimated fair value of \$81.4 million as compared to a carrying value of \$78.7 million. At December 31, 2005, the estimated fair value was approximately \$68.5 million as compared to a carrying value of \$63.9 million. These estimates are based on published corporate borrowing rates for debt instruments with similar terms and average maturities.

### **E. INVESTMENTS**

The investment balances at December 31, 2006 and 2005 represent a Rabbi Trust ("the trust") associated with the Company's Supplemental Executive Retirement Savings Plan. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company classifies these investments as trading securities. As a result of classifying them as trading securities, we are required to report the securities at their fair value, with any unrealized gains and losses included in other income. We also have an associated liability that is recorded and adjusted each month, along with other expense, for the gains and losses incurred by the trust. At December 31, 2006 and 2005, total investments had a fair value of \$2.0 million and \$1.7 million.

### **F. GOODWILL AND OTHER INTANGIBLE ASSETS**

In accordance with SFAS No. 142, goodwill is tested for impairment at least annually. In addition, goodwill of a reporting unit is tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. The propane unit had \$674,000 in goodwill for the two years ended December 31, 2006 and 2005. Testing for 2006 and 2005 has indicated that no impairment has occurred.

The carrying value and accumulated amortization of intangible assets subject to amortization for the two years ended December 31, 2006 are as follows:

|                   | <u>December 31, 2006</u> |                          | <u>December 31, 2005</u> |                          |
|-------------------|--------------------------|--------------------------|--------------------------|--------------------------|
|                   | Gross Carrying Amount    | Accumulated Amortization | Gross Carrying Amount    | Accumulated Amortization |
| Customer lists    | \$115,333                | \$75,057                 | \$115,333                | \$67,845                 |
| Acquisition costs | 263,659                  | 112,057                  | 263,659                  | 105,465                  |
| <b>Total</b>      | <b>\$378,992</b>         | <b>\$187,114</b>         | <b>\$378,992</b>         | <b>\$173,310</b>         |

Amortization of intangible assets was \$14,000 for the years ended December 31, 2006 and 2005, respectively. The estimated annual amortization of intangibles is \$14,000 per year for each of the years 2007 through 2011, respectively.

## G. STOCKHOLDERS' EQUITY

The changes in the common stock shares issued and outstanding are shown in the table below:

| <u>For the Years Ended December 31,</u>                          | <u>2006</u>      | <u>2005</u>      | <u>2004</u>      |
|--|------------------|------------------|------------------|
| <b>Common Stock shares issued and outstanding <sup>(1)</sup></b> |                  |                  |                  |
| Shares issued — beginning of period balance                      | 5,883,099        | 5,778,976        | 5,660,594        |
| Dividend Reinvestment Plan <sup>(2)</sup>                        | 38,392           | 41,175           | 40,993           |
| Retirement Savings Plan  | 29,705           | 21,071           | 39,157           |
| Conversion of debentures   | 16,677           | 22,609           | 18,616           |
| Employee award plan  | 350              | -                | -                |
| Performance shares and options exercised <sup>(3)</sup>          | 29,516           | 19,268           | 19,616           |
| Public offering  | 690,345          | -                | -                |
| Shares issued — end of period balance <sup>(4)</sup>             | 6,688,084        | 5,883,099        | 5,778,976        |
| Treasury shares — beginning of period balance                    | (97)             | (9,418)          | -                |
| Purchases  | -                | (4,852)          | (15,316)         |
| Dividend Reinvestment Plan                                       | -                | 2,142            | -                |
| Retirement Savings Plan  | -                | 12,031           | -                |
| Other issuances  | 97               | -                | 5,898            |
| Treasury Shares — end of period balance                          | -                | (97)             | (9,418)          |
| <b>Total Shares Outstanding</b>                                  | <b>6,688,084</b> | <b>5,883,002</b> | <b>5,769,558</b> |

<sup>(1)</sup> 12,000,000 shares are authorized at a par value of \$0.4867 per share.

<sup>(2)</sup> Includes shares purchased with reinvested dividends and optional cash payments.

<sup>(3)</sup> Includes shares issued for Directors' compensation.

<sup>(4)</sup> Includes 48,187, 37,528, and 48,175 shares at December 31, 2006, 2005 and 2004, respectively, held in a Rabbi Trust established by the Company relating to the Executive Deferred Compensation Plan.

In 2000 and 2001, the Company entered into agreements with an investment banker to assist in identifying acquisition candidates. Under the agreements, the Company issued warrants to the investment banker to purchase 15,000 shares of Chesapeake stock in 2000 at an exercise price of \$18.00 per share and 15,000 in 2001 at an exercise price of \$18.25 per share. In August 2006, the investment banker exercised the 30,000 warrants pursuant to the terms of the agreement at \$33.3657 per share. At the request of the investment banker, Chesapeake settled the warrants with a cash payment of \$435,000, in lieu of issuing shares of the Company's common stock. At December 31, 2006, Chesapeake does not have any stock warrants outstanding.

## Notes to the Consolidated Financial Statements

On November 21, 2006 the Company completed a public offering of 600,300 shares of its common stock at a price per share of \$30.10. On November 30, 2006, the Company completed the sale of 90,045 additional shares of its common stock, pursuant to the over-allotment option granted to the Underwriters by the Company. The net proceeds from the sale of common stock, after deducting underwriting commissions and expenses, were approximately \$19.8 million, which were added to the Company's general funds and used primarily to repay a portion of the Company's short-term debt under unsecured lines of credit.

### H. LONG-TERM DEBT

The outstanding long-term debt, net of current maturities, is as shown below.

| <u>At December 31,</u>           | <u>2006</u>         | <u>2005</u>         | <u>2004</u>         |
|----------------------------------|---------------------|---------------------|---------------------|
| Uncollateralized senior notes:   |                     |                     |                     |
| 7.97% note, due February 1, 2008 | \$1,000,000         | \$2,000,000         | \$3,000,000         |
| 6.91% note, due October 1, 2010  | 2,727,273           | 3,636,363           | 4,545,454           |
| 6.85% note, due January 1, 2012  | 4,000,000           | 5,000,000           | 6,000,000           |
| 7.83% note, due January 1, 2015  | 14,000,000          | 16,000,000          | 20,000,000          |
| 6.64% note, due October 31, 2017 | 27,272,727          | 30,000,000          | 30,000,000          |
| 5.50% note, due October 12, 2020 | 20,000,000          | -                   | -                   |
| Convertible debentures:          |                     |                     |                     |
| 8.25% due March 1, 2014          | 1,970,000           | 2,254,000           | 2,644,000           |
| Promissory note                  | 80,000              | 100,000             | -                   |
| <b>Total Long-Term Debt</b>      | <b>\$71,050,000</b> | <b>\$58,990,363</b> | <b>\$66,189,454</b> |

*Annual maturities of consolidated long-term debt for the next five years are as follows: \$7,656,364 for 2007; \$7,656,364 for 2008; \$6,656,364 for 2009; \$6,656,364 for 2010 and \$7,747,273 for 2011.*

The convertible debentures may be converted, at the option of the holder, into shares of the Company's common stock at a conversion price of \$17.01 per share. During 2006 and 2005, debentures totaling \$284,000 and \$385,000, respectively, were converted to stock. The debentures are also redeemable for cash at the option of the holder, subject to an annual non-cumulative maximum limitation of \$200,000. In 2006, no debentures were redeemed for cash. During 2005, debentures totaling \$5,000 were redeemed for cash. At the Company's option, the debentures may be redeemed at stated amounts.

On October 12, 2006, the Company issued \$20 million of 5.5 percent Senior Notes to three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company). The original note agreement was executed on October 18, 2005 and provided for the Company to sell the Notes at any time prior to January 15, 2007. The terms of the Notes require annual principal repayments of \$2 million beginning on the fifth anniversary of the issuance of the Notes. The Notes will mature on October 12, 2020. The proceeds from this issuance were used to reduce a portion of the Company's outstanding short-term debt.

Indentures to the long-term debt of the Company and its subsidiaries contain various restrictions. The most stringent restrictions state that the Company must maintain equity of at least 40 percent of total capitalization and the pro-forma fixed charge coverage ratio must be 1.5 times. The Company is in compliance with all of its debt covenants.

### I. SHORT-TERM BORROWING

As of December 31, 2006, the Board of Directors ("Board") has authorized the Company to borrow up to \$55.0 million from various banks and trust companies under short-term lines of credit. During 2006, the Board authorized increases in the Company's borrowing authority up to \$75 million to fund the 2006 capital budget and working capital. The \$75 million limit was subsequently reduced to its current level by the Board on November 7, 2006, following the placement on October 12, 2006 of \$20 million 5.50 percent Senior Notes.



As of December 31, 2006, the Company had four unsecured bank lines of credit with two financial institutions, totaling \$80.0 million, none of which required compensating balances. These bank lines provide funds for the Company's short-term cash needs to meet seasonal working capital requirements and to temporarily fund portions of its capital expenditures. Two of the bank lines, totaling \$15.0 million, are committed. The other two lines are subject to the banks' availability of funds. Under these lines of credit, the outstanding balances of short-term debt at December 31, 2006 and 2005 were \$27.6 million and \$35.5 million, respectively. The annual weighted average interest rates on short-term debt were 5.47 percent and 4.47 percent for 2006 and 2005, respectively. The Company also had a letter of credit outstanding in the amount of \$775,000 that reduced the amounts available under the lines of credit.

## **J. LEASE OBLIGATIONS**

The Company has entered into several operating lease arrangements for office space at various locations, equipment and pipeline facilities. Rent expense related to these leases was \$680,000, \$837,000, and \$934,000 for 2006, 2005 and 2004, respectively. Future minimum payments under the Company's current lease agreements are \$650,000, \$496,000, \$423,000, \$331,000 and \$321,000 for the years 2007 through 2011, respectively; and \$3.8 million thereafter, totaling \$6.0 million.

## **K. EMPLOYEE BENEFIT PLANS**

### **Retirement Plans**

Before 1999, Company employees generally participated in both a defined benefit pension plan ("Defined Pension Plan") and a Retirement Savings Plan. Effective January 1, 1999, the Company restructured its retirement program to compete more effectively with similar businesses. As part of this restructuring, the Company closed the Defined Pension Plan to new participants. Employees who participated in the Defined Pension Plan at that time were given the option of remaining in (and continuing to accrue benefits under) the Defined Pension Plan or receiving an enhanced matching contribution in the Retirement Savings Plan.

Because the Defined Pension Plan was not open to new participants, the number of active participants in that plan decreased and is approaching the minimum number needed for the Defined Pension Plan to maintain its tax-qualified status. To avoid jeopardizing the tax-qualified status of the Defined Pension Plan, the Company's Board of Directors amended the Defined Pension Plan on September 24, 2004. To ensure that the Company continues to provide appropriate levels of benefits to the Company's employees, the Board amended the Defined Pension Plan and the Retirement Savings Plan, effective January 1, 2005, so that Defined Pension Plan participants who were actively employed by the Company on that date (1) receive two additional years of benefit service credit to be used in calculating their Defined Pension Plan benefit (subject to the Defined Pension Plan's limit of 35 years of benefit service credit), (2) have the option to receive their Defined Pension Plan benefit in the form of a lump sum at the time they retire, and (3) are eligible to receive the enhanced matching contribution in the Retirement Savings Plan. In addition, effective January 1, 2005, the Board amended the Defined Pension Plan so that participants will not accrue any additional benefits under that plan. These changes were communicated to the Company's employees during the first week of November 2004. As a result of the amendments to the Defined Pension Plan, a gain of approximately \$172,000 (after tax) was recorded during 2004.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158). The Company adopted SFAS 158 prospectively on December 31, 2006. SFAS 158 requires that we recognize all obligations related to defined benefit pensions and other postretirement benefits. This statement requires that we quantify the plans' funded status as an asset or a liability on our consolidated balance sheets.

SFAS 158 requires that we measure the plans' assets and obligations that determine our funded status as of the end of the fiscal year. The Company is also required to recognize as a component of accumulated other comprehensive income ("AOCI") the changes in funded status that occurred during the year that are not recognized as part of net periodic benefit cost as explained in SFAS No. 87, "Employers' Accounting for Pensions," or SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions."

## Notes to the Consolidated Financial Statements

Based on the funded status of the Company's defined benefit pension and postretirement benefit plans as of December 31, 2006, the effects of adopting SFAS 158 on the Company's financial statement is set forth in the following table.

|  | Pre-SFAS 158  | SFAS 158<br>Adoption<br>Adjustments | Post<br>SFAS 158 |
|--|---------------|-------------------------------------|------------------|
| Asset (liability) for pension benefits | (\$3,741,054) | \$281,538                           | (\$3,459,516)    |
| Deferred income tax asset (liability)  | 1,224,742     | (111,973)                           | 1,112,769        |
| Accumulated other comprehensive income | 504,115       | (169,565)                           | 334,550          |

The amounts recognized in AOCI as a result of the adoption of SFAS 158 consist of:

|                                      | Defined<br>Benefit<br>Pension | Other<br>Postretirement<br>Benefit | Total       |
|--------------------------------------|-------------------------------|------------------------------------|-------------|
| Prior service cost (credit)          | (\$29,560)                    | -                                  | (\$29,560)  |
| Loss (gain)                          | (1,284,400)                   | 1,032,422                          | (251,978)   |
| Total                                | (1,313,960)                   | 1,032,422                          | (281,538)   |
| Less: Deferred tax asset (liability) | (522,582)                     | 410,609                            | (111,973)   |
| Loss (gain) in AOCI, net of tax      | (\$791,378)                   | \$621,813                          | (\$169,565) |

The amounts in AOCI for the respective retirement plans that are expected to be recognized as a component of net benefit cost in 2007 is set forth in the following table.

|                             | Defined<br>Benefit<br>Pension | Executive Excess<br>Defined Benefit<br>Pension | Other<br>Postretirement<br>Benefit |
|-----------------------------|-------------------------------|--|------------------------------------|
| Prior service cost (credit) | (\$4,699)                     | -  | -                                  |
| Loss (gain)                 | (6,846)                       | 51,279   | 136,978                            |

### Defined Benefit Pension Plan

As described above, effective January 1, 2005, the Defined Pension Plan was frozen with respect to additional years of service or additional compensation. Benefits under the plan were based on each participant's years of service and highest average compensation, prior to the freeze. The Company's funding policy provides that payments to the trustee shall be equal to the minimum funding requirements of the Employee Retirement Income Security Act of 1974. The Company does not expect to be required to make any funding payments toward the Defined Pension Plan in 2007. The measurement dates for the Pension Plan were December 31, 2006 and 2005, respectively.

The following schedule summarizes the assets of the Defined Pension Plan, by investment type, at December 31, 2006, 2005 and 2004:

| At December 31,       | 2006    | 2005    | 2004    |
|-----------------------|---------|---------|---------|
| <b>Asset Category</b> |         |         |         |
| Equity securities     | 77.34%  | 76.12%  | 72.64%  |
| Debt securities       | 18.59%  | 23.28%  | 12.91%  |
| Other                 | 4.07%   | 0.60%   | 14.45%  |
| Total                 | 100.00% | 100.00% | 100.00% |

The asset listed as "Other" in the above table represents monies temporarily held in money market funds. The money market fund invests at least 80 percent of its total assets in:

- United States Government obligations; and

- Repurchase agreements that are fully collateralized by such obligations.

The investment policy of the Plan calls for an allocation of assets between equity and debt instruments with equity being 60 percent and debt at 40 percent, but allowing for a variance of 20 percent in either direction. Additionally, as changes are made to holdings, cash, money market funds or United States Treasury Bills may be held temporarily by the fund. Investments in the following are prohibited: options, guaranteed investment contracts, real estate, venture capital, private placements, futures, commodities, limited partnerships and Chesapeake stock. Additionally, short selling and margin transactions are prohibited. During 2004, Chesapeake modified its investment policy to allow the Employee Benefits Committee to reallocate investments to better match the expected life of the plan.

The following schedule sets forth the funded status of the Defined Pension Plan at December 31, 2006, 2005 and 2004:

| <b>At December 31,</b>   | <b>2006</b>       | <b>2005</b>        | <b>2004</b>        |
|--|-------------------|--------------------|--------------------|
| <b>Change in benefit obligation:</b>                             |                   |                    |                    |
| Benefit obligation — beginning of year                           | \$12,399,621      | \$12,053,063       | \$11,948,755       |
| Service cost   | -                 | -                  | 338,352            |
| Interest cost  | 635,877           | 645,740            | 690,620            |
| Change in assumptions  | (301,851)         | 388,979            | 573,639            |
| Actuarial loss   | 607               | 28,895             | 220,842            |
| Amendments   | -                 | -                  | 883,753            |
| Effect of curtailment/settlement                                 | -                 | -                  | (2,171,289)        |
| Benefits paid  | (1,284,529)       | (717,056)          | (431,609)          |
| <b>Benefit obligation — end of year</b>                          | <b>11,449,725</b> | <b>12,399,621</b>  | <b>12,053,063</b>  |
| <b>Change in plan assets:</b>                                    |                   |                    |                    |
| Fair value of plan assets — beginning of year                    | 11,780,866        | 12,097,248         | 11,301,548         |
| Actual return on plan assets                                     | 1,543,950         | 400,674            | 1,227,309          |
| Benefits paid  | (1,284,529)       | (717,056)          | (431,609)          |
| <b>Fair value of plan assets — end of year</b>                   | <b>12,040,287</b> | <b>11,780,866</b>  | <b>12,097,248</b>  |
| <b>Reconciliation of funded status: <sup>(1)</sup></b>           |                   |                    |                    |
| Plan assets in excess (less than) benefit obligation at year-end | 590,560           | (618,755)          | 44,185             |
| Unrecognized prior service cost                                  | -                 | (34,259)           | (38,958)           |
| Unrecognized net actuarial gain                                  | -                 | (129,739)          | (850,224)          |
| <b>Net amount accrued</b>  | <b>\$590,560</b>  | <b>(\$782,753)</b> | <b>(\$844,997)</b> |
| <b>Assumptions:</b>  |                   |                    |                    |
| Discount rate  | 5.50%             | 5.25%              | 5.50%              |
| Expected return on plan assets                                   | 6.00%             | 6.00%              | 7.88%              |

(1) After the adoption of SFAS 158 on December 31, 2006, these amounts are recorded and this reconciliation is no longer required.

Net periodic pension costs for the defined benefit Pension Plan for 2006, 2005, and 2004 include the components as shown below:

| <b>For the Years Ended December 31,</b>         | <b>2006</b>       | <b>2005</b>       | <b>2004</b>      |
|---|-------------------|-------------------|------------------|
| <b>Components of net periodic pension cost:</b> |                   |                   |                  |
| Service cost                                    | \$0               | \$0               | \$338,352        |
| Interest cost                                   | 635,877           | 645,740           | 690,620          |
| Expected return on assets                       | (690,533)         | (703,285)         | (869,336)        |
| Amortization of:                                |                   |                   |                  |
| Transition assets                               | -                 | -                 | (11,328)         |
| Prior service cost                              | (4,699)           | (4,699)           | (4,699)          |
| <b>Net periodic pension cost (benefit)</b>      | <b>(\$59,355)</b> | <b>(\$62,244)</b> | <b>\$143,609</b> |

The following actuarial assumptions were used in calculating net periodic pension cost or benefit.

| <b>For the Years Ended December 31,</b> | <b>2006</b> | <b>2005</b> | <b>2004</b> |
|---|-------------|-------------|-------------|
| <b>Assumptions:</b>                     |             |             |             |
| Discount rate                           | 5.25%       | 5.50%       | 5.88%       |
| Expected return on plan assets          | 6.00%       | 6.00%       | 7.88%       |

## Notes to the Consolidated Financial Statements

The assumptions used for the discount rate of the plan were reviewed by the Company and increased from 5.25 percent to 5.50 percent, reflecting an increase in the interest rates of high quality bonds and reflecting the expected life of the plan, due to the lump sum payment option. Additionally, the average expected return on plan assets for the qualified plan remained constant at 6 percent due to the adoption of a change in the investment policy that allows for a higher level of investment in bonds and a lower level of equity investments. Since the Plan is frozen in regards to additional years of service and compensation, the rate of assumed compensation rate increases is not applicable. The accumulated benefit obligation was \$11.4 million and \$12.4 million at December 31, 2006 and 2005, respectively.

### Executive Excess Defined Benefit Pension Plan

The Company also sponsors an unfunded executive excess defined benefit pension plan. As noted above, this plan was frozen with respect to additional years of service and additional compensation as of December 31, 2004. Benefits under the plan were based on each participant's years of service and highest average compensation, prior to the freeze. The accumulated benefit obligation was \$2.29 million and \$2.32 million at December 31, 2006 and 2005, respectively.

Net periodic pension costs for the executive excess benefit pension plan for 2006, 2005, and 2004 include the components as shown below:

| For the Years Ended December 31,                | 2006             | 2005             | 2004             |
|---|------------------|------------------|------------------|
| <b>Components of net periodic pension cost:</b> |                  |                  |                  |
| Service cost                                    | \$0              | \$0              | \$105,913        |
| Interest cost                                   | 119,588          | 119,658          | 87,568           |
| Amortization of:                                |                  |                  |                  |
| Prior service cost                              | -                | -                | 2,090            |
| Actuarial loss                                  | 57,039           | 49,319           | 21,699           |
| <b>Net periodic pension cost</b>                | <b>\$176,627</b> | <b>\$168,977</b> | <b>\$217,270</b> |

The following schedule sets forth the status of the executive excess defined benefit plan:

| At December 31,                                | 2006                 | 2005                 | 2004                 |
|--|----------------------|----------------------|----------------------|
| <b>Change in benefit obligation:</b>           |                      |                      |                      |
| Benefit obligation — beginning of year         | \$2,322,471          | \$2,162,952          | \$1,406,190          |
| Service cost                                   | -                    | -                    | 105,913              |
| Interest cost                                  | 119,588              | 119,658              | 87,568               |
| Actuarial (gain) loss                          | (65,886)             | 133,839              | 713,225              |
| Amendments                                     | -                    | -                    | 60,000               |
| Effect of curtailment/settlement               | -                    | -                    | (184,844)            |
| Benefits paid                                  | (89,203)             | (93,978)             | (25,100)             |
| <b>Benefit obligation — end of year</b>        | <b>2,286,970</b>     | <b>2,322,471</b>     | <b>2,162,952</b>     |
| <b>Change in plan assets:</b>                  |                      |                      |                      |
| Fair value of plan assets — beginning of year  | -                    | -                    | -                    |
| Employer contributions                         | 89,203               | 93,978               | 25,100               |
| Benefits paid                                  | (89,203)             | (93,978)             | (25,100)             |
| <b>Fair value of plan assets — end of year</b> | <b>-</b>             | <b>-</b>             | <b>-</b>             |
| Funded status                                  | (2,286,970)          | (2,322,471)          | (2,162,952)          |
| Unrecognized net actuarial loss                | -                    | 959,492              | 874,972              |
| <b>Net amount accrued <sup>(1)</sup></b>       | <b>(\$2,286,970)</b> | <b>(\$1,362,979)</b> | <b>(\$1,287,980)</b> |
| <b>Assumptions:</b>                            |                      |                      |                      |
| Discount rate                                  | 5.50%                | 5.25%                | 5.50%                |

(1) After the adoption of SFAS 158 on December 31, 2006, these amounts are recorded and this reconciliation is no longer required.

The assumptions used for the discount rate of the plan were reviewed by the Company and increased from 5.25 percent to 5.50 percent, reflecting an increase in the interest rates of high quality bonds and a reduction in the expected life of the plan. Since the Plan is frozen in regards to additional years of service and compensation, the rate of assumed pay rate increases is not applicable. The measurement dates for the executive excess benefit plan were December 31, 2006 and 2005, respectively.

## Other Postretirement Benefits

The Company sponsors a defined benefit postretirement health care and life insurance plan that covers substantially all employees.

Net periodic postretirement costs for 2006, 2005 and 2004 include the following components:

| For the Years Ended December 31,                       | 2006             | 2005             | 2004             |
|--|------------------|------------------|------------------|
| <b>Components of net periodic postretirement cost:</b> |                  |                  |                  |
| Service cost   | \$9,194          | \$6,257          | \$5,354          |
| Interest cost  | 93,924           | 77,872           | 86,883           |
| Amortization of:                                       |                  |                  |                  |
| Transition obligation                                  | 22,282           | 27,859           | 27,859           |
| Actuarial loss   | 144,694          | 88,291           | 78,900           |
| <b>Net periodic postretirement cost</b>                | <b>\$270,094</b> | <b>\$200,279</b> | <b>\$198,996</b> |

The following schedule sets forth the status of the postretirement health care and life insurance plan:

| At December 31,                         | 2006                 | 2005               | 2004               |
|---|----------------------|--------------------|--------------------|
| <b>Change in benefit obligation:</b>    |                      |                    |                    |
| Benefit obligation — beginning of year  | \$1,534,684          | \$1,599,280        | \$1,471,664        |
| Retirees                                | 264,470              | (59,152)           | 91,747             |
| Fully-eligible active employees         | (114,082)            | (31,761)           | 22,071             |
| Other active                            | 78,036               | 26,317             | 13,798             |
| Benefit obligation — end of year        | \$1,763,108          | \$1,534,684        | \$1,599,280        |
| Funded status                           | (\$1,763,108)        | (\$1,534,684)      | (\$1,599,280)      |
| Unrecognized transition obligation      | -                    | 22,282             | 50,141             |
| Unrecognized net actuarial loss         | -                    | 751,450            | 899,228            |
| <b>Net amount accrued<sup>(1)</sup></b> | <b>(\$1,763,108)</b> | <b>(\$760,952)</b> | <b>(\$649,911)</b> |
| <b>Assumptions:</b>                     |                      |                    |                    |
| Discount rate                           | 5.50%                | 5.25%              | 5.50%              |

(1) After the adoption of SFAS 158 on December 31, 2006, these amounts are recorded and this reconciliation is no longer required.

The health care inflation rate for 2006 is assumed to be 6 percent for medical and 8 percent for prescription drugs. These rates are projected to gradually decrease to ultimate rates of 5 and 6 percent, respectively, by the year 2009. A one percentage point increase in the health care inflation rate from the assumed rate would increase the accumulated postretirement benefit obligation by approximately \$250,000 as of January 1, 2007, and would increase the aggregate of the service cost and interest cost components of the net periodic postretirement benefit cost for 2007 by approximately \$15,000. A one percentage point decrease in the health care inflation rate from the assumed rate would decrease the accumulated postretirement benefit obligation by approximately \$207,000 as of January 1, 2007, and would decrease the aggregate of the service cost and interest cost components of the net periodic postretirement benefit cost for 2007 by approximately \$13,000. The measurement dates were December 31, 2006 and 2005, respectively.

## Notes to the Consolidated Financial Statements

### Estimated Future Benefit Payments

The schedule below shows the estimated future benefit payments for each of the years 2007 through 2011 and the aggregate of the next five years for each of the plans previously described.

|                         | Defined<br>Benefit<br>Pension Plan <sup>(1)</sup> | Executive Excess<br>Defined Benefit<br>Pension Plan <sup>(2)</sup> | Other Post-<br>Retirement<br>Benefits <sup>(2)</sup> |
|-------------------------|---|--|--|
| 2007                    | \$721,575   | \$88,096   | \$180,205  |
| 2008                    | 713,699   | 86,868   | 182,977  |
| 2009                    | 1,447,370   | 85,513   | 185,059  |
| 2010                    | 898,179   | 84,026   | 204,870  |
| 2011                    | 460,335   | 82,411   | 194,448  |
| Years 2012 through 2016 | 4,714,092   | 758,013  | 1,010,982  |

<sup>(1)</sup> The pension plan is funded; therefore, benefit payments are expected to be paid out of the plan assets.

<sup>(2)</sup> Benefit payments are expected to be paid out of the general funds of the Company.

### Retirement Savings Plan

The Company sponsors a 401(k) Retirement Savings Plan, which provides participants a mechanism for making contributions for retirement savings. Each participant may make pre-tax contributions of up to 15 percent of eligible base compensation, subject to Internal Revenue Service limitations. These participants were eligible for the enhanced matching described below effective January 1, 2005.

Effective January 1, 1999, the Company began offering an enhanced 401(k) Plan to all new employees, as well as existing employees that elected to no longer participate in the Defined Benefit Plan. The Company makes matching contributions on a basis of up to six percent of each employee's pre-tax compensation for the year for all of the Company's employees, except the employees for our Advanced Information Services segment. The match is between 100 percent and 200 percent, based on a combination of the employee's age and years of service. The first 100 percent of the funds are matched with Chesapeake common stock. The remaining match is invested in the Company's 401(k) Plan according to each employee's election options.

Effective July 1, 2006, the matching contribution made on behalf of Advanced Information Services segment employees, is a 50 percent matching contribution, up to six percent of the employee's annual compensation. The matching contribution is funded in Chesapeake common stock. The Plan was also amended at the same time to enable it to receive discretionary profit-sharing contributions in the form of employee pre-tax deferrals. The extent, to which the Advanced Information Services segment has any dollars available for profit-sharing, is dependent upon the extent to which actual earnings exceed budgeted earnings. Any profit-sharing dollars made available to employees can be deferred into the Plan and/or paid out in the form of a bonus.

On December 1, 2001, the Company converted the 401(k) fund holding Chesapeake stock to an Employee Stock Ownership Plan ("ESOP").

Effective January 1, 1999, the Company began offering a non-qualified supplemental employee retirement savings plan open to Company executives over a specific income threshold. Participants receive a cash only matching contribution percentage equivalent to their 401(k) match level. All contributions and matched funds can be invested among the twenty-one mutual funds available for investment. These same funds are available for investment of employee contributions within the Retirement Savings Plan.

The Company's contributions to the 401(k) plans totaled \$1,612,000, \$1,681,000 and \$1,497,000 for the years ended December 31, 2006, 2005, and 2004, respectively. As of December 31, 2006, there are 77,479 shares reserved to fund future contributions to the Retirement Savings Plan.

## L. SHARE-BASED COMPENSATION PLANS

Effective January 1, 2006, the Company adopted SFAS No. 123R, "Share-Based Payment," which establishes accounting for equity instruments exchanged for employee services. Prior to January 1, 2006, the Company accounted for share-based compensation to employees in accordance with Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees," and related interpretations. The Company also followed the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," as amended by SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure." Commencing January 1, 2006, the Company elected to adopt the modified prospective method as provided by SFAS No. 123R and, accordingly, financial statement amounts for the prior periods presented have not been retrospectively adjusted to reflect the fair value of expensing stock-based compensation.

### Stock Options

The Company did not have any stock options outstanding at December 31, 2006 or December 31, 2005, nor were any stock options issued during 2006.

### Director Stock Compensation Plan ("DSCP")

Under the Company's DSCP, each non-employee director receives an annual retainer of 600 shares of common stock and an additional 150 shares of common stock for services as a committee chairman, subject to adjustment in future years consistent with the terms of the DSCP. Shares issued under the DSCP are fully vested as of the date of the grant. At the date of grant, the Company records a prepaid expense equal to the fair value of the shares issued and amortizes the expense equally over the service period of one year. Compensation expense recorded by the Company relating to the DSCP awards was \$165,000 and \$140,000 for 2006 and 2005, respectively.

A summary of restricted stock activity for the DSCP as of December 31, 2006 is presented below:

|                                 | Number of<br>Restricted Shares | Weighted Average<br>Grant Date Fair Value |
|---------------------------------|--------------------------------|---|
| Outstanding - December 31, 2005 | -                              |   |
| Issued - May 2, 2006            | 5,850                          | \$30.02                                   |
| Vested                          | 5,850                          |   |
| Outstanding - December 31 2006  | -                              |   |

As of December 31, 2006, there were 63,300 shares reserved for issuance under the terms of the Company's Director's Stock Compensation Plan.

### Performance Incentive Plans ("PIP")

The Company's Compensation Committee of the Board of Directors is authorized to grant to key employees of the Company the rights to receive awards of shares of the Company's common stock, contingent upon the achievement of established performance goals. These goals consist of annual or three-year performance targets. The awards are made pursuant to the Company's Performance Incentive Plan, subject to certain post-vesting transfer restrictions, and are granted in the first quarter of each year and are issued based upon the performance achieved in the previous fiscal year or three-year award period. In the first quarters of 2006 and 2005, the Company issued 23,666 and 10,130 shares, respectively, to key employees as PIP stock awards for each of the preceding fiscal years. Please note that 2005 concluded the three-year performance period and these awards were issued in the first quarter of 2006 and included in the 23,666 stock awards.

The Company accrues an expense each month of the fiscal year representing an estimate of the value of the stock awards granted for the current fiscal year. This accrual process matches the compensation expense with the employees' service period rather than recognizing the expense on the issue date, which occurs in the first quarter of the subsequent year. The shares issued under the PIP are fully vested and the fair value of each share is equal to the estimated market price of the

## Notes to the Consolidated Financial Statements

Company's stock on the date issued. Compensation expense recorded by the Company in 2006 and 2005 relating to the PIP was \$544,000 and \$721,000, respectively.

A summary of restricted stock activity for the PIP for 2006 is presented below:

|                                 | Number of<br>Restricted Shares | Weighted Average<br>Grant Date Fair Value |
|---------------------------------|--------------------------------|---|
| Outstanding - December 31, 2005 | -                              |   |
| Issued - February 23, 2006      | 23,666                         | \$30.3999                                 |
| Vested                          | 23,666                         |   |
| Outstanding - December 31, 2006 | -                              |   |

As of December 31, 2006, there were 293,480 shares reserved for issuance under the terms of the Company's Performance Incentive Plan.

## M. ENVIRONMENTAL COMMITMENTS AND CONTINGENCIES

Chesapeake is subject to federal, state and local laws and regulations governing environmental quality and pollution control. These laws and regulations require the Company to remove or remedy the effect on the environment of the disposal or release of specified substances at current and former operating sites.

In 2004, Chesapeake received a Certificate of Completion for the remedial work performed at a former gas manufacturing plant site located in Dover, Delaware. Chesapeake is also currently participating in the investigation, assessment or remediation of two additional former gas manufacturing plant sites located in Maryland and Florida. The Company has accrued liabilities for the three sites referred to, respectively, as the Dover Gas Light, Salisbury Town Gas Light and the Winter Haven Coal Gas sites. The Company has been in discussions with the Maryland Department of the Environment ("MDE") regarding a fourth former gas manufacturing plant site located in Cambridge, Maryland. The following provides details of each site.

### Dover Gas Light Site

The Dover Gas Light site is a former manufactured gas plant site located in Dover, Delaware. On January 15, 2004, the Company received a Certificate of Completion of Work from the United States Environmental Protection Agency ("EPA") regarding this site. This concluded Chesapeake's remedial action obligation related to this site and relieves Chesapeake from liability for future remediation at the site, unless previously unknown conditions are discovered at the site, or information previously unknown to the EPA is received that indicates the remedial action that has been taken is not sufficiently protective. These contingencies are standard and are required by the United States in all liability settlements.

The Company has reviewed its remediation costs incurred to date for the Dover Gas Light site and has concluded that all costs incurred have been paid. The Company does not expect any future environmental expenditure for this site. Through December 31, 2006, the Company has incurred approximately \$9.67 million in costs related to environmental testing and remedial action studies at the site. Approximately \$9.96 million has been recovered through December 2006 from other parties or through rates. As of December 31, 2006, a regulatory liability of approximately \$294,500, representing the over-recovery portion of the clean-up costs, has been recorded. The over-recovery is temporary and will be refunded by the Company to customers in future rates.

### Salisbury Town Gas Light Site

In cooperation with the MDE, the Company has completed remediation of the Salisbury Town Gas Light site, located in Salisbury, Maryland, where it was determined that a former manufactured gas plant had caused localized ground-water contamination. During 1996, the Company completed construction and began Air Sparging and Soil-Vapor Extraction ("AS/SVE") remediation procedures. Chesapeake has been reporting the remediation and monitoring results to the MDE



on an ongoing basis since 1996. In February 2002, the MDE granted permission to permanently decommission the AS/SVE system and to discontinue all on-site and off-site well monitoring, except for one well that is being maintained for continued product monitoring and recovery. In November 2002, Chesapeake submitted a letter to the MDE requesting a No Further Action determination. The Company has been in discussions with the MDE regarding such request and is awaiting a determination from the MDE.

Through December 31, 2006, the Company has incurred approximately \$2.9 million for remedial actions and environmental studies at the Salisbury Town Gas Light site. Of this amount, approximately \$1.8 million has been recovered through insurance proceeds or in rates. On September 26, 2006, the Company received approval from the Maryland Public Service Commission to recover through its rates charged to customers the remaining \$1.1 million of the incurred environmental remediation costs.

#### **Winter Haven Coal Gas Site**

The Winter Haven Coal Gas site is located in Winter Haven, Florida. Chesapeake has been working with the Florida Department of Environmental Protection ("FDEP") in assessing this coal gas site. In May 1996, the Company filed an AS/SVE Pilot Study Work Plan (the "Work Plan") for the Winter Haven site with the FDEP. The Work Plan described the Company's proposal to undertake an AS/SVE pilot study to evaluate the site. After discussions with the FDEP, the Company filed a modified Work Plan, the description of the scope of work to complete the site assessment activities and a report describing a limited sediment investigation performed in 1997. In December 1998, the FDEP approved the modified Work Plan, which the Company completed during the third quarter of 1999. In February 2001, the Company filed a Remedial Action Plan ("RAP") with the FDEP to address the contamination of the subsurface soil and groundwater in a portion of the site. The FDEP approved the RAP on May 4, 2001. Construction of the AS/SVE system was completed in the fourth quarter of 2002 and the system remains fully operational.

The Company has accrued a liability of \$212,000 as of December 31, 2006 for the Winter Haven Coal Gas site. Through December 31, 2006, the Company has incurred approximately \$1.7 million of environmental costs associated with this site. At December 31, 2006, the Company had collected \$90,000 through rates in excess of costs incurred. A regulatory asset of approximately \$122,000, representing the uncollected portion of the estimated clean-up costs, has also been recorded. The Company expects to recover the remaining costs through rates.

The FDEP has indicated that the Company may be required to remediate sediments along the shoreline of Lake Shipp, immediately west of the Winter Haven site. Based on studies performed to date, the Company objects to the FDEP's suggestion that the sediments have been contaminated and will require remediation. The Company's early estimates indicate that some of the corrective measures discussed by the FDEP may cost as much as \$1 million. Given the Company's view as to the absence of ecological effects, the Company believes that cost expenditures of this magnitude are unwarranted and plans to oppose any requirements that it undertake corrective measures in the offshore sediments. Chesapeake anticipates that it will be several years before this issue is resolved. At this time, the Company has not recorded a liability for sediment remediation. The outcome of this matter cannot be predicted at this time.

#### **Other**

The Company is in discussions with the MDE regarding a gas manufacturing plant site located in Cambridge, Maryland. The outcome of this matter cannot be determined at this time; therefore, the Company has not recorded an environmental liability for this location.

## **N. OTHER COMMITMENTS AND CONTINGENCIES**

### **Natural Gas and Propane Supply**

The Company's natural gas and propane distribution operations have entered into contractual commitments for gas from various suppliers. The contracts have various expiration dates. In November 2004, the Company renewed its contract

## Notes to the Consolidated Financial Statements

with an energy marketing and risk management company to manage a portion of the Company's natural gas transportation and storage capacity. The contract expires March 31, 2007.

### Corporate Guarantees

The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its Florida natural gas supply and management subsidiary, and Delmarva propane distribution subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases in the event of the subsidiaries' default. The liabilities for these purchases are recorded in the Consolidated Financial Statements. The aggregate amount guaranteed at December 31, 2006 totaled \$21.4 million, with the guarantees expiring on various dates in 2007.

In addition to the corporate guarantees, the Company has issued a letter of credit to its primary insurance company for \$775,000, which expires on May 31, 2007. The letter of credit is provided as security for claims amounts to satisfy the deductibles on the Company's policies. The current letter of credit was renewed during the second quarter of 2006 when the insurance policies were renewed.

### Other

The Company is involved in certain legal actions and claims arising in the normal course of business. The Company is also involved in certain legal and administrative proceedings before various governmental agencies concerning rates. In the opinion of management, the ultimate disposition of these proceedings will not have a material effect on the consolidated financial position, results of operations or cash flows of the Company.

## O. QUARTERLY FINANCIAL DATA (UNAUDITED)

In the opinion of the Company, the quarterly financial information shown below includes all adjustments necessary for a fair presentation of the operations for such periods. Due to the seasonal nature of the Company's business, there are substantial variations in operations reported on a quarterly basis.

| For the Quarters Ended  | March 31     | June 30      | September 30 | December 31  |
|-------------------------|--------------|--------------|--------------|--------------|
| <b>2006</b>             |              |              |              |              |
| Operating Revenue       | \$90,950,672 | \$44,303,752 | \$35,141,531 | \$60,804,636 |
| Operating Income        | \$11,437,228 | \$3,205,368  | \$162,137    | \$8,126,578  |
| Net Income (Loss)       | \$6,096,416  | \$1,132,509  | (\$656,579)  | \$3,934,179  |
| Earnings per share:     |              |              |              |              |
| Basic                   | \$1.03       | \$0.19       | (\$0.11)     | \$0.63       |
| Diluted                 | \$1.01       | \$0.19       | (\$0.11)     | \$0.62       |
| <b>2005</b>             |              |              |              |              |
| Operating Revenue       | \$77,845,248 | \$42,220,377 | \$35,155,121 | \$74,408,990 |
| Operating Income (Loss) | \$11,504,343 | \$2,324,945  | (\$99,149)   | \$7,800,360  |
| Net Income (Loss)       | \$6,232,796  | \$795,924    | (\$693,774)  | \$4,132,668  |
| Earnings per share:     |              |              |              |              |
| Basic                   | \$1.08       | \$0.14       | (\$0.12)     | \$0.70       |
| Diluted                 | \$1.05       | \$0.14       | (\$0.12)     | \$0.69       |

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None

**ITEM 9A. CONTROLS AND PROCEDURES.****Evaluation of Disclosure Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer of the Company, with the participation of other Company officials, have evaluated the Company's "disclosure controls and procedures" (as such term is defined under Rule 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of December 31, 2006. Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2006.

**Changes in Internal Controls**

During the quarter ended December 31, 2006, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Management's Report on Internal Control Over Financial Reporting**

See Management's Report on Internal Control Over Financial Reporting in Item 8, "Financial Statements and Supplemental Data."

**CEO and CFO Certifications**

The Company's Chief Executive Officer as well as the Senior Vice President and Chief Financial Officer have filed with the Securities and Exchange Commission the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits 31.1 and 31.2 to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006. In addition, on May 26, 2006 the Company's CEO certified to the New York Stock Exchange that he was not aware of any violation by the Company of the NYSE corporate governance listing standards.

**ITEM 9B. OTHER INFORMATION.**

The Company filed a Current Report on Form 8-K, dated November 29, 2006, discussing the Compensation Committee's (the "Committee") actions on that date, including their approval of the compensation arrangements relating to the executive officers of the Company for 2007.

On November 29, 2006, the Committee approved awards under the Company's Performance Incentive Plan to John R. Schimkaitis, President and Chief Executive Officer and Michael P. McMasters, Senior Vice President and Chief Financial Officer. According to the terms of the awards, each executive officer is entitled to earn up to a specified number of shares of the Company's common stock ("Contingent Performance Shares") depending on the extent to which pre-established performance goals (the "Performance Goals") are achieved during the year ended December 31, 2007 (the "2007 Award Year").

On November 29, 2006, the Compensation Committee also approved awards under the Company's Performance Incentive Plan to (i) Stephen C. Thompson, Senior Vice President, and (ii) S. Robert Zola, President of Sharp Energy, Inc., a Company subsidiary, for the three-year period ending December 31, 2008. For a performance period beginning January 1, 2007 and ending December 31, 2007, each executive officer is entitled to earn, in the form of shares of restricted stock, up to 30 percent of the annual award of Contingent Performance Shares if the Company achieves certain Performance Goals. The second component consists of performance awards pursuant to which the remaining 70 percent of the annual award of Contingent Performance Shares will be earned, if certain Performance Goals for the three-year period ending December 31, 2008 for each of the respective business units for which they are individually responsible, are achieved.

## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS OF THE REGISTRANT AND CORPORATE GOVERNANCE.**

The information required by this Item is incorporated herein by reference to the portions of the Proxy Statement, captioned "Proposal I – Election of Directors," "Information Regarding the Board of Directors and Nominees," "Corporate Governance Practices and Stockholder Communications – Nomination of Directors," "Committees of the Board – Audit Committee" and "Section 16(a) Beneficial Ownership Reporting Compliance" to be filed not later than March 31, 2007 in connection with the Company's Annual Meeting to be held on May 2, 2007.

The information required by this Item with respect to executive officers is, pursuant to instruction 3 of paragraph (b) of Item 401 of Regulation S-K, set forth in Part I of this Form 10-K under "Executive Officers of the Registrant."

The Company has adopted a Code of Ethics for Financial Officers, which applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. The information set forth under Item 1 hereof concerning the Code of Ethics for Financial Officers is incorporated herein by reference.

### **ITEM 11. EXECUTIVE COMPENSATION.**

The information required by this Item is incorporated herein by reference to the portion of the Proxy Statement captioned "Director Compensation," "Executive Compensation" and "Compensation Discussion and Analysis" in the Proxy Statement to be filed not later than March 31, 2007, in connection with the Company's Annual Meeting to be held on May 2, 2007.

### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information required by this Item is incorporated herein by reference to the portion of the Proxy Statement captioned "Beneficial Ownership of Chesapeake's Securities" to be filed not later than March 31, 2007 in connection with the Company's Annual Meeting to be held on May 2, 2007.

The following table sets forth information as of December 31, 2006, with respect to compensation plans of Chesapeake and its subsidiaries under which shares of Chesapeake common stock are authorized for issuance:

|  | (a)   | (b)   | (c)   |
|--|---|---|---|
|  | Number of securities to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
| Equity compensation plans approved by security holders     | 0 (1)   | N/A   | 381,431 (2)   |
| Equity compensation plans not approved by security holders | 0 (3)   | N/A   | 0   |
| <b>Total</b>   | <b>0</b>  |   | <b>381,431</b>  |

(1) All options to purchase shares under the 1992 Performance Incentive Plan, as amended, were exercised as of 12/31/05.

(2) Includes 293,481 shares under the 2005 Performance Incentive Plan, 63,300 shares available under the 2005 Directors Stock Compensation Plan, and 24,650 shares available under the 2005 Employee Stock Awards Plan.

(3) All warrants were exercised in 2006.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

None

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

The information required by this Item is incorporated herein by reference to the portion of the Proxy Statement captioned "Fees and Services of PricewaterhouseCoopers LLP" to be filed not later than March 31, 2007, in connection with the Company's Annual Meeting to be held on May 2, 2007.

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

#### (a) The following documents are filed as part of this report:

##### 1. Financial Statements:

- Report of Independent Registered Public Accounting Firm
- Consolidated Statements of Income for each of the three years ended December 31, 2006, 2005 and 2004
- Consolidated Balance Sheets at December 31, 2006 and December 31, 2005
- Consolidated Statements of Cash Flows for each of the three years ended December 31, 2006, 2005 and 2004
- Consolidated Statements of Common Stockholders' Equity for each of the three years ended December 31, 2006, 2005 and 2004
- Consolidated Statements of Comprehensive Income for each of the three years ended December 31, 2006, 2005 and 2004
- Consolidated Statements of Income Taxes for each of the three years ended December 31, 2006, 2005 and 2004
- Notes to Consolidated Financial Statements

##### 2. Financial Statement Schedule — Schedule II - Valuation and Qualifying Accounts

All other schedules are omitted because they are not required, are inapplicable or the information is otherwise shown in the financial statements or notes thereto.

##### 3. Exhibits

- Exhibit 1 Underwriting Agreement entered into by Chesapeake Utilities Corporation and Robert W. Baird & Co. Incorporated and A.G. Edwards & Sons, Inc., on November 15, 2007, relating to the sale and issuance of 600,300 shares of the Company's common stock, is incorporated herein by reference to Exhibit 1.1 of the Company's Current Report on Form 8-K, filed November 16, 2007, File No. 001-11590.
- Exhibit 3.1 Amended Certificate of Incorporation of Chesapeake Utilities Corporation is incorporated herein by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1998, File No. 001-11590.
- Exhibit 3.2 Amended Bylaws of Chesapeake Utilities Corporation, effective February 24, 2005, is incorporated herein by reference to Exhibit 3 of the Company's Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-11590.
- Exhibit 4.1 Form of Indenture between the Company and Boatmen's Trust Company, Trustee, with respect to the 8 1/4% Convertible Debentures is incorporated herein by reference to Exhibit 4.2 of the Company's Registration Statement on Form S-2, Reg. No. 33-26582, filed on January 13, 1989.
- Exhibit 4.2 Note Agreement dated February 9, 1993, by and between the Company and Massachusetts Mutual Life Insurance Company and MML Pension Insurance Company, with respect to \$10 million of 7.97% Unsecured Senior Notes due February 1, 2008, is incorporated herein by reference to Exhibit 4 to the Company's Annual Report on Form 10-K for the year ended December 31, 1992, File No. 0-593.

- Exhibit 4.3 Note Purchase Agreement entered into by the Company on October 2, 1995, pursuant to which the Company privately placed \$10 million of its 6.91% Senior Notes due in 2010, is not being filed herewith, in accordance with Item 601(b)(4)(iii) of Regulation S-K. The Company hereby agrees to furnish a copy of that agreement to the SEC upon request.
- Exhibit 4.4 Note Purchase Agreement entered into by the Company on December 15, 1997, pursuant to which the Company privately placed \$10 million of its 6.85% Senior Notes due 2012, is not being filed herewith, in accordance with Item 601(b)(4)(iii) of Regulation S-K. The Company hereby agrees to furnish a copy of that agreement to the SEC upon request.
- Exhibit 4.5 Note Purchase Agreement entered into by the Company on December 27, 2000, pursuant to which the Company privately placed \$20 million of its 7.83% Senior Notes due 2015, is not being filed herewith, in accordance with Item 601(b)(4)(iii) of Regulation S-K. The Company hereby agrees to furnish a copy of that agreement to the SEC upon request.
- Exhibit 4.6 Note Agreement entered into by the Company on October 31, 2002, pursuant to which the Company privately placed \$30 million of its 6.64% Senior Notes due 2017, is incorporated herein by reference to Exhibit 2 of the Company's Current Report on Form 8-K, filed November 6, 2002, File No. 001-11590.
- Exhibit 4.7 Note Agreement entered into by the Company on October 18, 2005, pursuant to which the Company, on October 12, 2006, privately placed \$20 million of its 5.5% Senior Notes, due 2020, with Prudential Investment Management, Inc., is incorporated herein by reference to Exhibit 4.1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2005, File No. 001-11590.
- Exhibit 4.8 Form of Senior Debt Trust Indenture between Chesapeake Utilities Corporation and the trustee for the debt securities is incorporated herein by reference to Exhibit 4.3.1 of the Company's Registration Statement on Form S-3A, Reg. No. 333-135602, dated November 6, 2006.
- Exhibit 4.9 Form of Subordinated Debt Trust Indenture between Chesapeake Utilities Corporation and the trustee for the debt securities is incorporated herein by reference to Exhibit 4.3.2 of the Company's Registration Statement on Form S-3A, Reg. No. 333-135602, dated November 6, 2006.
- Exhibit 4.10 Form of debt securities is incorporated herein by reference to Exhibit 4.4 of the Company's Registration Statement on Form S-3A, Reg. No. 333-135602, dated November 6, 2006.
- Exhibit 5.1 Opinion of Baker & Hostetler LLP is incorporated herein by reference to Exhibit 5.1 of the Company's Registration Statement on Form S-3, Reg. No. 333-135602, dated July 5, 2006.
- Exhibit 5.2 Opinion of Baker & Hostetler LLP is incorporated herein by reference to Exhibit 5.1 of the Company's Registration Statement on Form S-3A, Reg. No. 333-135602, dated November 6, 2006.
- Exhibit 10.1\* Non-Employee Director Compensation Arrangements, incorporated herein by reference to Exhibit 10.5 of the Company's Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-11590.
- Exhibit 10.2\* Chesapeake Utilities Corporation Cash Bonus Incentive Plan dated January 1, 2005, is incorporated herein by reference to Exhibit 10.3 of the Company's Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-11590.
- Exhibit 10.3\* Chesapeake Utilities Corporation Directors Stock Compensation Plan, adopted in 2005, is incorporated herein by reference to the Company's Proxy Statement dated March 28, 2005 in connection with the Company's Annual Meeting held on May 5, 2005, File No. 001-11590.
- Exhibit 10.4\* Chesapeake Utilities Corporation Employee Stock Award Plan, adopted in 2005, is incorporated herein by reference to the Company's Proxy Statement dated March 28, 2005 in connection with the Company's Annual Meeting held on May 5, 2005, File No. 001-11590.

- Exhibit 10.5\* Chesapeake Utilities Corporation Performance Incentive Plan, adopted in 2005, is incorporated herein by reference to the Company's Proxy Statement dated March 28, 2005 in connection with the Company's Annual Meeting held on May 5, 2005, File No. 001-11590.
- Exhibit 10.6\* Deferred Compensation Program (as amended and restated as of December 7, 2006) is incorporated herein by reference to Exhibit 10 of the Company's Current Report on Form 8-K, filed December 13, 2006, File No. 001-11590.
- Exhibit 10.7\* Executive Employment Agreement dated December 29, 2006, by and between Chesapeake Utilities Corporation and S. Robert Zola, is filed herewith.
- Exhibit 10.8\* Executive Employment Agreement dated December 29, 2006, by and between Chesapeake Utilities Corporation and Stephen C. Thompson, is filed herewith.
- Exhibit 10.9\* Executive Employment Agreement dated December 29, 2006, by and between Chesapeake Utilities Corporation and Beth W. Cooper, is filed herewith.
- Exhibit 10.10\* Executive Employment Agreement dated December 29, 2006, by and between Chesapeake Utilities Corporation and Michael P. McMasters, is filed herewith.
- Exhibit 10.11\* Executive Employment Agreement dated December 29, 2006, by and between Chesapeake Utilities Corporation and John R. Schimkaitis, is filed herewith.
- Exhibit 10.12\* Performance Share Agreement dated December 15, 2006, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and S. Robert Zola, is filed herewith.
- Exhibit 10.13\* Performance Share Agreement dated December 23, 2006, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and Stephen C. Thompson, is filed herewith.
- Exhibit 10.14\* Performance Share Agreement dated December 27, 2006, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and Beth W. Cooper, is filed herewith.
- Exhibit 10.15\* Performance Share Agreement dated December 29, 2006, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and Michael P. McMasters, is filed herewith.
- Exhibit 10.16\* Performance Share Agreement dated December 29, 2006, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and John R. Schimkaitis, is filed herewith.
- Exhibit 12 Computation of Ratio of Earning to Fixed Charges, filed herewith.
- Exhibit 14 Code of Ethics for Financial Officers, filed herewith.
- Exhibit 21 Subsidiaries of the Registrant, filed herewith.
- Exhibit 23.1 Consent of Independent Registered Public Accounting Firm is incorporated herein by reference to Exhibit 23.1 to the Company's Registration Statement on Form S-3, Reg. No. 333-135602, dated July 5, 2006.
- Exhibit 23.2 Consent of Independent Registered Public Accounting Firm is incorporated herein by reference to Exhibit 23.1 to the Company's Registration Statement on Form S-3A, Reg. No. 333-135602, dated November 6, 2006.
- Exhibit 23.3 Consent of Baker & Hostetler LLP (included in Exhibit 5.1).
- Exhibit 23.4 Consent of Baker & Hostetler LLP (included in Exhibit 5.2).
- Exhibit 23.5 Consent of Independent Registered Public Accounting Firm, filed herewith.



- Exhibit 24 Power of Attorney is incorporated herein by reference to Exhibit 24.1 of the Company's Registration Statement on Form S-3, Reg. No. 333-135602, dated July 5, 2006.
- Exhibit 31.1 Certificate of Chief Executive Office of Chesapeake Utilities Corporation pursuant to Exchange Act Rule 13a-14(a), dated March 13, 2007, filed herewith.
- Exhibit 31.2 Certificate of Chief Financial Officer of Chesapeake Utilities Corporation pursuant to Exchange Act Rule 13a-14(a), dated March 13, 2007, filed herewith.
- Exhibit 32.1 Certificate of Chief Executive Office of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated March 13, 2007, filed herewith.
- Exhibit 32.2 Certificate of Chief Financial Officer of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated March 13, 2007, filed herewith.

\* Management contract or compensatory plan or agreement.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, Chesapeake Utilities Corporation has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHESAPEAKE UTILITIES CORPORATION

By: /s/ JOHN R. SCHIMKAITIS  
John R. Schimkaitis  
President and Chief Executive Officer  
Date: March 13, 2007

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ RALPH J. ADKINS  
Ralph J. Adkins, Chairman of the Board  
and Director  
Date: February 21, 2007

/s/ JOHN R. SCHIMKAITIS  
John R. Schimkaitis, President,  
Chief Executive Officer and Director  
Date: March 13, 2007

/s/ MICHAEL P. MCMASTERS  
Michael P. McMasters, Senior Vice President  
and Chief Financial Officer  
(Principal Financial and Accounting Officer)  
Date: March 13, 2007

/s/ RICHARD BERNSTEIN  
Richard Bernstein, Director  
Date: February 21, 2007

/s/ EUGENE H. BAYARD  
Eugene H. Bayard, Director  
Date: February 21, 2007

/s/ THOMAS J. BRESNAN  
Thomas J. Bresnan, Director  
Date: March 13, 2007

/s/ THOMAS P. HILL, JR.  
Thomas P. Hill, Jr., Director  
Date: February 21, 2007

/s/ WALTER J. COLEMAN  
Walter J. Coleman, Director  
Date: February 21, 2007

/s/ J. PETER MARTIN  
J. Peter Martin, Director  
Date: February 21, 2007

/s/ JOSEPH E. MOORE, ESQ.  
Joseph E. Moore, Esq., Director  
Date: February 21, 2007

/s/ CALVERT A. MORGAN, JR.  
Calvert A. Morgan, Jr., Director  
Date: February 21, 2007

**Chesapeake Utilities Corporation and Subsidiaries**  
**Schedule II**  
**Valuation and Qualifying Accounts**

| <b>For the Year Ended December 31,</b>      | <b>Balance at<br/>Beginning of<br/>Year</b> | <b>Additions</b>             |  |                                  | <b>Balance at End<br/>of Year</b> |
|---|---|------------------------------|--|----------------------------------|-----------------------------------|
|   |   | <b>Charged to<br/>Income</b> | <b>Other<br/>Accounts <sup>(1)</sup></b> | <b>Deductions <sup>(2)</sup></b> |                                   |
| <b>Reserve Deducted From Related Assets</b> |   |                              |  |                                  |                                   |
| <b>Reserve for Uncollectible Accounts</b>   |   |                              |  |                                  |                                   |
| 2006  | \$861,378                                   | \$381,424                    | \$65,519                                 | (\$646,724)                      | \$661,597                         |
| 2005  | \$610,819                                   | \$632,644                    | \$158,409                                | (\$540,494)                      | \$861,378                         |
| 2004  | \$682,002                                   | \$505,595                    | \$103,020                                | (\$679,798)                      | \$610,819                         |

<sup>(1)</sup> Recoveries.

<sup>(2)</sup> Uncollectible accounts charged off.

**Chesapeake Utilities Corporation**  
**Ratio of Earnings to Fixed Charges**

| For the Years Ended December 31,                   | 2006                | 2005         | 2004         | 2003         | 2002         |
|--|---------------------|--------------|--------------|--------------|--------------|
| <b>Income from continuing operations</b>           | <b>\$10,506,525</b> | \$10,467,614 | \$9,549,667  | \$10,079,483 | \$7,535,009  |
| Add:   |                     |              |              |              |              |
| Income taxes                                       | 6,836,562           | 6,312,016    | 5,701,090    | 6,032,445    | 4,609,552    |
| Portion of rents representative of interest factor | 226,583             | 278,846      | 309,446      | 351,445      | 411,461      |
| Interest on indebtedness                           | 5,725,228           | 5,077,693    | 5,206,723    | 5,616,756    | 4,867,520    |
| Amortization of debt discount and expense          | 52,108              | 55,802       | 61,422       | 89,155       | 87,502       |
| <b>Earnings as adjusted</b>                        | <b>\$23,347,006</b> | \$22,191,971 | \$20,828,348 | \$22,169,284 | \$17,511,044 |
| <b>Fixed Charges</b>                               |                     |              |              |              |              |
| Portion of rents representative of interest factor | \$226,583           | \$278,846    | \$309,446    | \$351,445    | \$411,461    |
| Interest on indebtedness                           | 5,725,228           | 5,077,693    | 5,206,723    | 5,616,756    | 4,867,520    |
| Amortization of debt discount and expense          | 52,108              | 55,802       | 61,422       | 89,155       | 87,502       |
| <b>Fixed Charges</b>                               | <b>\$6,003,919</b>  | \$5,412,341  | \$5,577,591  | \$6,057,356  | \$5,366,483  |
| <b>Ratio of Earnings to Fixed Charges</b>          | <b>3.89</b>         | 4.10         | 3.73         | 3.66         | 3.26         |

**Chesapeake Utilities Corporation**  
**Subsidiaries of the Registrant**

| <u>Subsidiaries</u>                     | <u>State Incorporated</u> |
|---|---------------------------|
| Eastern Shore Natural Gas Company       | Delaware                  |
| Sharp Energy, Inc.                      | Delaware                  |
| Chesapeake Service Company              | Delaware                  |
| Xeron, Inc.                             | Mississippi               |
| Sam Shannahan Well Company, Inc.        | Maryland                  |
| Sharp Water, Inc.                       | Delaware                  |
| OnSight Energy, LLC                     | Delaware                  |
| Peninsula Energy Services Company, Inc. | Delaware                  |
| Peninsula Pipeline Company, Inc.        | Delaware                  |

| <u>Subsidiaries of Sharp Energy, Inc.</u> | <u>State Incorporated</u> |
|---|---------------------------|
| Sharpgas, Inc.                            | Delaware                  |
| Tri-County Gas Co., Incorporated          | Maryland                  |

| <u>Subsidiaries of Chesapeake Service Company</u> | <u>State Incorporated</u> |
|---|---------------------------|
| Skipjack, Inc.                                    | Delaware                  |
| BravePoint, Inc.                                  | Georgia                   |
| Chesapeake Investment Company                     | Delaware                  |
| Eastern Shore Real Estate, Inc.                   | Maryland                  |

| <u>Subsidiaries of Sharp Water, Inc.</u> | <u>State Incorporated</u> |
|--|---------------------------|
| Sharp Water of Idaho, Inc.               | Delaware                  |
| Sharp Water of Minnesota, Inc.           | Delaware                  |

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

---

We hereby consent to the incorporation by reference in the Registration Statements on Form S-3 (Nos. 333-63381, 333-121524 and 333-135602) and Form S-8 (Nos. 333-01175, 333-94159, 333-124646, 333-124694 and 333-124717) of Chesapeake Utilities Corporation of our report dated March 13, 2007 relating to the consolidated financial statements, financial statement schedule, management's assessment of the effectiveness of internal control over financial reporting and the effectiveness of internal control over financial reporting, which appears in this Form 10-K.

*PricewaterhouseCoopers LLP*

PRICEWATERHOUSECOOPERS LLP  
Boston, Massachusetts  
March 13, 2007

**CERTIFICATE PURSUANT TO RULE 13A-14(A)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, John R. Schimkaitis, certify that:

I have reviewed this annual report on Form 10-K of Chesapeake Utilities Corporation;

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

- a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and
- d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2007

/s/ JOHN R. SCHIMKAITIS

John R. Schimkaitis

President and Chief Executive Officer

**CERTIFICATE PURSUANT TO RULE 13A-14(A)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Michael P. McMasters, certify that:

I have reviewed this annual report on Form 10-K of Chesapeake Utilities Corporation;

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:

- a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
- b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
- c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluations; and
- d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

- a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
- b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 13, 2007

/s/ MICHAEL P. MCMASTERS

Michael P. McMasters

Senior Vice President and Chief Financial Officer



**Certificate of Chief Executive Officer**

**of**

**Chesapeake Utilities Corporation**

**(pursuant to 18 U.S.C. Section 1350)**

I, John R. Schimkaitis, President and Chief Executive Officer of Chesapeake Utilities Corporation, certify that, to the best of my knowledge, the Annual Report on Form 10-K of Chesapeake Utilities Corporation (“Chesapeake”) for the year ended December 31, 2006, filed with the Securities and Exchange Commission on the date hereof (i) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Chesapeake.

/s/ JOHN R. SCHIMKAITIS

John R. Schimkaitis

March 13, 2007

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Chesapeake Utilities Corporation and will be retained by Chesapeake Utilities Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

**Certificate of Chief Financial Officer**

**of**

**Chesapeake Utilities Corporation**

**(pursuant to 18 U.S.C. Section 1350)**

I, Michael P. McMasters, Senior Vice President and Chief Financial Officer of Chesapeake Utilities Corporation, certify that, to the best of my knowledge, the Annual Report on Form 10-K of Chesapeake Utilities Corporation (“Chesapeake”) for the year ended December 31, 2006, filed with the Securities and Exchange Commission on the date hereof (i) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Chesapeake.

/S/ MICHAEL P. MCMASTERS

Michael P. McMasters

March 13, 2007

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Chesapeake Utilities Corporation and will be retained by Chesapeake Utilities Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

*Upon written request,  
Chesapeake will provide, free of  
charge, a copy of any exhibit to  
the 2006 Annual Report on  
Form 10-K not included  
in this document.*

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended: June 30, 2007

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-11590

**CHESAPEAKE UTILITIES CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**51-0064146**

(I.R.S. Employer  
Identification No.)

**909 Silver Lake Boulevard, Dover, Delaware 19904**  
(Address of principal executive offices, including Zip Code)

**(302) 734-6799**

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Common Stock, par value \$0.4867 — 6,751,983 shares outstanding as of July 31, 2007.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

| For the Three Months Ended June 30,                       | 2007                | 2006                |
|---|---------------------|---------------------|
| <b>Operating Revenues</b>                                 | <b>\$52,501,920</b> | <b>\$44,303,752</b> |
| <b>Operating Expenses</b>                                 |                     |                     |
| Cost of sales, excluding costs below                      | 34,232,939          | 28,505,528          |
| Operations  | 10,316,296          | 8,851,831           |
| Maintenance   | 564,854             | 583,638             |
| Depreciation and amortization                             | 2,367,523           | 2,037,003           |
| Other taxes   | 1,332,249           | 1,120,384           |
| Total operating expenses                                  | 48,813,861          | 41,098,384          |
| <b>Operating Income</b>                                   | <b>3,688,059</b>    | <b>3,205,368</b>    |
| Other income net of other expenses                        | 234,195             | 63,715              |
| Interest charges  | 1,594,701           | 1,501,352           |
| <b>Income Before Income Taxes</b>                         | <b>2,327,553</b>    | <b>1,767,731</b>    |
| Income taxes  | 845,762             | 635,222             |
| <b>Net Income</b>   | <b>\$1,481,791</b>  | <b>\$1,132,509</b>  |
| <b>Earnings Per Share of Common Stock:</b>                |                     |                     |
| Basic   | \$0.22              | \$0.19              |
| Diluted   | \$0.22              | \$0.19              |
| Basic weighted average shares outstanding                 | 6,737,384           | 5,952,074           |
| Diluted weighted average shares outstanding               | 6,849,890           | 5,963,596           |
| <b>Cash Dividends Declared Per Share of Common Stock:</b> | <b>\$0.295</b>      | <b>\$0.290</b>      |

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

## Chesapeake Utilities Corporation and Subsidiaries

### Condensed Consolidated Statements of Income (Unaudited)

| For the Six Months Ended June 30,                         | 2007                 | 2006                 |
|---|----------------------|----------------------|
| <b>Operating Revenues</b>                                 | <b>\$146,028,811</b> | <b>\$135,254,425</b> |
| <b>Operating Expenses</b>                                 |                      |                      |
| Cost of sales, excluding costs below                      | 98,168,806           | 94,430,289           |
| Operations  | 20,875,996           | 18,453,112           |
| Maintenance   | 1,145,019            | 1,027,607            |
| Depreciation and amortization                             | 4,683,318            | 4,014,350            |
| Other taxes   | 2,885,561            | 2,686,471            |
| Total operating expenses                                  | 127,758,700          | 120,611,829          |
| <b>Operating Income</b>                                   | <b>18,270,111</b>    | <b>14,642,596</b>    |
| Other income net of other expenses                        | 287,567              | 142,299              |
| Interest charges  | 3,193,951            | 2,994,689            |
| <b>Income Before Income Taxes</b>                         | <b>15,363,727</b>    | <b>11,790,206</b>    |
| Income taxes  | 5,890,848            | 4,561,281            |
| <b>Net Income</b>   | <b>\$9,472,879</b>   | <b>\$7,228,925</b>   |
| <b>Earnings Per Share of Common Stock:</b>                |                      |                      |
| Basic   | \$1.41               | \$1.22               |
| Diluted   | \$1.39               | \$1.20               |
| Basic weighted average shares outstanding                 | 6,721,694            | 5,930,872            |
| Diluted weighted average shares outstanding               | 6,835,257            | 6,070,191            |
| <b>Cash Dividends Declared Per Share of Common Stock:</b> | <b>\$0.585</b>       | <b>\$0.575</b>       |

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

# Chesapeake Utilities Corporation and Subsidiaries

## Condensed Consolidated Statements of Cash Flows (Unaudited)

| For the Six Months Ended June 30,   | 2007               | 2006               |
|---|--------------------|--------------------|
| <b>Operating Activities</b>   |                    |                    |
| Net Income  | \$9,472,879        | \$7,228,925        |
| Adjustments to reconcile net income to net operating cash:                        |                    |                    |
| Depreciation and amortization   | 4,683,318          | 4,014,350          |
| Depreciation and accretion included in other costs                                | 1,682,980          | 1,503,982          |
| Deferred income taxes, net  | 1,590,955          | (2,594,606)        |
| Gain on sale of assets  | (204,882)          | -                  |
| Unrealized gain on commodity contracts  | (296,892)          | (99,715)           |
| Unrealized gain on investments  | (188,203)          | (56,628)           |
| Employee benefits and compensation  | 920,460            | 876,543            |
| Other, net  | (1,839)            | (1,806)            |
| Changes in assets and liabilities:  |                    |                    |
| Sale (purchase) of investments  | 71,432             | (66,146)           |
| Accounts receivable and accrued revenue   | 6,961,621          | 20,855,446         |
| Propane inventory, storage gas and other inventory                                | 2,781,638          | 2,947,555          |
| Regulatory assets   | 597,354            | 3,826,484          |
| Prepaid expenses and other current assets   | (686,387)          | (145,410)          |
| Other deferred charges  | (1,405,003)        | 27,409             |
| Long-term receivables   | 51,557             | 87,643             |
| Accounts payable and other accrued liabilities                                    | (7,026,333)        | (20,874,990)       |
| Income taxes receivable (payable)   | (139,486)          | 5,346,331          |
| Accrued interest  | (20,910)           | 54,094             |
| Customer deposits and refunds   | 361,078            | (468,019)          |
| Accrued compensation  | (400,959)          | (1,532,150)        |
| Regulatory liabilities  | 1,798,097          | 2,110,251          |
| Other liabilities   | 15,582             | (68,757)           |
| Net cash provided by operating activities   | 20,618,057         | 22,970,786         |
| <b>Investing Activities</b>   |                    |                    |
| Property, plant and equipment expenditures  | (15,969,557)       | (16,825,679)       |
| Proceeds from sale of assets  | 204,882            | -                  |
| Environmental recoveries (expenditures)   | (135,953)          | 1,620              |
| Net cash used in investing activities   | (15,900,628)       | (16,824,059)       |
| <b>Financing Activities</b>   |                    |                    |
| Common stock dividends  | (3,465,987)        | (2,945,899)        |
| Issuance of stock for Dividend Reinvestment Plan                                  | 174,315            | 177,077            |
| Change in cash overdrafts due to outstanding checks                               | 843,845            | 1,268,914          |
| Net repayment under line of credit agreements                                     | (4,829,053)        | (3,747,750)        |
| Repayment of long-term debt   | (1,020,132)        | (1,020,454)        |
| Net cash used in financing activities   | (8,297,012)        | (6,268,112)        |
| <b>Net Decrease in Cash and Cash Equivalents</b>                                  | <b>(3,579,583)</b> | <b>(121,385)</b>   |
| <b>Cash and Cash Equivalents — Beginning of Period</b>                            | <b>4,488,367</b>   | <b>2,487,658</b>   |
| <b>Cash and Cash Equivalents — End of Period</b>                                  | <b>\$908,784</b>   | <b>\$2,366,273</b> |
| <b>Supplemental Disclosures of Non-Cash Investing Activities:</b>                 |                    |                    |
| Capital property and equipment acquired on account,<br>but not paid as of June 30 | \$1,216,749        | \$788,758          |

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



## Chesapeake Utilities Corporation and Subsidiaries

### Condensed Consolidated Balance Sheets (Unaudited)

| Assets   | June 30,<br>2007     | December 31,<br>2006 |
|--|----------------------|----------------------|
| <b>Property, Plant and Equipment</b>   |                      |                      |
| Natural gas  | \$277,239,562        | \$269,012,516        |
| Propane  | 46,361,641           | 44,791,552           |
| Advanced information services  | 1,098,355            | 1,054,368            |
| Other plant  | 9,140,526            | 9,147,500            |
| <b>Total property, plant and equipment</b>   | <b>333,840,084</b>   | <b>324,005,936</b>   |
| Less: Accumulated depreciation and amortization  | (89,484,746)         | (85,010,472)         |
| Plus: Construction work in progress  | 6,739,641            | 1,829,948            |
| <b>Net property, plant and equipment</b>   | <b>251,094,979</b>   | <b>240,825,412</b>   |
| <b>Investments</b>   | <b>2,132,348</b>     | <b>2,015,577</b>     |
| <b>Current Assets</b>  |                      |                      |
| Cash and cash equivalents  | 908,784              | 4,488,366            |
| Accounts receivable (less allowance for uncollectible accounts of \$720,353 and \$661,597, respectively) | 40,938,891           | 44,969,182           |
| Accrued revenue  | 1,394,021            | 4,325,351            |
| Propane inventory, at average cost   | 6,874,869            | 7,187,035            |
| Other inventory, at average cost   | 1,368,907            | 1,564,937            |
| Regulatory assets  | 650,139              | 1,275,653            |
| Storage gas prepayments  | 5,119,893            | 7,393,335            |
| Income taxes receivable  | 1,218,368            | 1,078,882            |
| Deferred income taxes  | 412,493              | 1,365,316            |
| Prepaid expenses   | 2,995,506            | 2,280,900            |
| Other current assets   | 3,641,451            | 1,553,284            |
| <b>Total current assets</b>  | <b>65,523,322</b>    | <b>77,482,241</b>    |
| <b>Deferred Charges and Other Assets</b>   |                      |                      |
| Goodwill   | 674,451              | 674,451              |
| Other intangible assets, net   | 184,976              | 191,878              |
| Pension  | 630,082              | 590,562              |
| Long-term receivables  | 772,776              | 824,333              |
| Other regulatory assets  | 1,757,691            | 1,765,088            |
| Other deferred charges   | 2,593,474            | 1,215,004            |
| <b>Total deferred charges and other assets</b>   | <b>6,613,450</b>     | <b>5,261,316</b>     |
| <b>Total Assets</b>  | <b>\$325,364,099</b> | <b>\$325,584,546</b> |

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

| <b>Capitalization and Liabilities</b>  | <b>June 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|--------------------------|------------------------------|
| <b>Capitalization</b>  |                          |                              |
| Stockholders' equity   |                          |                              |
| Common Stock, par value \$0.4867 per share<br>(authorized 12,000,000 shares) | <b>\$3,281,792</b>       | \$3,254,998                  |
| Additional paid-in capital   | <b>64,129,089</b>        | 61,960,220                   |
| Retained earnings  | <b>51,806,645</b>        | 46,270,884                   |
| Accumulated other comprehensive loss   | <b>(334,550)</b>         | (334,550)                    |
| Deferred compensation obligation   | <b>1,370,547</b>         | 1,118,509                    |
| Treasury stock   | <b>(1,370,547)</b>       | (1,118,509)                  |
| <b>Total stockholders' equity</b>  | <b>118,882,976</b>       | 111,151,552                  |
| <b>Long-term debt, net of current maturities</b>                             | <b>69,965,000</b>        | 71,050,000                   |
| <b>Total capitalization</b>  | <b>188,847,976</b>       | 182,201,552                  |
| <b>Current Liabilities</b>   |                          |                              |
| Current portion of long-term debt  | <b>7,656,364</b>         | 7,656,364                    |
| Short-term borrowing   | <b>23,568,733</b>        | 27,553,941                   |
| Accounts payable   | <b>26,645,349</b>        | 33,870,552                   |
| Customer deposits and refunds  | <b>7,863,343</b>         | 7,502,265                    |
| Accrued interest   | <b>811,482</b>           | 832,392                      |
| Dividends payable  | <b>1,989,086</b>         | 1,939,482                    |
| Accrued compensation   | <b>1,881,211</b>         | 2,901,053                    |
| Regulatory liabilities   | <b>6,117,618</b>         | 4,199,147                    |
| Other accrued liabilities  | <b>5,739,405</b>         | 4,005,795                    |
| <b>Total current liabilities</b>   | <b>82,272,591</b>        | 90,460,991                   |
| <b>Deferred Credits and Other Liabilities</b>                                |                          |                              |
| Deferred income taxes  | <b>27,155,230</b>        | 26,517,098                   |
| Deferred investment tax credits  | <b>300,869</b>           | 328,277                      |
| Other regulatory liabilities   | <b>1,053,294</b>         | 1,236,254                    |
| Environmental liabilities  | <b>102,656</b>           | 211,581                      |
| Accrued pension costs  | <b>2,241,819</b>         | 2,198,874                    |
| Accrued asset removal cost   | <b>19,355,153</b>        | 18,410,992                   |
| Other liabilities  | <b>4,034,511</b>         | 4,018,927                    |
| <b>Total deferred credits and other liabilities</b>                          | <b>54,243,532</b>        | 52,922,003                   |
| <b>Other Commitments and Contingencies (Note 4)</b>                          |                          |                              |
| <b>Total Capitalization and Liabilities</b>                                  | <b>\$325,364,099</b>     | \$325,584,546                |

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

# Chesapeake Utilities Corporation and Subsidiaries

## Condensed Consolidated Statements of Stockholders' Equity (Unaudited)

|   | For the Six<br>Months Ended<br>June 30, 2007 | For the Twelve<br>Months Ended<br>December 31, 2006 |
|---|--|---|
| <b>Common Stock</b>   |  |   |
| Balance — beginning of period                               | \$3,254,998                                  | \$2,863,212   |
| Dividend Reinvestment Plan                                  | 9,375  | 18,685  |
| Retirement Savings Plan                                     | 7,616  | 14,457  |
| Conversion of debentures                                    | 1,858  | 8,117   |
| Performance shares and options exercised                    | 7,945  | 14,536  |
| Stock issuance  | -  | 335,991   |
| Balance — end of period                                     | <b>\$3,281,792</b>                           | <b>\$3,254,998</b>                                  |
| <b>Additional Paid-in Capital</b>                           |  |   |
| Balance — beginning of period                               | \$61,960,220                                 | \$39,619,849  |
| Dividend Reinvestment Plan                                  | 585,503                                      | 1,148,100   |
| Retirement Savings Plan                                     | 476,758                                      | 900,354   |
| Conversion of debentures                                    | 63,010                                       | 275,300   |
| Stock-based compensation                                    | 1,043,598                                    | 887,426   |
| Stock issuance  | -  | 19,362,518  |
| Exercise of warrants  | -  | (233,327)   |
| Balance — end of period                                     | <b>\$64,129,089</b>                          | <b>\$61,960,220</b>                                 |
| <b>Retained Earnings</b>                                    |  |   |
| Balance — beginning of period                               | \$46,270,884                                 | \$42,854,894  |
| Net income  | 9,472,879                                    | 10,506,525  |
| Cash dividends declared                                     | (3,937,118)                                  | (7,090,535)   |
| Balance — end of period                                     | <b>\$51,806,645</b>                          | <b>\$46,270,884</b>                                 |
| <b>Accumulated Other Comprehensive Loss</b>                 |  |   |
| Balance — beginning of period                               | (\$334,550)                                  | (578,151)   |
| Minimum pension liability adjustment, net of tax            | -  | 74,036  |
| Gain on funded status of Employee Benefit Plans, net of tax | -  | 169,565   |
| Balance — end of period                                     | <b>(\$334,550)</b>                           | <b>(\$334,550)</b>                                  |
| <b>Deferred Compensation Obligation</b>                     |  |   |
| Balance — beginning of period                               | \$1,118,509                                  | \$794,535   |
| New deferrals   | 252,038                                      | 323,974   |
| Balance — end of period                                     | <b>\$1,370,547</b>                           | <b>\$1,118,509</b>                                  |
| <b>Treasury Stock</b>                                       |  |   |
| Balance — beginning of period                               | (\$1,118,509)                                | (\$797,156)   |
| New deferrals related to compensation obligation            | (252,038)                                    | (323,974)   |
| Purchase of treasury stock <sup>(1)</sup>                   | (29,771)                                     | (51,572)  |
| Sale and distribution of treasury stock <sup>(2)</sup>      | 29,771                                       | 54,193  |
| Balance — end of period                                     | <b>(\$1,370,547)</b>                         | <b>(\$1,118,509)</b>                                |
| <b>Total Stockholders' Equity</b>                           | <b>\$118,882,976</b>                         | <b>\$111,151,552</b>                                |

<sup>(1)</sup> Amount includes shares purchased in the open market for the Company's Rabbi Trust to secure its obligations under the Company's Executive Deferred Compensation Plan.

<sup>(2)</sup> Amount includes shares issued to the Company's Rabbi Trust as obligation under the Executive Deferred Compensation Plan.

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

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 1. Basis of Presentation

References in this document to “the Company,” “Chesapeake,” “we,” “us” and “our” are intended to mean Chesapeake Utilities Corporation and its subsidiaries.

The accompanying unaudited condensed consolidated financial statements have been prepared in compliance with the rules and regulations of the Securities and Exchange Commission (“SEC”) and United States of America Generally Accepted Accounting Principles (“GAAP”). In accordance with these rules and regulations, certain information and disclosures normally required for audited financial statements have been condensed or omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company’s latest Annual Report on Form 10-K filed with the SEC on March 14, 2007. In the opinion of management, these statements reflect normal recurring adjustments that are necessary for a fair presentation of the Company’s results of operations, financial position and cash flows for the interim periods presented.

### 2. Comprehensive Income

Comprehensive income contains items that are excluded from net income and recorded directly to stockholders’ equity. Chesapeake did not have any adjustments to the components of comprehensive income that are required to be reported by Financial Accounting Standards Board (“FASB”) Statement of Financial Accounting Standards (“SFAS”) No. 130, “Reporting Comprehensive Income,” for the first six months of 2007 and 2006. Accumulated other comprehensive loss was \$334,550 at June 30, 2007 and December 31, 2006.

### 3. Calculation of Earnings Per Share

| For the Periods Ended June 30,                    | Three Months Ended |                    | Six Months Ended   |                    |
|---|--------------------|--------------------|--------------------|--------------------|
|   | 2007               | 2006               | 2007               | 2006               |
| <b>Calculation of Basic Earnings Per Share:</b>   |                    |                    |                    |                    |
| Net Income  | \$1,481,791        | \$1,132,509        | \$9,472,879        | \$7,228,925        |
| Weighted average shares outstanding               | 6,737,384          | 5,952,074          | 6,721,694          | 5,930,872          |
| <b>Basic Earnings Per Share</b>                   | <b>\$0.22</b>      | <b>\$0.19</b>      | <b>\$1.41</b>      | <b>\$1.22</b>      |
| <b>Calculation of Diluted Earnings Per Share:</b> |                    |                    |                    |                    |
| <b>Reconciliation of Numerator:</b>               |                    |                    |                    |                    |
| Net Income  | \$1,481,791        | \$1,132,509        | \$9,472,879        | \$7,228,925        |
| Effect of 8.25% Convertible debentures (1)        | 24,015             | -                  | 48,214             | 54,048             |
| <b>Adjusted numerator — Diluted</b>               | <b>\$1,505,806</b> | <b>\$1,132,509</b> | <b>\$9,521,093</b> | <b>\$7,282,973</b> |
| <b>Reconciliation of Denominator:</b>             |                    |                    |                    |                    |
| Weighted shares outstanding — Basic               | 6,737,384          | 5,952,074          | 6,721,694          | 5,930,872          |
| Effect of dilutive securities (1)                 |                    |                    |                    |                    |
| Warrants  | -                  | 11,522             | -                  | 12,016             |
| 8.25% Convertible debentures                      | 112,506            | -                  | 113,563            | 127,303            |
| <b>Adjusted denominator — Diluted</b>             | <b>6,849,890</b>   | <b>5,963,596</b>   | <b>6,835,257</b>   | <b>6,070,191</b>   |
| <b>Diluted Earnings per Share</b>                 | <b>\$0.22</b>      | <b>\$0.19</b>      | <b>\$1.39</b>      | <b>\$1.20</b>      |

(1) Amounts associated with securities resulting in an anti-dilutive effect on earnings per share are not included in this calculation.

### 4. Commitments and Contingencies Environmental Matters

Chesapeake is subject to federal, state and local laws and regulations governing environmental quality and pollution control. These laws and regulations require the Company to remove or remedy the effect on the environment of the disposal or release of specified substances at current and former operating sites.

In 2004, Chesapeake received a Certificate of Completion for the remedial work performed at a former manufactured gas plant site located in Dover, Delaware. Chesapeake is also currently participating in the investigation, assessment or remediation of two additional former manufactured gas plant sites located in Maryland and Florida. The Company has accrued liabilities for the three sites referred to, respectively, as the Dover Gas Light, Salisbury Town Gas Light and the Winter Haven Coal Gas sites. The Company has been in discussions with the Maryland Department of the Environment ("MDE") regarding a fourth former gas manufacturing plant site located in Cambridge, Maryland. The following provides details of each site.

#### **Dover Gas Light Site**

The Dover Gas Light site is a former manufactured gas plant site located in Dover, Delaware. On January 15, 2004, the Company received a Certificate of Completion of Work from the United States Environmental Protection Agency ("EPA") regarding this site. This concluded Chesapeake's remedial action obligation related to this site and relieves Chesapeake from liability for future remediation at the site, unless previously unknown conditions are discovered at the site, or information previously unknown to the EPA is received that indicates the remedial action that has been taken is not sufficiently protective. These contingencies are standard and are required by the EPA in all liability settlements.

The Company has reviewed its remediation costs incurred to date for the Dover Gas Light site and has concluded that all costs incurred have been paid. The Company does not expect any future environmental expenditure for this site. Through June 30, 2007, the Company has incurred approximately \$9.67 million in costs related to environmental testing and remedial action studies at the site. Approximately \$9.96 million has been recovered through June 2007 from other parties or through rates. As of June 30, 2007, a regulatory liability of approximately \$294,500, representing the over-recovery portion of the clean-up costs, has been recorded. The over-recovery is temporary and will be refunded by the Company to customers in future rates.

#### **Salisbury Town Gas Light Site**

In cooperation with the MDE, the Company has completed remediation of the Salisbury Town Gas Light site, located in Salisbury, Maryland, where it was determined that a former manufactured gas plant had caused localized ground-water contamination. During 1996, the Company completed construction and began Air Sparging and Soil-Vapor Extraction ("AS/SVE") remediation procedures. Chesapeake has been reporting the remediation and monitoring results to the MDE on an ongoing basis since 1996. In February 2002, the MDE granted permission to decommission permanently the AS/SVE system and to discontinue all on-site and off-site well monitoring, except for one well that is being maintained for continued product monitoring and recovery. Chesapeake has requested a No Further Action determination and is awaiting such a determination from the MDE.

Through June 30, 2007, the Company has incurred approximately \$2.9 million for remedial actions and environmental studies at the Salisbury Town Gas Light site. Of this amount, approximately \$1.77 million has been recovered through insurance proceeds or in rates. On September 26, 2006, the Company received approval from the Maryland Public Service Commission to recover, through its rates charged to customers, the remaining \$1.16 million of the incurred environmental remediation costs.

#### **Winter Haven Coal Gas Site**

The Winter Haven Coal Gas site is located in Winter Haven, Florida. Chesapeake has been working with the Florida Department of Environmental Protection ("FDEP") in assessing this coal gas site. In May 1996, the Company filed an AS/SVE Pilot Study Work Plan (the "Work Plan") for the Winter Haven Coal Gas site with the FDEP. After discussions with the FDEP, the Company filed a modified Work Plan, which contained a description of the scope of work to complete the site assessment activities and a report describing a limited sediment investigation performed in 1997. In December 1998, the FDEP approved the modified Work Plan, which the Company completed during the third quarter of 1999. In February 2001, the

Company filed a Remedial Action Plan ("RAP") with the FDEP to address the contamination of the subsurface soil and ground-water in a portion of the site. The FDEP approved the RAP on May 4, 2001. Construction of the AS/SVE system was completed in the fourth quarter of 2002, and the system remains fully operational.

Through June 30, 2007, the Company has incurred approximately \$1.8 million of environmental costs associated with this site. At June 30, 2007, the Company had accrued a liability of \$103,000 related to this site, offsetting 1.) \$17,000 collected, through rates in excess of costs incurred and 2.) a regulatory asset of approximately \$86,000, representing the uncollected portion of the estimated clean-up costs. The Company expects to recover the remaining clean-up costs through rates.

The FDEP has indicated that the Company may be required to remediate sediments along the shoreline of Lake Shipp, immediately west of the Winter Haven Coal Gas site. Based on studies performed to date, the Company objects to the FDEP's suggestion that the sediments have been contaminated and will require remediation. The Company's early estimates indicate that some of the corrective measures discussed by the FDEP may cost as much as \$1 million. Given the Company's view as to the absence of ecological effects, the Company believes that cost expenditures of this magnitude are unwarranted and plans to oppose any requirement that it undertake corrective measures in the offshore sediments. Chesapeake anticipates that it will be several years before this issue is resolved. At this time, the Company has not recorded a liability for sediment remediation. The outcome of this matter cannot be predicted at this time.

#### **Other**

The Company is in discussions with the MDE regarding a manufactured gas plant site located in Cambridge, Maryland. The outcome of this matter cannot be determined at this time; therefore, the Company has not recorded an environmental liability for this location.

#### **Other Commitments and Contingencies**

##### **Natural Gas and Propane Supply**

The Company's natural gas and propane distribution operations have entered into contractual commitments to purchase gas from various suppliers. The contracts have various expiration dates. In April 2007, the Company renewed its contract with an energy marketing and risk management company to manage a portion of the Company's natural gas transportation and storage capacity. This new contract expires on March 31, 2008.

##### **Corporate Guarantees**

The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its Florida natural gas supply and management subsidiary, and its Delmarva propane distribution subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases in the event of the subsidiaries' default. The liabilities for these purchases are recorded in the Consolidated Financial Statements. The aggregate amount guaranteed at June 30, 2007 totaled \$21.7 million, with the guarantees expiring on various dates in 2007 and 2008.

In addition to the corporate guarantees, the Company has issued a letter of credit to its primary insurance company for \$775,000, which expires on May 31, 2008. The letter of credit is provided as security to satisfy the deductibles for claim amounts on the Company's policies.

##### **Application of SFAS No. 71**

Certain assets and liabilities of the Company are accounted for in accordance with SFAS No. 71 — "Accounting for the Effects of Certain Types of Regulation." SFAS No. 71 provides guidance for public utilities and other regulated operations where the rates (prices) charged to customers are subject to regulatory review and approval. Regulators sometimes include allowable costs in a period other than

the period in which the costs would be charged to expense by an unregulated enterprise. That procedure can create assets, reduce assets, or create liabilities for the regulated enterprise. For financial reporting, an incurred cost for which a regulator permits recovery in a future period is accounted for like an incurred cost that is reimbursable under a cost-reimbursement type contract. The Company believes that all regulatory assets as of June 30, 2007 are probable of recovery through rates. If the Company were required to terminate the application of SFAS No. 71 to its regulated operations, all such deferred amounts would be recognized in the income statement at that time. This would result in a charge to earnings, net of applicable income taxes, which could be material.

#### **Other**

The Company is involved in certain legal actions and claims arising in the normal course of business. The Company is also involved in certain legal and administrative proceedings before various governmental agencies concerning rates and other matters. In the opinion of management, the ultimate disposition of these proceedings will not have a material effect on the consolidated financial position, results of operations or cash flows of the Company.

#### **5. Recent Authoritative Pronouncements on Financial Reporting and Accounting**

In June 2006, the FASB issued FASB Interpretation ("FIN") No. 48, "Employers' Accounting for Uncertainty in Income Taxes." This interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This interpretation also provides guidance on derecognition and classification of uncertain tax positions, reporting of interest and penalties, accounting in interim periods, disclosure, and transition. This interpretation is effective for fiscal years beginning after December 15, 2006. Chesapeake was required to adopt FIN No. 48 in the first quarter of 2007, and its adoption did not have any impact on the Company's Consolidated Financial Statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements." This statement defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Chesapeake will be required to adopt SFAS No. 157 in the first quarter of 2008. The Company has not yet evaluated the impact that SFAS No. 157 will have on its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value, with unrealized gains and losses related to these financial instruments reported in earnings at each subsequent reporting date. This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company has not yet evaluated the impact that this statement will have on its Consolidated Financial Statements.

In April 2007, the FASB directed the FASB Staff to issue FSP No. FIN 39-1, "Amendment of FASB Interpretation No. 39" ("FSP FIN 39-1"). FSP FIN 39-1 modifies FIN No. 39, "Offsetting of Amounts Related to Certain Contracts," and permits companies to offset cash collateral receivables or payables with net derivative positions under certain circumstances. FSP FIN 39-1 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted. The Company is evaluating the effect of adopting FSP FIN 39-1 on its Consolidated Financial Statements.

## 6. Segment Information

Chesapeake uses the management approach to identify operating segments. The Company organizes its business around differences in products or services, and the operating results of each segment are regularly reviewed by the Company's chief operating decision maker in order to make decisions about the allocation of resources and to assess performance. The following table presents information about the Company's reportable segments.

| For the Periods Ended June 30,                          | Three Months Ended  |                     | Six Months Ended     |                      |
|---|---------------------|---------------------|----------------------|----------------------|
|   | 2007                | 2006                | 2007                 | 2006                 |
| <b>Operating Revenues, Unaffiliated Customers</b>       |                     |                     |                      |                      |
| Natural gas   | \$39,287,667        | \$33,327,846        | \$104,719,271        | \$100,906,504        |
| Propane   | 9,494,170           | 7,937,378           | 34,416,570           | 28,488,315           |
| Advanced information services                           | 3,720,083           | 3,038,015           | 6,892,970            | 5,858,581            |
| Other   | -                   | 513                 | -                    | 1,025                |
| <b>Total operating revenues, unaffiliated customers</b> | <b>\$52,501,920</b> | <b>\$44,303,752</b> | <b>\$146,028,811</b> | <b>\$135,254,425</b> |
| <b>Intersegment Revenues <sup>(1)</sup></b>             |                     |                     |                      |                      |
| Natural gas   | \$78,087            | \$58,769            | \$156,150            | \$117,717            |
| Propane   | -                   | -                   | 406                  | -                    |
| Advanced information services                           | 95,991              | 16,875              | 228,227              | 21,513               |
| Other   | 154,623             | 154,623             | 309,246              | 309,246              |
| <b>Total intersegment revenues</b>                      | <b>\$328,701</b>    | <b>\$230,267</b>    | <b>\$694,029</b>     | <b>\$448,476</b>     |
| <b>Operating Income</b>                                 |                     |                     |                      |                      |
| Natural gas   | \$3,992,282         | \$3,500,628         | \$13,608,264         | \$11,495,833         |
| Propane   | (545,898)           | (441,632)           | 4,327,658            | 2,992,101            |
| Advanced information services                           | 178,706             | 172,061             | 227,528              | 188,371              |
| Other and eliminations                                  | 62,969              | (25,689)            | 106,661              | (33,709)             |
| <b>Total operating income</b>                           | <b>\$3,688,059</b>  | <b>\$3,205,368</b>  | <b>\$18,270,111</b>  | <b>\$14,642,596</b>  |

<sup>(1)</sup> All significant intersegment revenues are billed at market rates and have been eliminated from consolidated revenues.

|                                  | June 30,<br>2007     | December 31,<br>2006 |
|----------------------------------|----------------------|----------------------|
| <b>Identifiable Assets</b>       |                      |                      |
| Natural gas                      | \$249,358,307        | \$252,292,600        |
| Propane                          | 62,151,633           | 60,170,200           |
| Advanced information services    | 2,877,021            | 2,573,810            |
| Other                            | 10,977,138           | 10,547,936           |
| <b>Total identifiable assets</b> | <b>\$325,364,099</b> | <b>\$325,584,546</b> |

The Company's operations are primarily domestic. The advanced information services segment, headquartered in Norcross, Georgia, provides domestic and international clients with information technology related business services and solutions. Transactions with foreign companies are denominated and paid in U.S. dollars and are immaterial to the consolidated revenues.



## 7. Employee Benefit Plans

Net periodic benefit costs for the defined benefit pension plan, the executive excess benefit plan and other post-retirement benefits are shown below:

| For the Three Months Ended June 30, | Defined Benefit Pension Plan |            | Executive Excess Retirement Benefit Plan |          | Other Post-Retirement Benefits |          |
|-------------------------------------|------------------------------|------------|--|----------|--------------------------------|----------|
|                                     | 2007                         | 2006       | 2007                                     | 2006     | 2007                           | 2006     |
| Service Cost                        | \$0                          | \$0        | \$0                                      | \$0      | \$2,529                        | \$1,565  |
| Interest Cost                       | 155,514                      | 156,726    | 30,841                                   | 29,897   | 23,233                         | 19,468   |
| Expected return on plan assets      | (174,100)                    | (171,076)  | -  | -        | -                              | -        |
| Amortization of transition amount   | -                            | -          | -  | -        | -                              | 6,965    |
| Amortization of prior service cost  | (1,175)                      | (1,175)    | -  | -        | -                              | -        |
| Amortization of net loss            | -                            | -          | 12,933                                   | 14,260   | 41,640                         | 22,074   |
| Net periodic (benefit) cost         | (\$19,761)                   | (\$15,525) | \$43,774                                 | \$44,157 | \$67,402                       | \$50,072 |

| For the Six Months Ended June 30,  | Defined Benefit Pension Plan |            | Executive Excess Retirement Benefit Plan |          | Other Post-Retirement Benefits |           |
|------------------------------------|------------------------------|------------|--|----------|--------------------------------|-----------|
|                                    | 2007                         | 2006       | 2007                                     | 2006     | 2007                           | 2006      |
| Service Cost                       | \$0                          | \$0        | \$0                                      | \$0      | \$5,057                        | \$3,129   |
| Interest Cost                      | 311,029                      | 313,452    | 61,681                                   | 59,794   | 46,467                         | 38,936    |
| Expected return on plan assets     | (348,199)                    | (342,152)  | -  | -        | -                              | -         |
| Amortization of transition amount  | -                            | -          | -  | -        | -                              | 13,930    |
| Amortization of prior service cost | (2,350)                      | (2,350)    | -  | -        | -                              | -         |
| Amortization of net loss           | -                            | -          | 25,867                                   | 28,520   | 83,280                         | 44,147    |
| Net periodic (benefit) cost        | (\$39,520)                   | (\$31,050) | \$87,548                                 | \$88,314 | \$134,804                      | \$100,142 |

As disclosed in the December 31, 2006 financial statements, no contributions are expected to be required in 2007 for the defined benefit pension plan. The cost of the executive excess defined benefit pension plan and the other post-retirement benefit plans are unfunded, and are expected to be paid out of the general funds of the Company. Cash benefits paid under the executive excess defined benefit pension plan for the three months and six months ended June 30, 2007 were \$23,000 and \$45,000, respectively; for the year 2007, such benefits paid are expected to be \$89,000. Cash benefits paid for other post-retirement benefits, primarily for medical claims, for the three months and six months ended June 30, 2007 totaled \$117,000 and \$161,000, respectively; for the year 2007, the Company's actuary has estimated that such benefits to be paid are \$180,000.

## 8. Investments

The investment balance at June 30, 2007 represents a Rabbi Trust ("the Trust") associated with the Company's Supplemental Executive Retirement Savings Plan. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company classifies these investments as trading securities. As a result of classifying them as trading securities, the Company is required to report the securities at their fair value, with any unrealized gains and losses included in other income. The Company also has an associated liability that is recorded and adjusted each month for the gains and losses incurred by the Trust. At June 30, 2007, total investments had a fair value of \$2.1 million.

## 9. Share-Based Compensation

The Company accounts for its share-based compensation arrangements under the revised SFAS No. 123, "Share Based Payments" ("SFAS 123R"), which requires the recognition of compensation cost over the respective service period for employee services received in exchange for an award of equity or equity-based compensation based on the fair value of the grant on the date it was awarded. The Company currently has two share-based compensation plans, Director's Stock Compensation ("DSCP") and the Performance Incentive Plan ("PIP"), that require accounting under SFAS 123R.

The table below presents the amounts included in net income, after tax, related to share-based compensation expense, in respect of restricted stock awards issued under the DSCP and the PIP.

| For the periods ended June 30,                   | Three Months Ended |                   | Six Months Ended  |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | 2007               | 2006              | 2007              | 2006              |
| Director's Stock Compensation Plan               | \$ 27,600          | \$ 25,100         | \$ 54,400         | \$ 47,100         |
| Performance Incentive Plan                       | 130,800            | 134,900           | 253,900           | 217,300           |
| <b>Amounts included in net income, after tax</b> | <b>\$ 158,400</b>  | <b>\$ 160,000</b> | <b>\$ 308,300</b> | <b>\$ 264,400</b> |

#### Stock Options

The Company did not have any stock options outstanding at June 30, 2007 or December 31, 2006, nor were any stock options issued during the six months ended June 30, 2007 and June 30, 2006.

#### Director's Stock Compensation Plan

Under the DSCP, each non-employee director of the Company received in 2007 an annual retainer of 600 shares of common stock and an additional 150 shares of common stock for services as a committee chairman. Shares issued under the DSCP are fully vested as of the date of the grant. The Company records a prepaid expense as of the date of the grant equal to the fair value of the shares issued and amortizes the expense equally over the service period of one year.

Compensation expense related to DSCP awards recorded by the Company for the three months and six months ended June 30, 2007 and 2006 is presented in the following table:

| For the periods ended June 30, | Three Months Ended |           | Six Months Ended |           |
|--------------------------------|--------------------|-----------|------------------|-----------|
|                                | 2007               | 2006      | 2007             | 2006      |
| Compensation expense for DSCP  | \$ 45,200          | \$ 41,200 | \$ 89,100        | \$ 77,200 |

A summary of restricted stock activity under the DSCP as of June 30, 2007, and changes during the six months then ended, is presented below:

|                                 | Number of Restricted Shares | Weighted Average Grant Date Fair Value |
|---------------------------------|-----------------------------|--|
| Outstanding — December 31, 2006 | -                           |  |
| Issued — May 2, 2007            | 5,850                       | \$31.38                                |
| Vested                          | 5,850                       |  |
| Outstanding — June 30, 2007     | -                           |  |

#### Performance Incentive Plan ("PIP")

The Company's Compensation Committee of the Board of Directors is authorized to grant key employees of the Company the rights to receive awards of shares of the Company's common stock, contingent upon the achievement of established performance goals. These awards are subject to certain post-vesting transfer restrictions. The Company issued 10,124 and 23,666 restricted stock awards during the three months of March 2007 and 2006, respectively, to key employees under the Company's PIP. The shares granted under the PIP are fully vested, and the fair value of each share is equal to the market price of the Company's common stock on the date of grant. The fair value of these restricted stock awards, based on the fair value of the Company's stock on the issue date, was \$30.89 and \$30.40, for the shares issued in March 2007 and 2006, respectively.

Compensation expense related to the PIP recorded by the Company for the three months and six months ended June 30, 2007 and 2006 is presented in the following table:

| For the periods ended June 30, | Three Months Ended |            | Six Months Ended |            |
|--------------------------------|--------------------|------------|------------------|------------|
|                                | 2007               | 2006       | 2007             | 2006       |
| Compensation expense for PIP   | \$ 214,400         | \$ 221,100 | \$ 416,300       | \$ 356,200 |

A summary of restricted stock activity under the PIP as of June 30, 2007, and changes during the six months then ended, is presented below:

|                                 | Number of Restricted Shares | Weighted Average Grant Date Fair Value |
|---------------------------------|-----------------------------|--|
| Outstanding — December 31, 2006 | -                           |  |
| Issued — March 1, 2007          | 10,124                      | \$30.89                                |
| Vested                          | 10,124                      |  |
| Outstanding — June 30, 2007     | -                           |  |

#### 10. Stockholders' Equity

The changes in common stock shares issued and outstanding are shown below:

|  | For the Six Months Ended June 30, 2007 | For the Twelve Months Ended December 31, 2006 |
|--|--|---|
| <b>Common Stock shares issued and outstanding</b> <sup>(1)</sup> |  |   |
| Shares issued — beginning of period balance                      | 6,688,084                              | 5,883,099                                     |
| Dividend Reinvestment Plan <sup>(2)</sup>                        | 19,262                                 | 38,392  |
| Retirement Savings Plan  | 15,649                                 | 29,705  |
| Conversion of debentures   | 3,817                                  | 16,677  |
| Employee award plan  | 350                                    | 350   |
| Performance shares and options exercised <sup>(3)</sup>          | 15,974                                 | 29,516  |
| Public offering  | -                                      | 690,345                                       |
| Shares issued — end of period balance <sup>(4)</sup>             | 6,743,136                              | 6,688,084                                     |
| Treasury shares — beginning of period balance                    | -                                      | (97)  |
| Other issuances  | -                                      | 97  |
| Treasury Shares — end of period balance                          | -                                      | -   |
| <b>Total Shares Outstanding</b>                                  | <b>6,743,136</b>                       | <b>6,688,084</b>                              |

<sup>(1)</sup> 12,000,000 shares are authorized at a par value of \$0.4867 per share.

<sup>(2)</sup> Includes shares purchased with reinvested dividends and optional cash payments.

<sup>(3)</sup> Includes shares issued for DSCP.

<sup>(4)</sup> Includes 54,978 and 48,187 shares at June 30, 2007 and December 31, 2006, respectively, held in a Rabbi Trust established by the Company relating to the Executive Deferred Compensation Plan.

## 11. Reclassifications

The Company reclassified some previously reported amounts to conform to current period classifications.

- Share-based compensation was recorded as a liability to Accrued Compensation at December 31, 2006. Accordingly, the Company reclassified the \$123,000 remaining in the liability account, after the issuance of the 2006 performance shares, to Additional Paid in Capital. This reclassification is considered immaterial to the overall presentation of the Company's consolidated financial statements.
- Pension assets were netted against the liabilities for the executive excess defined benefit pension plan and the other post-retirement benefit plans at December 31, 2006 and March 31, 2007. Accordingly, the Company reclassified the pension assets of \$630,000 at June 30, 2007 to the asset side of the balance sheet. For comparison, the balance of \$591,000 at December 31, 2006 has also been reclassified to the asset side of the balance sheet. This reclassification is considered immaterial to the overall presentation of the Company's consolidated financial statements.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") is designed to provide a reader of the financial statements with a narrative on the Company's financial condition, results of operations and liquidity. This discussion and analysis should be read in conjunction with the attached unaudited condensed consolidated financial statements and notes thereto and Chesapeake's Annual Report on Form 10-K for the year ended December 31, 2006, including the audited consolidated financial statements and notes contained in the Form 10-K.

### Safe Harbor for Forward-Looking Statements

Chesapeake Utilities Corporation has made statements in this Form 10-Q that are considered to be "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are not matters of historical fact and are typically identified by words such as, but not limited to, "believes," "expects," "intends," "plans," and similar expressions, or future or conditional verbs such as "may," "will," "should," "would," and "could." These statements relate to matters such as customer growth, changes in revenues or gross margins, capital expenditures, environmental remediation costs, regulatory trends and decisions, market risks associated with our propane operations, the competitive position of the Company and other matters. It is important to understand that these forward-looking statements are not guarantees, but are subject to certain risks and uncertainties and other important factors that could cause actual results to differ materially from those in the forward-looking statements. The factors that could cause actual results to differ materially from the Company's expectations include, but are not limited to:

- the temperature sensitivity of the natural gas and propane businesses;
- the effects of spot, forward, futures market prices, and the Company's use of derivative instruments on the Company's distribution, wholesale marketing and energy trading businesses;
- amount and availability of natural gas and propane supplies;
- the access to interstate pipelines' transportation and storage capacity and the construction of new facilities to support future growth;
- the effects of natural gas and propane commodity price changes on the operating costs and competitive positions of our natural gas and propane distribution operations;
- third-party competition for the Company's unregulated and regulated businesses;
- changes in federal, state or local regulatory and tax requirements, including deregulation;
- changes in technology affecting the Company's advanced information services segment;
- changes in credit risk and credit requirements affecting the Company's energy marketing subsidiaries;
- the effects of accounting changes;
- changes in benefit plan assumptions;
- cost of compliance with environmental regulations or the remediation of environmental damage;
- the effects of general economic conditions, including interest rates, on the Company and its customers;
- the ability of the Company's new and planned facilities and acquisitions to generate expected revenues;
- the ability of the Company to construct facilities at its estimated costs;
- the Company's ability to obtain the rate relief and cost recovery requested from utility regulators and the timing of the requested regulatory actions;
- the Company's ability to obtain necessary approvals and permits from regulatory agencies on a timely basis;
- impact of inflation on the results of operations, cash flows, financial position and on the Company's planned capital expenditures;
- inability to access the financial markets that may impair future growth; and
- operating and litigation risks that may not be covered by insurance.

## **Overview**

Chesapeake is a diversified utility company engaged directly or through subsidiaries in natural gas distribution, transmission and marketing, propane distribution and wholesale marketing, advanced information services and other related businesses. For additional information regarding segments, refer to Note 6, Segment Information, of the Notes to the Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

The Company's strategy is focused on growing earnings from a stable utility foundation and investing in related businesses and services that provide opportunities for returns greater than traditional utility returns. The key elements of this strategy include:

- executing a capital investment program in pursuit of organic growth opportunities that generate returns equal to or greater than our cost of capital;
- expanding the natural gas distribution and transmission business through expansion into new geographic areas in our current service territories;
- expanding the propane distribution business in existing and new markets through leveraging our community gas system services and our bulk delivery capabilities;
- utilizing the Company's expertise across our various businesses to improve overall performance;
- enhancing marketing channels to attract new customers;
- providing reliable and responsive customer service to retain existing customers;
- maintaining a capital structure that enables the Company to access capital as needed; and
- maintaining a consistent and competitive dividend for shareholders.

Due to the seasonality of the Company's business, results for interim periods are not necessarily indicative of results for the entire fiscal year. Revenue and earnings are typically greater during the Company's first and fourth quarters, when natural gas and propane consumption is highest due to colder temperatures.

## **Results of Operations for the Quarter Ended June 30, 2007**

*The following discussions on operating income and segment results for the three months ended June 30, 2007 include use of the term "gross margin." Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for natural gas and propane and the cost of labor spent on direct revenue-producing activities. Gross margin should not be considered an alternative to operating income or net income, which are determined in accordance with GAAP. Chesapeake believes that gross margin, although a non-GAAP measure, is useful and meaningful to investors as a basis for making investment decisions. It provides investors with information that demonstrates the profitability achieved by the Company under its allowed rates for regulated operations and under its competitive pricing structure for non-regulated segments. Chesapeake's management uses gross margin in measuring its business units' performance and has historically analyzed and reported gross margin information publicly. Other companies may calculate gross margin in a different manner.*

### Consolidated Overview

The Company's net income for the quarter ended June 30, 2007 increased \$349,000, or 31 percent, compared to the same period in 2006. Net income was \$1.5 million, or \$0.22 per share (diluted), an increase of \$0.03 per share compared to 2006. The period-over-period increase in quarterly earnings reflects an increase in the operating income of the Company's natural gas and other segments, partially offset by a decrease in the propane segment. The period-over-period increase in the quarterly operating income resulted primarily from the Company's continued growth, colder weather on the Delmarva Peninsula, and increased rates for our natural gas customers. The Company estimates that the growth, colder weather, and rate increases contributed \$1.4 million, \$425,000, and \$295,000, respectively, to gross margin during the second quarter of 2007.

| For the Three Months Ended June 30, | 2007        | 2006        | Change    |
|-------------------------------------|-------------|-------------|-----------|
| Operating Income                    |             |             |           |
| Natural Gas                         | \$3,992,282 | \$3,500,628 | \$491,654 |
| Propane                             | (545,898)   | (441,632)   | (104,266) |
| Advanced Information Services       | 178,706     | 172,061     | 6,645     |
| Other & Eliminations                | 62,969      | (25,689)    | 88,658    |
| Operating Income                    | 3,688,059   | 3,205,368   | 482,691   |
| Other Income                        | 234,195     | 63,715      | 170,480   |
| Interest Charges                    | 1,594,701   | 1,501,352   | 93,349    |
| Income Taxes                        | 845,762     | 635,222     | 210,540   |
| Net Income                          | \$1,481,791 | \$1,132,509 | \$349,282 |
| Diluted Earnings Per Share          | \$0.22      | \$0.19      | \$0.03    |

### Natural Gas

The natural gas segment earned operating income of approximately \$4.0 million for the second quarter ended June 30, 2007 compared to \$3.5 million for the corresponding period in 2006, an increase of approximately \$492,000, or 14 percent.

| For the Three Months Ended June 30, | 2007         | 2006         | Change      |
|-------------------------------------|--------------|--------------|-------------|
| Revenue                             | \$39,365,754 | \$33,386,615 | \$5,979,139 |
| Cost of sales                       | 26,130,962   | 21,941,405   | 4,189,557   |
| Gross margin                        | 13,234,792   | 11,445,210   | 1,789,582   |
| Operations & maintenance            | 6,440,171    | 5,563,477    | 876,694     |
| Depreciation & amortization         | 1,834,712    | 1,565,995    | 268,717     |
| Other taxes                         | 967,627      | 815,110      | 152,517     |
| Other operating expenses            | 9,242,510    | 7,944,582    | 1,297,928   |
| Total Operating Income              | \$3,992,282  | \$3,500,628  | \$491,654   |

### Statistical Data — Delmarva Peninsula

|                                    |         |         |      |
|------------------------------------|---------|---------|------|
| Heating degree-days ("HDD"):       |         |         |      |
| Actual                             | 527     | 388     | 139  |
| 10-year average (normal)           | 496     | 512     | (16) |
| Estimated gross margin per HDD     | \$2,283 | \$2,234 | \$49 |
| Per residential customer added:    |         |         |      |
| Estimated gross margin             | \$372   | \$372   | \$0  |
| Estimated other operating expenses | \$106   | \$106   | \$0  |

### Residential Customer Information

|                              |        |        |       |
|------------------------------|--------|--------|-------|
| Average number of customers: |        |        |       |
| Delmarva                     | 43,331 | 40,037 | 3,294 |
| Florida                      | 13,361 | 12,511 | 850   |
| Total                        | 56,692 | 52,548 | 4,144 |

Gross margin for the Company's natural gas segment increased by \$1.8 million, or 16 percent, and other operating expenses increased \$1.3 million, or 16 percent, in the quarter ended June 30, 2007, compared to the same period in 2006. The gross margin increases of \$1.1 million for the natural gas transmission operation, \$790,000 for the Delmarva natural gas distribution operations, and \$7,000 for the Florida natural gas distribution operation were partially offset by lower gross margin of \$70,000 for the natural gas marketing operation, as further explained below.

#### Natural Gas Transmission

The natural gas transmission operation achieved gross margin growth of \$1.1 million, or 26 percent. This increase was primarily attributed to new transportation capacity contracts implemented in November 2006 and the implementation of temporary rates, subject to refund, based on the status of the Company's rate proceeding discussed below in the "Regulatory Matters" section. In total for 2007, these new transportation capacity contracts are expected to generate a gross margin of \$3.3 million above the 2006 gross margin. An increase of \$845,000 in other operating expenses partially offset the increased gross margin. The factors contributing to the increase in other operating expenses are as follow:

- The increase in operating expenses for the second quarter of 2007 relative to the second quarter of 2006 is magnified by the approval from the Federal Energy Regulatory Commission ("FERC") in July 2006 to defer pre-service costs of the Company's Energylink Expansion Project as a regulatory asset. The deferral of these costs resulted in the reduction of \$310,000 in other operating expenses in the second quarter of 2006. Please refer to the "Regulatory Matters" section below for further information regarding this expansion project.
- Payroll and benefit costs increased by \$76,000 and \$34,000, respectively, to comply with federal pipeline integrity maintenance regulations and to serve the additional growth experienced by the operation.
- Incentive compensation increased by \$71,000 as a result of the improved operating results in 2007 compared to 2006.
- Regulatory expenses increased by \$55,000 in the second quarter of 2007 as the Company incurred costs associated with its rate filing with the FERC.
- The increased level of capital investment caused higher depreciation and asset removal costs of \$194,000 and increased property taxes of \$31,000.
- Other operating expenses relating to various items increased collectively by approximately \$74,000.

#### Natural Gas Distribution

The Delmarva distribution operations experienced an increase of \$790,000, or 20 percent, in gross margin. The significant factors contributing to the increase in gross margin include:

- Continued residential customer growth contributed to the increase in gross margin. The average number of residential customers on the Delmarva Peninsula increased by 3,294, or eight percent, for the second quarter 2007 compared to the same period in 2006, and the Company estimates that these additional residential customers contributed approximately \$243,000 to gross margin.
- The Company estimates that colder weather contributed \$224,000 to gross margin in the second quarter of 2007 compared to the same period in 2006, as temperatures on the Delmarva Peninsula were 36 percent colder in 2007. The colder temperatures did not have a significant impact on the Maryland distribution operation's gross margin in the second quarter of 2007 because the operation's approved rate structure now includes a weather normalization adjustment ("WNA") mechanism. The WNA mechanism was implemented in October 2006 and is designed to protect a portion of the Company's revenues against warmer-than-normal weather, as deviations from normal weather can affect our financial performance and liquidity. The WNA also serves to offset the impact of colder-



than-normal weather by reducing the amounts the Company can charge its customers during such periods.

- In October 2006, the Maryland PSC granted the Company a base rate increase, which resulted in an \$183,000 period-over-period increase to gross margin in the second quarter of 2007.
- The remaining \$140,000 increase in gross margin can be attributed to various factors, including increases in the number of commercial and industrial customers.

Gross margin for the Florida distribution operation increased by \$7,000 in the second quarter of 2007 compared to the second quarter of 2006. The impact of a seven percent growth in residential customers and a three percent growth in commercial customers was offset by lower volumes sold to industrial customers.

Other operating expense for the natural gas distribution operations increased by \$220,000 in the second quarter of 2007 compared to the second quarter of 2006. Among the key components of the increase were the following:

- Payroll costs increased by \$48,000 to serve the additional growth experienced by the operations.
- Health care costs increased by \$103,000 during the second quarter of 2007 compared to the second quarter of 2006 as the Company experienced higher cost of health care claims during this period.
- Depreciation and amortization expense, asset removal cost and property taxes increased by \$96,000, \$51,000 and \$21,000, respectively, as a result of the Company's continued capital investments.
- The 2007 increase in revenue related taxes is magnified by the Company's receipt of approval in the second quarter of 2006 from the Delaware Public Service Commission to defer \$74,000 of previously expensed taxes associated with the Annual Gross Revenue Tax as a regulatory asset.
- In addition, other operating expenses relating to various minor items increased by approximately \$36,000.
- The above increases were partially offset by a decrease of \$111,000 in the allowance for uncollectible accounts, which was due primarily to increased collection efforts. In addition, merchant payment fees decreased by \$98,000 as the Company's Delmarva operation outsourced the processing of credit card payments in April of 2007 in an effort to reduce operating costs.

#### Natural Gas Marketing

Gross margin for the natural gas marketing operation decreased by \$70,000, or 13 percent, for the second quarter of 2007 compared to the same period in 2006. The decline in gross margin was primarily the result of unfavorable imbalance resolutions with interstate pipelines, which caused an increase in the cost of gas. Other operating expenses increased by \$233,000 for the marketing operation due to increased payroll and benefit costs and increased incentive compensation. The year-over-year increase in incentive compensation is due to an adjustment that occurred in second quarter 2006 to record compensation at the expected payout based on the level of earnings.

## Propane

The propane segment incurred an operating loss of \$546,000, representing an increased loss of \$104,000, or 24 percent, for the second quarter of 2007 compared to the same period in 2006. Gross margin increased by \$408,000, which was offset by an increase in other operating expenses of \$512,000.

| For the Three Months Ended June 30, | 2007        | 2006        | Change      |
|-------------------------------------|-------------|-------------|-------------|
| Revenue                             | \$9,494,170 | \$7,937,378 | \$1,556,792 |
| Cost of sales                       | 5,930,398   | 4,781,819   | 1,148,579   |
| Gross margin                        | 3,563,772   | 3,155,559   | 408,213     |
| Operations & maintenance            | 3,463,047   | 3,024,725   | 438,322     |
| Depreciation & amortization         | 458,788     | 402,675     | 56,113      |
| Other taxes                         | 187,835     | 169,791     | 18,044      |
| Other operating expenses            | 4,109,670   | 3,597,191   | 512,479     |
| Total Operating Loss                | (\$545,898) | (\$441,632) | (\$104,266) |

| Statistical Data — Delmarva Peninsula |         |         |       |
|---------------------------------------|---------|---------|-------|
| Heating degree-days ("HDD"):          |         |         |       |
| Actual                                | 527     | 388     | 139   |
| 10-year average (normal)              | 496     | 512     | (16)  |
| Estimated gross margin per HDD        | \$1,974 | \$1,743 | \$231 |

Gross margin for the Company's propane segment increased by \$408,000, or 13 percent, and other operating expenses increased \$512,000, or 14 percent, in the three months ended June 30, 2007 compared to the same period in 2006. The gross margin increases of \$216,000 for the Delmarva propane distribution operations, \$39,000 for the Florida propane distribution operations, and \$153,000 for the propane wholesale marketing are further explained below.

### Delmarva Propane Distribution

The Delmarva propane distribution operation's increase in gross margin of \$216,000 resulted from the following:

- Volumes sold in the second quarter 2007 increased by 365,000 gallons, or 13 percent, primarily because temperatures on the Delmarva Peninsula were 36 percent colder during this period in 2007 when compared to the same period in 2006. The Company estimates that the colder weather increased gross margin by approximately \$201,000 for the Delmarva propane distribution operation compared to the second quarter of 2006.
- Gross margin for the Delmarva Community Gas Systems ("CGS") increased by \$116,000 in the second quarter of 2007, compared to the same period in 2006, primarily because of an increase in the average number of customers and the colder weather on the Delmarva Peninsula. The average number of CGS customers increased by approximately 1,020 to a total count of approximately 4,800, or a 27 percent increase, compared to the second quarter 2006. The Company expects the growth of its CGS operation to continue, as the number of systems currently under construction or under contract is anticipated to provide an additional 7,900 CGS customers once the systems are built out.
- The remaining \$90,000 increase in gross margin can be attributed to various factors, including service sales and wholesale sales.
- Partially offsetting the increases to gross margin listed above, the Delmarva propane distribution operations experienced a decrease in gross margin of \$191,000 in the second quarter of 2007 compared to the same period in 2006 because of a \$0.06 decrease in the average gross margin per retail gallon. This decrease occurs when the market price of propane decreases to levels closer to the Company's average inventory price per gallon. Propane gross margin is also impacted by the Company's pricing with its customers.

Total other operating expenses increased by \$379,000 for the Delmarva propane distribution operations in the quarter ended June 30, 2007 compared to the same period in 2006. The significant items contributing to this increase are explained below.

- The increase in operating expenses for the second quarter of 2007 is magnified by the Company's one-time recovery of previously incurred costs of \$87,000 from one of its propane suppliers. This recovery reimbursed the Company for fixed costs incurred in the removal of above-normal levels of petroleum by-products contained in approximately 75,000 gallons of propane that it purchased from the supplier. The recovery of these costs reduced other operating expenses in the second quarter of 2006.
- Health care costs increased by \$85,000 during the second quarter of 2007 compared to the second quarter of 2006 as the Company experienced a higher cost of health care claims during the period.
- The operation incurred an additional \$108,000 in the second quarter of 2007 compared to 2006 for propane tank recertifications and maintenance to comply with Department of Transportation standards.
- Depreciation and amortization expense increased by \$40,000 as a result of the Company's continued capital investments.
- In addition, other operating expenses relating to various items increased collectively by approximately \$59,000.

#### Florida Propane Distribution

The Florida propane distribution operation experienced an increase in gross margin of \$39,000, or 15 percent, in the second quarter of 2007 compared to the same period in 2006. Gross margin from propane sales increased \$32,000 as a higher average gross margin per retail gallon was partially offset by a nine percent decrease in the volumes sold in 2007. The remaining increase of \$7,000 is attributed to higher in-house piping sales. Other operating expenses in the second quarter 2007 compared to the second quarter 2006 increased by \$69,000 primarily due to an increase in payroll costs, insurance and higher depreciation expense, partially offset by lower incentive compensation.

#### Propane Wholesale and Marketing

Gross margin for the Company's propane wholesale marketing operation increased by \$153,000, or 35 percent, in the second quarter of 2007 compared to the same period in 2006. This increase reflects the larger number of market opportunities that arose in the second quarter of 2007 due to price volatility in the propane wholesale market. The increase in gross margin was partially offset by higher other operating expenses of \$64,000 primarily due to higher incentive compensation based on the increased earnings in 2007.

### Advanced Information Services

The advanced information services segment provides domestic and international clients with information-technology-related business services and solutions for both enterprise and e-business applications. The advanced information services business experienced gross margin growth of approximately \$376,000, or 30 percent, and contributed operating income of approximately \$179,000 for the three months ended June 30, 2007. Increases in revenue and gross margin were almost completely offset by increases in other operating expenses, consequently, operating income increased by only \$7,000 compared to the same period in 2006.

| <b>For the Three Months Ended June 30,</b> | <b>2007</b> | <b>2006</b> | <b>Change</b> |
|--|-------------|-------------|---------------|
| Revenue                                    | \$3,816,074 | \$3,054,890 | \$761,184     |
| Cost of sales                              | 2,166,963   | 1,781,866   | 385,097       |
| Gross margin                               | 1,649,111   | 1,273,024   | 376,087       |
| Operations & maintenance                   | 1,273,241   | 958,234     | 315,007       |
| Depreciation & amortization                | 35,248      | 28,276      | 6,972         |
| Other taxes                                | 161,916     | 114,453     | 47,463        |
| Other operating expenses                   | 1,470,405   | 1,100,963   | 369,442       |
| Total Operating Income                     | \$178,706   | \$172,061   | \$6,645       |

The increase of revenues in the three months ended June 30, 2007 is attributable to:

- An increase of \$654,000 in consulting revenues as the number of billable hours increased by 20 percent;
- An increase of \$69,000 from Managed Database Administration ("MDBA") services, first offered in 2006, which provide clients with professional database monitoring and support solutions during business hours or around the clock; and
- An increase of \$38,000 in revenue from training services and product sales.

Other operating expenses increased by \$369,000 in the three months ended June 30, 2007 to \$1.5 million, compared to \$1.1 million for the same period in 2006. This increase in operating expenses is primarily due to an increase in accrued incentive compensation based on improved operating results and other costs incurred to support the growth.

### Other Business Operations and Eliminations

Other operations consist primarily of subsidiaries that own real estate leased to other Company subsidiaries and the results of operations for OnSight Energy, LLC ("OnSight"). Other operations generated an operating income of approximately \$63,000 for the three months ended June 30, 2007 compared to an operating loss of approximately \$26,000 for the same period in 2006. The improved results are primarily from OnSight experiencing a reduced operating loss in the second quarter of 2007.

The Company formed OnSight in 2004 to provide distributed energy services. Distributed energy refers to a variety of small, modular power generating technologies that may be combined with heating and/or cooling systems. For the three months ended June 30, 2007, OnSight had an operating loss of \$10,000 compared to an operating loss of \$98,000 for the same period in 2006. The reduced operating loss in 2007 is a direct result of actions which the Company took in the third quarter of 2006 to reduce operating expenses going forward.

| For the Three Months Ended June 30, | 2007      | 2006       | Change   |
|-------------------------------------|-----------|------------|----------|
| Revenue                             | \$154,623 | \$155,136  | (\$513)  |
| Cost of sales                       | 4,616     | 438        | 4,178    |
| Gross margin                        | 150,007   | 154,698    | (4,691)  |
| Operations & maintenance            | 33,394    | 119,301    | (85,907) |
| Depreciation & amortization         | 39,545    | 40,827     | (1,282)  |
| Other taxes                         | 14,871    | 21,029     | (6,158)  |
| Other operating expenses            | 87,810    | 181,157    | (93,347) |
| Operating Income (Loss) - Other     | 62,197    | (26,459)   | 88,656   |
| Operating Income - Eliminations (1) | 772       | 770        | 2        |
| Total Operating Income (Loss)       | \$62,969  | (\$25,689) | \$88,658 |

(1) Eliminations are entries required to eliminate activities between business segments from the consolidated results.

#### Interest Expense

Total interest expense for the three months ended June 30, 2007 increased approximately \$93,000, or six percent, compared to the same period in 2006. The higher interest expense is a result of the following developments:

- The Company's average long-term debt balance during the three months ended June 30, 2007 was \$78.0 million with a weighted average interest rate of 6.67 percent, compared to \$62.8 million with a weighted average interest rate of 7.11 percent for the same period in 2006. The large period-over-period increase in the average long-term debt balance is the result of a debt placement of \$20 million Senior Notes ("Notes") at 5.5 percent in October 2006 with three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company).
- An increase in the Company's average short-term interest rate in the three months ended June 30, 2007 compared to 2006. The average interest rate for short-term borrowing increased from 5.46 percent to 5.73 percent.
- A decrease in the Company's average short-term debt balance during the three months ended June 30, 2007 compared to the same period in 2006. The average short-term borrowing balance decreased \$9.8 million in 2007 to \$14.1 million compared to \$23.9 million in 2006.

#### Income Taxes

Income tax expense for the three months ended June 30, 2007 was \$846,000 compared to \$635,000 for the three months ended June 30, 2006. The increase in income tax expense primarily reflects higher earnings. The effective tax rate for the second quarter of 2007 is 36.3 percent compared to an effective tax rate of 35.9 percent for the same period in 2006.

### Results of Operations for the Six Months Ended June 30, 2007

The following discussions on operating income and segment results for the six months ended June 30, 2007 include use of the term "gross margin." Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for natural gas and propane and the cost of labor spent on direct revenue-producing activities. Gross margin should not be considered an alternative to operating income or net income, which are determined in accordance with GAAP. Chesapeake believes that gross margin, although a non-GAAP measure, is useful and meaningful to investors as a basis for making investment decisions. It provides investors with information that demonstrates the profitability achieved by the Company under its allowed rates for regulated operations and under its competitive pricing structure for non-regulated segments. Chesapeake's management uses gross margin in measuring its business units' performance and has historically analyzed and reported gross margin information publicly. Other companies may calculate gross margin in a different manner.

### Consolidated Overview

The Company's net income for the six months ended June 30, 2007 increased \$2.2 million, or 31 percent, compared to the same period in 2006. Net income was \$9.4 million, or \$1.39 per share (diluted), an increase of \$0.19 per share compared to 2006. The period-over-period increase in earnings reflects an increase in operating income at the Company's natural gas and propane operations as a result of continued growth and colder temperatures on the Delmarva Peninsula, which increased volumes sold to customers. The Company estimates that the growth and colder weather contributed \$3.4 million and \$1.7 million, respectively, to gross margin during the first six months of 2007.

| <b>For the Six Months Ended June 30,</b> | <b>2007</b>         | <b>2006</b>  | <b>Change</b> |
|--|---------------------|--------------|---------------|
| Operating Income                         |                     |              |               |
| Natural Gas                              | <b>\$13,608,264</b> | \$11,495,833 | \$2,112,431   |
| Propane                                  | <b>4,327,658</b>    | 2,992,101    | 1,335,557     |
| Advanced Information Services            | <b>227,528</b>      | 188,371      | 39,157        |
| Other & Eliminations                     | <b>106,661</b>      | (33,709)     | 140,370       |
| Operating Income                         | <b>18,270,111</b>   | 14,642,596   | 3,627,515     |
| Other Income                             | <b>287,567</b>      | 142,299      | 145,268       |
| Interest Charges                         | <b>3,193,951</b>    | 2,994,689    | 199,262       |
| Income Taxes                             | <b>5,890,848</b>    | 4,561,281    | 1,329,567     |
| Net Income                               | <b>\$9,472,879</b>  | \$7,228,925  | \$2,243,954   |
| Diluted Earnings Per Share               | <b>\$1.39</b>       | \$1.20       | \$0.19        |

## Natural Gas

The natural gas segment earned operating income of \$13.6 million for the six months ended June 30, 2007 compared to \$11.5 million for the corresponding period in 2006, an increase of \$2.1 million, or 18 percent.

| For the Six Months Ended June 30, | 2007          | 2006          | Change      |
|-----------------------------------|---------------|---------------|-------------|
| Revenue                           | \$104,875,421 | \$101,024,221 | \$3,851,200 |
| Cost of sales                     | 72,899,708    | 73,166,577    | (266,869)   |
| Gross margin                      | 31,975,713    | 27,857,644    | 4,118,069   |
| Operations & maintenance          | 12,703,572    | 11,367,924    | 1,335,648   |
| Depreciation & amortization       | 3,630,193     | 3,053,083     | 577,110     |
| Other taxes                       | 2,033,684     | 1,940,804     | 92,880      |
| Other operating expenses          | 18,367,449    | 16,361,811    | 2,005,638   |
| Total Operating Income            | \$13,608,264  | \$11,495,833  | \$2,112,431 |

### Statistical Data — Delmarva Peninsula

|                                    |         |         |      |
|------------------------------------|---------|---------|------|
| Heating degree-days ("HDD"):       |         |         |      |
| Actual                             | 2,966   | 2,457   | 509  |
| 10-year average (normal)           | 2,737   | 2,793   | (56) |
| Estimated gross margin per HDD     | \$2,283 | \$2,234 | \$49 |
| Per residential customer added:    |         |         |      |
| Estimated gross margin             | \$372   | \$372   | \$0  |
| Estimated other operating expenses | \$106   | \$106   | \$0  |

### Residential Customer Information

|                              |        |        |       |
|------------------------------|--------|--------|-------|
| Average number of customers: |        |        |       |
| Delmarva                     | 43,471 | 40,126 | 3,345 |
| Florida                      | 13,311 | 12,470 | 841   |
| Total                        | 56,782 | 52,596 | 4,186 |

Gross margin for the Company's natural gas segment increased by \$4.1 million, or 15 percent, and other operating expenses increased \$2.0 million, or 12 percent, in the six months ended June 30, 2007 compared to the same period in 2006. The gross margin increases of \$2.0 million for the natural gas transmission operation, \$2.3 million for the Delmarva natural gas distribution operations, and \$132,000 for the Florida natural gas distribution operation were partially offset by a lower gross margin of \$274,000 for the natural gas marketing operation, as further explained below.

### Natural Gas Transmission

The natural gas transmission operation achieved gross margin growth of \$2.0 million, or 22 percent. This increase was primarily attributed to new transportation capacity contracts implemented in November 2006 and the implementation of temporary rates, subject to refund, based on the status of the FERC rate proceeding discussed below in the "Regulatory Matters" section. In total for 2007, these new transportation capacity contracts are expected to generate a gross margin of \$3.3 million above the 2006 gross margin. An increase of \$1.3 million in other operating expenses partially offset the increased gross margin. The factors contributing to the increase in other operating expenses are as follows:

- The increase in operating expenses for the first six months of 2007 is magnified by the FERC's approval, in July 2006, to defer pre-service costs of the Company's Energylink Expansion Project as a regulatory asset. The deferral of these costs resulted in the reduction of \$310,000 in other operating expenses in the second quarter of 2006. Please refer to the "Regulatory Matters" section below for further information on this expansion project.
- Payroll and benefit costs increased by \$149,000 and \$45,000, respectively, to comply with federal pipeline integrity maintenance regulations and to serve the additional growth experienced by the operation.

- Incentive compensation increased by \$24,000 as a result of the improved operating results in 2007 compared to 2006.
- Regulatory expenses increased by \$108,000 in the first six months of 2007 as the Company incurred costs associated with its rate filing with the FERC.
- The increased level of capital investment caused higher depreciation and asset removal costs of \$425,000 and increased property taxes of \$52,000.
- Other operating expenses relating to various items increased collectively by approximately \$169,000.

#### Natural Gas Distribution

The Delmarva distribution operations experienced an increase of \$2.3 million, or 19 percent, in gross margin. The significant items contributing to the increase in gross margin include the following:

- The Company estimates that weather contributed \$756,000 to gross margin in the six months ended June 30, 2007 compared to the same period in 2006, as temperatures on the Delmarva Peninsula were 21 percent colder in 2007. The colder temperatures did not have a significant impact on the Maryland distribution operation's gross margin in the first six months of 2007, because the operation's approved rate structure now includes a WNA mechanism. The WNA mechanism was implemented in October 2006 and is designed to protect a portion of the Company's revenues against warmer-than-normal weather, as deviations from normal weather can affect our financial performance and liquidity. The WNA also serves to offset the impact of colder-than-normal weather by reducing the amounts the Company can charge its customers during such periods.
- Continued residential customer growth also contributed to the increase in gross margin. The average number of residential customers on the Delmarva Peninsula increased by 3,345, or eight percent, for the six months ended June 30, 2007 compared to the same period in 2006, and the Company estimates that these additional residential customers contributed approximately \$703,000 to gross margin.
- In October 2006, the Maryland PSC granted the Company a base rate increase, which resulted in a \$495,000 period-over-period increase to gross margin in the first six months of 2007.
- The remaining \$205,000 increase in gross margin can be attributed to various factors, including an increase in the number of commercial and industrial customers.

Gross margin for the Florida distribution operation increased by \$133,000, or two percent, in the first six months of 2007 compared to the same period in 2006. The higher gross margin for the period is primarily attributed to the increase in customers as the operation experienced a seven percent growth in residential customers and a three percent growth in commercial customers.



Other operating expense for the natural gas distribution operations increased by \$599,000 in the first six months of 2007 compared to the same period in 2006. Among the key components of the increase were the following:

- Payroll costs increased by \$90,000 to serve the additional growth experienced by the operation.
- Health care costs increased by \$113,000 as the Company experienced a higher cost of claims in the first six months of 2007 compared to the same period in 2006.
- Depreciation and amortization expense, asset removal cost and property taxes increased by \$200,000, \$99,000 and \$52,000, respectively, as a result of the Company's continued capital investments.
- In addition, other operating expenses relating to various minor items increased by approximately \$86,000.
- Merchant payment fees decreased by \$41,000, as the Company's Delmarva operation outsourced the processing of credit card payments in April of 2007; this decrease was partially offset by the increased merchant payment fees incurred in the first quarter of 2007.

#### Natural Gas Marketing

Gross margin for the natural gas marketing operation decreased by \$274,000, or 21 percent, for the first six months of 2007 compared to the same period in 2006. The decline in gross margin was primarily the result of unfavorable imbalance resolutions with interstate pipelines, which caused an increase in the cost of gas. Other operating expenses increased by \$125,000 for the marketing operation primarily due to increases in payroll and benefit costs, allowance for uncollectible accounts and corporate overhead costs.

#### **Propane**

The propane segment experienced an increase of \$1.3 million, or 45 percent, in operating income for the six months ended June 30, 2007 compared to the same period in 2006. Gross margin increased by \$2.5 million, which was partially offset by an increase in other operating expenses of \$1.2 million.

| <b>For the Six Months Ended June 30,</b> | <b>2007</b>        | <b>2006</b>        | <b>Change</b>      |
|--|--------------------|--------------------|--------------------|
| Revenue                                  | \$34,416,976       | \$28,488,315       | \$5,928,661        |
| Cost of sales                            | 21,263,372         | 17,877,811         | 3,385,561          |
| Gross margin                             | 13,153,604         | 10,610,504         | 2,543,100          |
| Operations & maintenance                 | 7,459,990          | 6,365,200          | 1,094,790          |
| Depreciation & amortization              | 904,368            | 819,384            | 84,984             |
| Other taxes                              | 461,588            | 433,819            | 27,769             |
| Other operating expenses                 | 8,825,946          | 7,618,403          | 1,207,543          |
| <b>Total Operating Income</b>            | <b>\$4,327,658</b> | <b>\$2,992,101</b> | <b>\$1,335,557</b> |

#### **Statistical Data — Delmarva Peninsula**

|                                       |                |                |              |
|---------------------------------------|----------------|----------------|--------------|
| Heating degree-days ("HDD"):          |                |                |              |
| Actual                                | 2,966          | 2,457          | 509          |
| 10-year average (normal)              | 2,737          | 2,793          | (56)         |
| <b>Estimated gross margin per HDD</b> | <b>\$1,974</b> | <b>\$1,743</b> | <b>\$231</b> |

Operating income for the propane segment increased by \$1.3 million, or 45 percent, to \$4.3 million for the six months ended June 30, 2007 compared to the same period in 2006. This increase was due primarily to colder weather on the Delmarva Peninsula in the first six months of 2007, which resulted in increased consumption by customers. Gross margin in the Delmarva propane distribution operations increased, compared to the first six months of 2006, by \$2.1 million, primarily due to colder weather. Gross margin also increased in the Florida propane distribution operation and the Company's wholesale propane marketing operation by \$62,000 and \$367,000, respectively.

#### Delmarva Propane Distribution

The Delmarva propane distribution operation's increase in gross margin of \$2.1 million resulted from the following:

- Volumes sold in the first six months of 2007 increased by 1.9 million gallons, or 13 percent, primarily because temperatures on the Delmarva Peninsula were 21 percent colder during the first six months of 2007 than during the same period in 2006. The Company estimates that the colder weather increased gross margin by approximately \$931,000 for the Delmarva propane distribution operation compared to the first six months of 2006.
- Gross margin further increased by \$577,000 in the first six months of 2007, compared to the same period in 2006, because of a \$0.05 increase in the average gross margin per retail gallon. This increase occurs when market prices of propane rise greater than the Company's average inventory price per gallon. This trend reverses, as it did in the second quarter of 2007, when market prices decrease and moves closer to the Company's inventory price per gallon. Propane gross margin is also impacted by the Company's pricing with its customers.
- Gross margin for the Delmarva Community Gas Systems ("CGS") increased by \$529,000 in the first six months of 2007, compared to the same period in 2006, primarily because of the colder weather and an increase in the average number of customers. The average number of CGS customers increased by approximately 1,000 to a total count of approximately 4,680, or a 27 percent increase, compared to the first six months of 2006. The Company expects the growth of its CGS operation to continue as the number of systems currently under construction or under contract is anticipated to provide an additional 7,900 CGS customers, an increase of 169 percent.
- The remaining \$77,000 decrease in gross margin can be attributed to various factors, including lower service sales and wholesale sales.

Total other operating expenses increased by \$995,000 for the Delmarva operations in the six months ended June 30, 2007, compared to the same period in 2006. The significant items contributing to this increase are explained below:

- The increase in operating expenses for the first six months of 2007 is magnified by the Company's one-time recovery of previously incurred costs of \$387,000 from one of its propane suppliers. This recovery reimbursed the Company for fixed costs incurred in the removal of above-normal levels of petroleum by-products contained in approximately 75,000 gallons of propane that it purchased from the supplier. The recovery of these costs reduced other operating expenses in the first six months of 2006.
- Payroll costs have increased by \$73,000 to serve the additional growth experienced by the operation.
- Incentive compensation increased by \$183,000 as a result of the improved operating results in 2007 compared to 2006.
- Health care costs increased by \$80,000 during the first six months of 2007 compared to the same period in 2006 as the Company experienced a higher cost of claims during the period.
- The operation incurred an additional \$116,000 in 2007 for propane tank recertifications and maintenance to comply with Department of Transportation standards.
- Depreciation and amortization expense increased by \$60,000 as a result of the Company's continued capital investments.
- In addition, other operating expenses relating to various items increased collectively by approximately \$96,000.

#### Florida Propane Distribution

The Florida propane distribution operation experienced an increase in gross margin of \$62,000, or 10 percent, in the first six months 2007 compared to the same period in 2006. Gross margin from propane sales increased \$14,000 as a higher average gross margin per retail gallon was partially offset by a two percent decrease in

the volumes sold in 2007. The remaining increase of \$48,000 is attributed to higher in-house piping sales. Other operating expenses in the first six months of 2007, compared to the same period in 2006, increased by \$118,000, primarily due to increases in payroll costs, insurance and depreciation expense, which were partially offset by lower incentive compensation.

*Propane Wholesale and Marketing*

Gross margin for the Company's propane wholesale marketing operation increased by \$367,000, or 38 percent, in the first six months of 2007 compared to the same period in 2006. This increase reflects the larger number of market opportunities that arose in the first six months of 2007, due to price volatility in the propane wholesale market, which exceeded the level of price fluctuations experienced in the same period of 2006. The increase in gross margin was partially offset by higher other operating expenses of \$94,000, due primarily to higher incentive compensation based on the increased earnings in 2007.

**Advanced Information Services**

The advanced information services business experienced gross margin growth of approximately \$625,000, or 25 percent, and contributed operating income of \$228,000 for the six months ended June 30, 2007, an increase of \$39,000 compared to the same period in 2006.

| <b>For the Six Months Ended June 30,</b> | <b>2007</b> | <b>2006</b> | <b>Change</b> |
|--|-------------|-------------|---------------|
| Revenue                                  | \$7,121,197 | \$5,880,094 | \$1,241,103   |
| Cost of sales                            | 4,001,111   | 3,385,026   | 616,085       |
| Gross margin                             | 3,120,086   | 2,495,068   | 625,018       |
| Operations & maintenance                 | 2,464,659   | 1,972,680   | 491,979       |
| Depreciation & amortization              | 69,485      | 61,940      | 7,545         |
| Other taxes                              | 358,414     | 272,077     | 86,337        |
| Other operating expenses                 | 2,892,558   | 2,306,697   | 585,861       |
| Total Operating Income                   | \$227,528   | \$188,371   | \$39,157      |

The increase of revenues in the six months ended June 30, 2007 is resulted from:

- An increase of \$1.0 million in consulting revenues as the number of billable hours increased by 17 percent;
- An increase of \$150,000 from Managed Database Administration ("MDBA") services, first offered in 2006, which provide clients with professional database monitoring and support solutions during business hours or around the clock; and
- An increase of \$66,000 in revenue from training services and product sales.

Other operating expenses increased by \$586,000 to \$2.9 million in the six months ended June 30, 2007, compared to \$2.3 million for the same period in 2006. This increase in operating expenses is due primarily to an increase in accrued incentive compensation based on improved operating results and other costs incurred to support the growth and improved earnings.

### Other Business Operations and Eliminations

Other operations generated an operating income of approximately \$107,000 for the six months ended June 30, 2007 compared to an operating loss of approximately \$34,000 for the same period in 2006. The improved results are attainable primarily to OnSight experiencing a reduced operating loss in the first six months of 2007.

For the six months ended June 30, 2007, OnSight had an operating loss of \$42,000 compared to an operating loss of \$196,000 for the same period in 2006. The reduced operating loss in 2007 is a direct result of actions which the Company took in the third quarter of 2006 to reduce operating expenses going forward.

| <b>For the Six Months Ended June 30,</b> | <b>2007</b>      | <b>2006</b>       | <b>Change</b>    |
|--|------------------|-------------------|------------------|
| Revenue                                  | \$309,246        | \$310,271         | (\$1,025)        |
| Cost of sales                            | 4,616            | 875               | 3,741            |
| Gross margin                             | 304,630          | 309,396           | (4,766)          |
| Operations & maintenance                 | 86,822           | 223,390           | (136,568)        |
| Depreciation & amortization              | 80,813           | 81,484            | (671)            |
| Other taxes                              | 31,874           | 39,771            | (7,897)          |
| Other operating expenses                 | 199,509          | 344,645           | (145,136)        |
| Operating Income (Loss) - Other          | 105,121          | (35,249)          | 140,370          |
| Operating Income - Eliminations (1)      | 1,540            | 1,540             | 0                |
| <b>Total Operating Income (Loss)</b>     | <b>\$106,661</b> | <b>(\$33,709)</b> | <b>\$140,370</b> |

(1) Eliminations are entries required to eliminate activities between business segments from the consolidated results.

### Interest Expense

Total interest expense for the first six months of 2007 increased approximately \$199,000, or seven percent, compared to the same period in 2006. The higher interest expense is a result of the following developments:

- The Company's average long-term debt balance during the first six months of 2007 was \$77.8 million with a weighted average interest rate of 6.68 percent, compared to \$62.8 million with a weighted average interest rate of 7.14 percent for the same period in 2006. The large year-over-year increase in the average long-term debt balance is the result of a debt placement of \$20 million Senior Notes ("Notes") at 5.5 percent in October 2006 with three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company).
- An increase in the average short-term interest rates in the first six months of 2007 compared to the same period in 2006. The Company's average interest rate for short-term borrowing increased from 5.20 percent to 5.72 percent.
- A decrease in the Company's average short-term debt balance during the first six months of 2007 compared to the same period in 2006. The average short-term borrowing balance decreased \$10.7 million in 2007 to \$15.8 million compared to \$26.5 million in 2006.

### Income Taxes

Income tax expense for the six months ended June 30, 2007 was \$5.9 million compared to \$4.6 million for the six months ended June 30, 2006. The increase in income tax expense primarily reflects higher earnings. The effective tax rate for the first six months of 2007 is 38.3 percent compared to an effective tax rate of 38.7 percent for the same period in 2006.

## FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES

Chesapeake's capital requirements reflect the capital-intensive nature of its business and are principally attributable to its investment in new plant and equipment and the retirement of outstanding debt. The Company relies on cash generated from operations, short-term borrowing, and other sources to meet normal working capital requirements and to finance capital expenditures. During the first six months of 2007, net cash provided by operating activities was \$20.6 million, cash used by investing activities was \$15.9 million and cash used by financing activities was \$8.3 million.

By comparison, during the first six months of 2006, net cash provided by operating activities was \$23.0 million, cash used by investing activities was \$16.8 million and cash used by financing activities was \$6.3 million.

The Board of Directors has authorized the Company to borrow up to \$55.0 million of short-term debt, as required, from various banks and trust companies under short-term lines of credit. As of June 30, 2007, Chesapeake had four unsecured bank lines of credit with two financial institutions, totaling \$80.0 million. These bank lines will provide funds for the Company's short-term cash needs to meet seasonal working capital requirements and to temporarily fund portions of its capital expenditures. Two of the bank lines, totaling \$15.0 million, are committed. The other two lines are subject to the availability of bank funds. The outstanding balance of short-term borrowing at June 30, 2007 and December 31, 2006 was \$23.6 million and \$27.6 million, respectively.

Chesapeake has budgeted \$45.5 million for capital expenditures during 2007. This amount includes \$20.2 million for natural gas distribution, \$16.5 million for natural gas transmission, \$7.5 million for propane distribution and wholesale marketing, \$154,000 for advanced information services and \$915,000 for other operations. The natural gas distribution and transmission expenditures are for expansion and improvement of facilities. The propane expenditures are to support customer growth and the replacement of equipment. The advanced information services expenditures are for computer hardware, software and related equipment. The other operations category includes general plant, computer software and hardware. Financing for the 2007 capital expenditure program is expected from short-term borrowing, cash provided by operating activities, and other sources. The capital expenditure program is subject to continuous review and modification. Actual capital requirements may vary from the above estimates due to a number of factors, including acquisition opportunities, changing economic conditions, customer growth in existing areas, regulation, new growth opportunities and availability of capital.

Chesapeake expects to incur approximately \$75,000 for environmental-related expenditures in 2007 and the same amount in 2008. Additional expenditures may be required in future years (see Note 4 to the Consolidated Financial Statements). Management does not expect financing of future environmental-related expenditures to have a material adverse effect on the financial position or capital resources of the Company.

### Capital Structure

The following presents the Company's capitalization as of June 30, 2007 and December 31, 2006:

|  | <u>June 30, 2007</u>               |             | <u>December 31, 2006</u> |             |
|--|------------------------------------|-------------|--------------------------|-------------|
|  | (In thousands, except percentages) |             |                          |             |
| Long-term debt, net of current maturities              | \$69,965                           | 37%         | \$71,050                 | 39%         |
| Stockholders' equity                                   | \$118,883                          | 63%         | \$111,152                | 61%         |
| <u>Total capitalization, excluding short-term debt</u> | <u>\$188,848</u>                   | <u>100%</u> | <u>\$182,202</u>         | <u>100%</u> |

As of June 30, 2007, common equity represented 63 percent of total capitalization, compared to 61 percent at December 31, 2006. If short-term borrowing and the current portion of long-term debt were included in total capitalization, the equity component of the Company's capitalization would have been 54 percent and 51

percent at June 30, 2007 and December 31, 2006, respectively. Chesapeake remains committed to maintaining a sound capital structure and strong credit ratings to provide the financial flexibility needed to access capital markets when required. This commitment, along with adequate and timely rate relief for the Company's regulated operations, is intended to ensure that Chesapeake will be able to attract capital from outside sources at a reasonable cost. The Company believes that the achievement of these objectives will provide benefits to customers and creditors, as well as to the Company's investors.

### Shelf Registration

In July 2006, the Company filed a registration statement on Form S-3 with the SEC to issue up to \$40.0 million in new common stock and/or debt securities. The registration statement was declared effective by the SEC in November 2006. At June 30, 2007, the Company had approximately \$20.0 million remaining under this registration statement.

### Cash Flows Provided By Operating Activities

Cash flows provided by operating activities were as follows:

| For the Six Months Ended June 30,                | 2007                | 2006                |
|--|---------------------|---------------------|
| Net Income                                       | \$9,472,879         | \$7,228,925         |
| Non-cash adjustments to net income               | 8,185,897           | 3,642,120           |
| Changes in working capital                       | 2,959,281           | 12,099,741          |
| <b>Net cash provided by operating activities</b> | <b>\$20,618,057</b> | <b>\$22,970,786</b> |

Period-over-period changes in our cash flows from operating activities are attributable primarily to net income, depreciation and working capital changes. The changes in working capital are impacted by weather, the price of natural gas and propane, the timing of customer collections, payments of natural gas and propane purchases, and deferred gas cost recoveries.

For the six months ended June 30, 2007, net cash flow provided by operating activities was \$20.6 million, a decrease of \$2.4 million compared to the same period of 2006. The decrease was due primarily to changes in working capital, which were partially offset by higher net income and higher non-cash adjustments for depreciation and amortization expense and changes in deferred income taxes. The reduction in working capital was due primarily to the decrease in cash provided from accounts receivable and income tax receivable, which was partially offset by a decrease in cash used by accounts payable for gas purchases payable. The changes in accounts receivable and accounts payable were impacted by the weather and the lower gas commodity costs.

### Cash Flows Used in Investing Activities

Net cash flows used in investing activities totaled \$15.9 million and \$16.8 million during the six months ended June 30, 2007 and 2006, respectively. Cash utilized for capital expenditures was \$16.0 million and \$16.8 million for the first six months of 2007 and 2006, respectively. Additions to property, plant and equipment in these quarters were primarily for natural gas transmission, natural gas distribution and propane distribution. In both 2007 and 2006, the natural gas distribution expenditures were used primarily to fund expansion and facilities improvements. In both periods, the natural gas transmission capital expenditures related primarily to expanding the Company's transmission system. In addition, \$136,000 more than what was recovered through rates charged to customers was used for environmental expenditures in the first six months of 2007 compared to a net recovery of \$2,000 for environmental costs through rates charged to customers in the same period in 2006.

### Cash Flows Used in Financing Activities

Cash flows used in financing activities totaled \$8.3 million and \$6.3 million for the six months ended June 30, 2007 and 2006, respectively. Significant financing activities included the following:

- During the first six months of 2007, the Company reduced short-term debt by \$4.8 million compared to a \$3.7 million reduction in the first six months of 2006.
- During the first six months of 2007, the Company paid \$3.5 million in cash dividends compared with dividend payments of \$2.9 million for the same time period in 2006. The increase in dividends paid over the prior year reflects an increase in the annualized dividend rate from \$1.14 per share during the first quarter of 2006 to \$1.16 per share in the first quarter of 2007 and the issuance of additional shares of common stock.
- The Company repaid \$1.0 million of long-term debt during the first six months of 2007 and 2006.

### Off-Balance Sheet Arrangements

The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its Florida natural gas supply and management subsidiary and its Delmarva propane distribution subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases in the event of a subsidiary's default. Liabilities for these purchases are recorded in the Consolidated Financial Statements. The aggregate amount guaranteed at June 30, 2007 was \$21.7 million, with the guarantees expiring on various dates in 2007 and 2008.

In addition to the corporate guarantees, the Company has issued a letter of credit to its primary insurance company for \$775,000, which expires on May 31, 2008. The letter of credit is provided as security for claims amounts to satisfy the deductibles on the Company's policies.

### Contractual Obligations

There have not been any material changes in the contractual obligations presented in the Company's 2006 Annual Report on Form 10-K, except for commodity purchase obligations and forward contracts entered into in the ordinary course of the Company's business. Below is a summary of the commodity and forward contract obligations at June 30, 2007.

| Purchase Obligations       | Payments Due by Period |             |             |                   | Total        |
|----------------------------|------------------------|-------------|-------------|-------------------|--------------|
|                            | Less than 1 year       | 1 - 3 years | 3 - 5 years | More than 5 years |              |
| Commodities <sup>(1)</sup> | \$2,264,343            | \$55,506    | \$0         | \$0               | \$2,319,849  |
| Propane <sup>(2)</sup>     | 67,461,710             | -           | -           | -                 | 67,461,710   |
| Total Purchase Obligations | \$69,726,053           | \$55,506    | \$0         | \$0               | \$69,781,559 |

<sup>(1)</sup> In addition to the obligations noted above, the natural gas distribution and propane distribution operations have agreements with commodity suppliers that have provisions allowing the Company to reduce or eliminate the quantities purchased. There are no monetary penalties for reducing the amounts purchased; however, the propane contracts allow the suppliers to reduce the amounts available in the winter season if the Company does not purchase specified amounts during the summer season. Under these contracts, the commodity prices will fluctuate as market prices fluctuate.

<sup>(2)</sup> The Company has also entered into forward sale contracts in the aggregate amount of \$69.6 million. See Part I, Item 3, "Quantitative and Qualitative Disclosures about Market Risk," below for further information.

### **Environmental Matters**

As more fully described above in Note 4 to the Condensed Consolidated Financial Statements, Chesapeake has incurred costs relating to the completed or ongoing environmental remediation at three former manufactured gas plant sites. In addition, Chesapeake is currently participating in discussions regarding possible responsibility of the Company for remediation of a fourth former manufactured gas plant site located in Cambridge, Maryland. Chesapeake believes that future costs associated with these sites will be recoverable in rates or through sharing arrangements with, or contributions by, other responsible parties.

### **OTHER MATTERS**

#### **Regulatory Matters**

The Company's natural gas distribution operations in Delaware, Maryland and Florida are subject to regulation by the respective Public Service Commissions. Eastern Shore Natural Gas ("Eastern Shore"), the Company's natural gas transmission operation, is subject to regulation by the FERC.

Delaware. On September 2, 2005, the Delaware division filed an application with the Delaware Public Service Commission ("Delaware PSC") requesting approval of an alternative rate design and rate structure in order to provide natural gas service to prospective customers in eastern Sussex County. While Chesapeake does provide natural gas service to residents and businesses in portions of Sussex County under the Company's current tariff, natural gas distribution lines have not been extended to a large portion of the State of Delaware's recently targeted growth areas in eastern Sussex County. In April 2002, Governor Ruth Ann Minner established the Delaware Energy Task Force ("Task Force"), whose mission was to address the State of Delaware's long-term and short-term energy challenges. In September 2003, the Task Force issued its final report to the Governor that included a strategy related to enhancing the availability of natural gas within the State by evaluating possible incentives for expanding residential and commercial natural gas service. Chesapeake believes its current proposal to implement a rate design that will enable the Company to provide natural gas as a viable energy choice to a broad number of prospective customers within eastern Sussex County is consistent with the Task Force recommendation. As the Delaware division has included these proposals in its filing made on July 6, 2007, the Delaware division anticipates closing this particular proceeding and continuing discussions in the context of the base rate proceeding.

On September 1, 2006, the Company filed with the Delaware PSC its annual Gas Sales Service Rates Application ("GSR") seeking the approval of the Delaware PSC to change its GSR rates effective for service rendered on and after November 1, 2006. On October 3, 2006, the Delaware PSC authorized the Company to implement the GSR charges on a temporary basis and subject to refund, pending the completion of full evidentiary hearings and a final decision by the Delaware PSC. The Division of the Public Advocate ("DPA") recommended a cost disallowance of approximately \$4.4 million related to the Delaware division's commodity procurement purchases and a disallowance of approximately \$275,000 related to pipeline capacity the Delaware division holds in eastern Sussex County, Delaware. The Delaware PSC Staff recommended a cost disallowance of approximately \$2.2 million related to the Delaware division's commodity procurement purchases and the deferral of approximately \$535,000 related to pipeline capacity the Delaware division holds in eastern Sussex County, Delaware. The Company disagreed with these recommendations and opposed the proposed cost disallowance and deferral in its rebuttal position submitted on April 19, 2007. Under established Delaware law, gas procurement costs, like other normally accepted operating expenses, cannot be disallowed unless it is shown that the costs were the result of an abuse of discretion, bad faith, or waste. Management believes that the Company's gas procurement practices and pipeline capacity costs were reasonable and that, in no event were the costs at issue incurred as a result of any abuse of discretion, bad faith, or waste on the part of the Company. On July 24, 2007, the Delaware PSC approved a settlement agreement between the parties resulting in no cost disallowance for the Delaware division. As a result of the settlement agreement, the Delaware division has agreed to contribute an amount equal to \$37,500 per year for the next three years to its internal program designed to benefit elderly, disabled, and low-income customers of the Delaware division. Additionally, with respect to the allowances for recovery of costs associated with pipeline capacity in eastern



Sussex County, the settlement provides for the Delaware division to reduce the total amount of GSR charges to be collected from its customers by \$275,000, effective beginning with the billing period from November 1, 2007 through October 31, 2008, and provides for the Delaware division to subsequently add \$275,000 to the total of its GSR charges to be collected from customers effective for billings from November 1, 2008 through October 31, 2009.

On November 1, 2006, the Delaware division filed with the Delaware PSC its annual Environmental Rider ("ER") rate application to become effective for service rendered on and after December 1, 2006. The Delaware PSC granted approval of the ER rate at its regularly scheduled meeting on November 21, 2006, subject to full evidentiary hearings and a final decision. On January 23, 2007, the Delaware PSC granted final approval of the ER rate as filed.

On November 9, 2006, the Delaware division filed two applications with the Delaware PSC requesting approval for a Town of Millsboro Franchise Fee Rider and a Town of Georgetown Franchise Fee Rider. These Riders will allow the Delaware division to charge all respective natural gas customers within town limits the franchise fee paid by the Delaware division to the Towns of Millsboro and Georgetown as a condition to providing natural gas service. The Delaware PSC granted approval of both Riders on January 23, 2007.

On July 6, 2007, the Company filed with the Delaware PSC an application seeking approval of the following: (i) participation by the Company's Delaware commercial and industrial customers in transportation buying pools served by third-party natural gas marketers; (ii) a base rate adjustment of \$1,896,000 annually that represents approximately a 3.25 percent rate increase on average for the Delaware division's firm customers; (iii) an alternative rate design for residential customers in a defined expansion area in eastern Sussex County, Delaware; and (iv) a revenue normalization mechanism that reduces the impact of natural gas consumption on both customers and the Company. As an incentive for the Delaware division to make the significant capital investments to serve the growing areas of eastern Sussex County and in supporting Delaware's Energy Policy, the Company has proposed as part of the filing that the Delaware division be permitted to earn a return on equity up to 15 percent. This level of return ensures that the Company's investors are adequately compensated for the increased risk associated with the higher levels of capital investment necessary to provide natural gas in those growing areas.

Maryland. On September 26, 2006, the Maryland PSC approved a base rate increase for the Maryland division of approximately \$780,000 annually. In a settlement agreement entered into in that proceeding, the Maryland division was required to file a depreciation study, which was filed on April 9, 2007. The Maryland division filed formal testimony on July 10, 2007, initiating a phase II of this proceeding. In this filing, the Maryland division proposed a rate decrease of approximately \$80,000 annually, resulting from a change in depreciation expense. The Maryland division anticipates a decision from the Maryland PSC on its proposed change in depreciation expense during the fourth quarter of 2007.

On December 14, 2006, the Maryland PSC held an evidentiary hearing to determine the reasonableness of the Maryland division's four quarterly gas cost recovery filings during the twelve months ended September 30, 2006. On December 15, 2006, the Hearing Examiner issued proposed findings approving the quarterly gas cost recovery rates as filed by the Maryland division and permitting complete recovery of its purchased gas costs for the period under review. No appeals or written exceptions to the proposed findings were made, and a final order approving the quarterly gas cost recovery rates, as filed, was issued by the Maryland PSC on January 17, 2007.

Florida. On September 15, 2006, the Florida gas distribution division filed a petition with the Florida PSC for approval of its Energy Conservation Cost Recovery Factors for the year 2007. Approved on November 30, 2006 by the Florida PSC, the new factors went into effect on January 1, 2007.

On October 10, 2006, the Florida division filed a petition with the Florida PSC for authority to implement phase two of its experimental transitional transportation service (“TTS”) pilot program, and for approval of a new tariff to reflect the division’s transportation service environment. Phase two of the TTS program for residential and certain small commercial consumers will expand the number of pool managers from one to two and increase the gas supply pricing options available to these consumers. Approved on April 24, 2007 by the Florida PSC, phase two of the TTS program will go into effect in the third quarter of 2007.

On November 29, 2006, the Florida division filed a petition with the Florida PSC for authority to modify its energy conservation programs. In this petition, the Florida division is seeking approval to increase the cash allowances paid within the Residential Homebuilder Program and the Residential Appliance Replacement Program, and to expand the scope of the Residential Water Heater Retention Program to add natural gas heating systems, cooking and clothes drying appliances. The Florida PSC granted approval of the petition in an order dated March 5, 2007. The modifications and new cash allowances became effective on March 30, 2007.

On May 2, 2007, the Florida division filed its summary of activity and true-up calculation for its 2006 Energy Conservation Cost Recovery Program with the Florida PSC. The outcome of this filing is dependent upon an audit of the costs by the Florida PSC, which is expected in the third quarter of 2007. The results of the audit will be incorporated into the calculation of the 2008 Energy Conservation Cost Recovery Factors, which is expected to be filed with the Florida PSC in mid-September 2007.

In compliance with the Florida Administrative Code, the Florida division filed its 2007 Depreciation Study with the Florida PSC on May 17, 2007. This study provides the Florida PSC with the opportunity to review and address the lives, salvage values, reserves and resulting life depreciation rates since the last study performed in 2002. In its filing, the Florida division has requested that any changes to the depreciation rates be made effective January 1, 2008. While the Company cannot predict the outcome of the Florida PSC’s review at this time, the Company anticipates a final decision regarding the depreciation rates in the fourth quarter of 2008.

Eastern Shore. The system expansion and rate matters for Eastern Shore include:

System Expansion 2006 – 2008. On January 20, 2006, Eastern Shore filed an application for a Certificate of Public Convenience and Necessity for its 2006-2008 system expansion project (the “2006 – 2008 Project”) with the FERC. The application requested authority to construct and operate approximately 55 miles of new pipeline facilities and two new metering and regulating station facilities to provide an additional 47,350 dekatherms per day (“dt/d”) of firm transportation service in accordance with the phased-in customer requests of 26,200 dt/d in 2006, 10,300 dt/d in 2007, and 10,850 dt/d in 2008, at a total estimated cost of approximately \$33.6 million. On June 13, 2006, the FERC issued a Certificate to Eastern Shore authorizing it to construct and operate the 2006 – 2008 Project as proposed. The following table provides a breakdown of the additional amounts of firm capacity per day, the estimated capital investment required, and the estimated annual gross margin contribution for the new services that will become effective November 1<sup>st</sup> for each of the respective years of the project:

| Services implemented November 1,     | Year          |               |               |
|--------------------------------------|---------------|---------------|---------------|
|                                      | 2006          | 2007          | 2008          |
| Additional firm capacity per day     | 26,200        | 10,300        | 10,850        |
| Capital investment                   | \$17 million  | \$8 million   | \$8 million   |
| Annualized gross margin contribution | \$3.7 million | \$1.5 million | \$1.6 million |

Eastern Shore has completed and placed in service the authorized Phase I facilities. The actual capital investment for Phase I was \$25.5 million, compared to the \$17.0 million original estimate included in the filing. Phase II and Phase III facilities are expected to be constructed in 2007 and 2008, respectively.

Eastern Shore Energylink Expansion Project ("E3 Project"). Eastern Shore has proposed to develop, construct and operate approximately 63 miles of new pipeline facilities to transport natural gas from Calvert County, Maryland, crossing under the Chesapeake Bay into Dorchester and Caroline Counties, Maryland, to points on the Delmarva Peninsula where such facilities would interconnect with Eastern Shore's existing facilities in Sussex County, Delaware.

On May 31, 2006, Eastern Shore entered into Precedent Agreements (the "Precedent Agreements") with Delmarva Power & Light Company ("Delmarva") and Chesapeake, through its Delaware and Maryland Divisions, to provide additional firm transportation services upon completion of the E3 Project.

Chesapeake and Delmarva are parties to existing firm natural gas transportation service agreements with Eastern Shore, and each desires firm transportation services under the E3 Project, as evidenced by the Precedent Agreements. Pursuant to the Precedent Agreements, the parties have agreed to proceed with the required initiatives to obtain the governmental and regulatory authorizations that are necessary for Eastern Shore to provide, and for Chesapeake and Delmarva to utilize firm transportation services under the E3 Project.

Eastern Shore, Chesapeake and Delmarva have also entered into Letter Agreements which provide that, in the event that the E3 Project is not certificated and placed in service, Chesapeake and Delmarva will each pay their proportionate share of certain pre-certification costs by means of a negotiated surcharge of up to \$2 million each, over a period of not less than 20 years.

In furtherance of the E3 Project, Eastern Shore submitted a petition to the FERC on June 27, 2006 seeking approval of an uncontested rate-related Settlement Agreement by and between Eastern Shore, Chesapeake and Delmarva (the "Settlement Agreement"). The Settlement Agreement provides Eastern Shore and all customers utilizing Eastern Shore's system with benefits, including but not limited to the following: (1) advancement of a necessary infrastructure project to meet the growing demand for natural gas on the Delmarva Peninsula; (2) sharing of project development costs by the participating customers in the project; and (3) no development cost risk for non-participating customers. On August 1, 2006, the FERC approved the Settlement Agreement, which was uncontested. On September 6, 2006, Eastern Shore submitted to FERC proposed tariff sheets to implement the provisions of the Settlement Agreement. By Letter Order dated October 6, 2006, the FERC accepted the tariff sheets effective September 7, 2006.

Eastern Shore submitted its Request for Pre-Filing to the FERC on April 23, 2007, and on May 15, 2007, the FERC notified Eastern Shore that its request had been approved. The pre-filing process is intended to engage all interested and affected stakeholders early in the process with the intention of resolving all environmental issues prior to the formal certificate application being filed.

Eastern Shore is actively involved in the FERC's pre-filing process. Eastern Shore has performed various environmental, engineering and cultural surveys and studies to advance the project and has held meetings with federal, state and local permitting/regulatory agencies, non-governmental organizations and other interested stakeholders. As part of an updated and revised engineering study, Eastern Shore received construction cost estimates for the E3 project which are significantly higher than previous estimates. Eastern Shore has initiated additional analyses to identify and quantify alternative construction methods, cost mitigation strategies and additional markets to retain the

economic viability of the project. Eastern Shore has had discussions with several potential new customers who have interest in the project; their participation in the project could offset the impact of the increased project cost. The ultimate success of the E3 project, however, depends upon a number of external factors which cannot be predicted at this time.

Rate Matters. On October 31, 2006 Eastern Shore filed a Section 4 base rate proceeding with the FERC in compliance with the settlement approved in its prior base rate proceeding. Eastern Shore's filed rates, proposed to be effective November 1, 2006, reflect an annual increase of \$5,589,000 over its current annual operating revenues. The proposed rates reflect increases in operating and maintenance expenses, depreciation expense, taxes other than income taxes, and return on new gas plant facilities placed into service before March 31, 2007.

On November 30, 2006 the FERC issued its *Order Accepting and Suspending Tariff Sheets Subject to Refund and Establishing a Hearing*. The FERC accepted and suspended the effectiveness of Eastern Shore's rate increase until May 1, 2007, subject to refund and the outcome of the hearing established in the order. On December 19, 2006 the FERC's Presiding Administrative Law Judge approved a procedural schedule to govern further proceedings in this case.

An initial settlement conference was held on April 17, 2007 at the FERC's offices in Washington, D.C. On May 14, 2007, Eastern Shore filed a motion to implement its suspended rate increase on May 15, 2007, subject to refund, pending ultimate resolution of the rate case. The Parties reached an agreement in principle at the June 6, 2007 conference. On June 8, 2007, the Chief Administrative Law Judge suspended the procedural schedule to allow time for the Parties to memorialize the settlement in principle into a formal Stipulation and Agreement ("Stipulation"). The Stipulation is currently being circulated among the Parties for final review and revisions. It is anticipated that the Stipulation will be forwarded to the FERC for final approval in the second half of 2007.

### **Competition**

The Company's natural gas operations compete with other forms of energy including electricity, oil and propane. The principal competitive factors are price, and to a lesser extent, accessibility. The Company's natural gas distribution operations have several large volume industrial customers that have the capacity to use fuel oil as an alternative to natural gas. When oil prices decline, these interruptible customers convert to oil to satisfy their fuel requirements. Lower levels of interruptible sales occur when oil prices are lower than the price of natural gas. Oil prices, as well as the prices of electricity and other fuels, are subject to fluctuation for a variety of reasons; therefore, future competitive conditions are not predictable. To address this uncertainty, the Company uses flexible pricing arrangements on both the supply and sales side of this business to maximize sales volumes. As a result of the transmission operation's conversion to open access and the Florida gas distribution division's restructuring of its services, their businesses have shifted from providing competitive sales service to providing transportation and contract storage services.

The Company's natural gas distribution operations in Delaware, Maryland and Florida offer transportation services to certain commercial and industrial customers. In 2002, the Florida operation extended transportation service to residential customers. With transportation service available on the Company's distribution systems, the Company is competing with third-party suppliers to sell gas to industrial customers. As it relates to transportation services, the Company's competitors include interstate transmission companies if the distribution customer is located close enough to a transmission company's pipeline to make a connection economically feasible. The customers at risk are usually large volume commercial and industrial customers with the financial resources and capability to bypass the Company's distribution operations in this manner. In certain situations, the Company's distribution operations may adjust services and rates for these customers to retain their business. The Company expects to continue to expand the availability of transportation service to additional classes of distribution customers in the future. The Company established a natural gas sales and

supply operation in Florida to compete for customers eligible for transportation services. The Company also provides sales service in Delaware.

The Company's propane distribution operations compete with several other propane distributors in their service territories, primarily on the basis of service and price, emphasizing reliability of service and responsiveness. Competition is generally from local outlets of national distribution companies and local businesses; because distributors located in close proximity to customers incur lower costs of providing service. Propane competes with electricity as an energy source, because it is typically less expensive than electricity, based on equivalent BTU value. Propane also competes with home heating oil as an energy source. Since natural gas has historically been less expensive than propane, propane is generally not distributed in geographic areas serviced by natural gas pipeline or distribution systems.

The propane wholesale marketing operation competes against various marketers, many of which have significantly greater resources and are able to obtain price or volumetric advantages.

The advanced information services business faces significant competition from a number of larger competitors having substantially greater resources available to them than does the Company. In addition, changes in the advanced information services business are occurring rapidly, which could adversely impact the markets for the products and services offered by these businesses. This segment competes on the basis of technological expertise, reputation and price.

#### **Inflation**

Inflation affects the cost of supply, labor, products and services required for operations, maintenance and capital improvements. While the impact of inflation has remained low in recent years, natural gas and propane prices are subject to rapid fluctuations. Fluctuations in natural gas prices are passed on to customers through the gas cost recovery mechanism in the Company's tariffs. To help cope with the effects of inflation on its capital investments and returns, the Company seeks rate relief from regulatory commissions for its regulated operations while monitoring the returns of its unregulated business operations. To compensate for fluctuations in propane gas prices, the Company adjusts its propane selling prices to the extent allowed by the market.

#### **Recent Authoritative Pronouncements on Financial Reporting and Accounting**

Recent accounting developments and their impact on our financial position, results of operations and cash flows are described in Note 5 to the unaudited condensed consolidated financial statements.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Market risk represents the potential loss arising from adverse changes in market rates and prices. Long-term debt is subject to potential losses based on changes in interest rates. The Company's long-term debt consists of first mortgage bonds, fixed-rate senior notes and convertible debentures. All of the Company's long-term debt is fixed-rate debt and was not entered into for trading purposes. The carrying value of long-term debt, including current maturities, was \$77.6 million at June 30, 2007, as compared to a fair value of \$79.4 million, based mainly on current market prices or discounted cash flows, using current rates for similar issues with similar terms and remaining maturities. The Company evaluates whether to refinance existing debt or permanently refinance existing short-term borrowing, based in part on the fluctuation in interest rates.

The Company's propane distribution business is exposed to market risk as a result of propane storage activities and fixed price contracts for supply. The Company can store up to approximately four million gallons (including leased storage and rail cars) of propane during the winter season to meet its customers' peak requirements and to serve metered customers. Decreases in the wholesale price of propane may cause the value of stored propane to decline. To mitigate the impact of price fluctuations, the Company has adopted a Risk Management Policy that allows the propane distribution operation to enter into fair value hedges of its

inventory. Management reviewed the Company's storage position as of June 30, 2007 and elected not to hedge any of its inventories.

The Company's propane wholesale marketing operation is a party to natural gas liquids ("NGL") forward contracts, primarily propane contracts, with various third parties. These contracts require that the propane wholesale marketing operation purchase or sell NGL at a fixed price at fixed future dates. At expiration, the contracts are settled by the delivery of NGL to the Company or the counter-party or booking out the transaction (booking out is a procedure for financially settling a contract in lieu of the physical delivery of energy). The propane wholesale marketing operation also enters into futures contracts that are traded on the New York Mercantile Exchange. In certain cases, the futures contracts are settled by the payment or receipt of a net amount equal to the difference between the current market price of the futures contract and the original contract price; however, they may also be settled for physical receipt or delivery of propane.

The forward and futures contracts are entered into for trading and wholesale marketing purposes. The propane wholesale marketing business is subject to commodity price risk on its open positions to the extent that market prices for NGL deviate from fixed contract settlement prices. Market risk associated with the trading of futures and forward contracts are monitored daily for compliance with the Company's Risk Management Policy, which includes volumetric limits for open positions. To manage exposures to changing market prices, open positions are marked up or down to market prices and reviewed by the Company's oversight officials on a daily basis. In addition, the Risk Management Committee reviews periodic reports on market and the credit risk of counter-parties, approves any exceptions to the Risk Management Policy (within limits established by the Board of Directors) and authorizes the use of any new types of contracts. Quantitative information on forward and futures contracts at June 30, 2007 is presented in the following table.

| <b>At June 30, 2007</b>  | <b>Quantity in<br/>gallons</b> | <b>Estimated Market<br/>Prices</b> | <b>Weighted Average<br/>Contract Prices</b> |
|--------------------------|--------------------------------|------------------------------------|---|
| <b>Forward Contracts</b> |                                |                                    |   |
| Sale                     | 62,081,838                     | \$0.8850 — \$1.2100                | \$1.1209                                    |
| Purchase                 | 59,934,000                     | \$0.8700 — \$1.2000                | \$1.1256                                    |

*Estimated market prices and weighted average contract prices are in dollars per gallon.  
All contracts expire in 2007 or the first quarter 2008.*

#### **Item 4. Controls and Procedures**

##### **Evaluation of Disclosure Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer of the Company, with the participation of other Company officials, have evaluated the Company's "disclosure controls and procedures" (as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended) as of June 30, 2007. Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2007.

##### **Changes in Internal Control Over Financial Reporting**

During the quarter ended June 30, 2007, there was no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART II — OTHER INFORMATION

### Item 1. Legal Proceedings

As disclosed in Note 4 "Commitments and Contingencies" of the unaudited condensed consolidated financial statements, the Company is involved in certain legal actions and claims arising in the normal course of business. The Company is also involved in certain legal and administrative proceedings before various government agencies concerning rates. In the opinion of management, the ultimate disposition of these proceedings and claims will not have a material effect on the consolidated financial position, results of operations or cash flows of the Company.

### Item 1A. Risk Factors

In addition to the other information set forth in this Form 10-Q, including the risks and uncertainties described under Item 2 of the MD&A hereof entitled "Safe Harbor and Forward Looking Statements," consideration should be given to the factors discussed under "Item 1A. Risk Factors" in the Company's Form 10-K for the fiscal year ended December 31, 2006. These risks could affect the operations and/or financial performance of the Company. The risks described in the Form 10-K and this Form 10-Q are not the only risks that the Company faces. The Company's operations and/or financial performance could also be affected by additional factors that are not presently known to it or that the Company considers immaterial to its operations and/or financial performance.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

| Period                                      | Total<br>Number of<br>Shares<br>Purchased | Average<br>Price Paid<br>per Share | Total Number of Shares<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs (2) | Maximum Number of<br>Shares That May Yet Be<br>Purchased Under the<br>Plans or Programs (2) |
|---|---|------------------------------------|---|---|
| April 1, 2007<br>through April 30, 2007 (1) | 505                                       | \$31.22                            | 0   | 0   |
| May 1, 2007<br>through May 31, 2007         | 0   | \$0.00                             | 0   | 0   |
| June 1, 2007<br>through June 30, 2007       | 0   | \$0.00                             | 0   | 0   |
| <b>Total</b>                                | <b>505</b>                                | <b>\$31.22</b>                     | <b>0</b>  | <b>0</b>  |

(1) Chesapeake purchased shares of stock on the open market for the purpose of reinvesting the dividend on shares held in Rabbi Trust accounts for certain Senior Executives. During the quarter, 505 shares were purchased through executive dividend deferrals.

(2) Except for the purpose described in Footnote (1), Chesapeake has no publicly announced plans or programs to repurchase its shares.

### Item 3. Defaults upon Senior Securities

None

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

The Annual Meeting of the Stockholders of Chesapeake Utilities Corporation was held on May 2, 2007. The items set forth below were submitted to a vote of security holders. Proxies for the meeting were solicited in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended. Broker non-votes had no effect on the outcome of the vote on these matters.

The stockholders elected three nominees to the Company's Board of Directors to serve as Class II directors for three-year terms ending in 2010, and until their successors are duly elected and qualified.

The following shows the separate tabulation of votes for each nominee:

| <b>Name</b>       | <b>Votes For</b> | <b>Votes Withheld</b> |
|-------------------|------------------|-----------------------|
| Ralph J. Adkins   | 6,072,913        | 297,758               |
| Richard Bernstein | 6,181,633        | 189,038               |
| J. Peter Martin   | 6,222,313        | 148,358               |

The terms of the following directors were not subject to re-nomination or re-election on May 2, 2007 and their terms are continuing:

| <b>Class III Directors (Terms Expire in 2008)</b> | <b>Class I Directors (Terms Expire in 2009)</b> |
|---|---|
| Thomas J. Bresnan                                 | Calvert A. Morgan, Jr.                          |
| Walter J. Coleman                                 | Eugene H. Bayard                                |
| Joseph E. Moore                                   | Thomas P. Hill, Jr.                             |
| John R. Schimkaitis                               |   |

The stockholders approved the ratification of the appointment of Beard Miller Company LLP as the Company's independent auditors for the fiscal year ending December 31, 2007. There were 6,299,634 affirmative votes, 54,095 negative votes, and 16,942 abstentions.

As of the Record Date, March 15, 2007, 6,717,348 shares of common stock of the Company, the only outstanding class of voting or equity securities of the Company, were outstanding.

**Item 5. Other Information**  
None

**Item 6. Exhibits**  
The exhibits listed on the following Exhibit Index are filed as part of this Report. Exhibits required by Item 601 of Regulation S-K, but which are not listed below, are not applicable.

| <b>Exhibit</b> | <b>Description</b>  |
|----------------|---|
| 31.1           | Certificate of Chief Executive Officer of Chesapeake Utilities Corporation pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, dated August 9, 2007 |
| 31.2           | Certificate of Chief Financial Officer of Chesapeake Utilities Corporation pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, dated August 9, 2007 |
| 32.1           | Certificate of Chief Executive Officer of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated August 9, 2007                                   |
| 32.2           | Certificate of Chief Financial Officer of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated August 9, 2007                                   |



## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHESAPEAKE UTILITIES CORPORATION

/s/ MICHAEL P. MCMASTERS

Michael P. McMasters

Senior Vice President and Chief Financial Officer

Date: August 9, 2007

**CERTIFICATE PURSUANT TO RULE 13A-14(A)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, John R. Schimkaitis, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended June 30, 2007 of Chesapeake Utilities Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007

/S/ JOHN R. SCHIMKAITIS

John R. Schimkaitis

President and Chief Executive Officer

**CERTIFICATE PURSUANT TO RULE 13A-14(A)  
UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, Michael P. McMasters, certify that:

1. I have reviewed this quarterly report on Form 10-Q for the quarter ended June 30, 2007 of Chesapeake Utilities Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation;
  - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) all significant deficiencies and material weakness in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2007

/s/ MICHAEL P. McMASTERS

Michael P. McMasters

Senior Vice President and Chief Financial Officer

**Certificate of Chief Executive Officer**

**of**

**Chesapeake Utilities Corporation**

**(pursuant to 18 U.S.C. Section 1350)**

I, John R. Schimkaitis, President and Chief Executive Officer of Chesapeake Utilities Corporation, certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of Chesapeake Utilities Corporation ("Chesapeake") for the period ended June 30, 2007, filed with the Securities and Exchange Commission on the date hereof (i) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Chesapeake.

/s/ JOHN R. SCHIMKAITIS

John R. Schimkaitis

August 9, 2007

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Chesapeake Utilities Corporation and will be retained by Chesapeake Utilities Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

**Certificate of Chief Financial Officer**

**of**

**Chesapeake Utilities Corporation**

**(pursuant to 18 U.S.C. Section 1350)**

I, Michael P. McMasters, Senior Vice President and Chief Financial Officer of Chesapeake Utilities Corporation, certify that, to the best of my knowledge, the Quarterly Report on Form 10-Q of Chesapeake Utilities Corporation ("Chesapeake") for the period ended June 30, 2007, filed with the Securities and Exchange Commission on the date hereof (i) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and (ii) the information contained therein fairly presents, in all material respects, the financial condition and results of operations of Chesapeake.

/S/ MICHAEL P. MCMASTERS  
Michael P. McMasters  
August 9, 2007

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Chesapeake Utilities Corporation and will be retained by Chesapeake Utilities Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

CHESAPEAKE UTILITIES CORPORATION  
 2007 SUMMARY OF ESTIMATED CAPITAL EXPENDITURES  
 DISTRIBUTION UTILITY PLANT  
 UNAUDITED

EXHIBIT B

| <u>PLANT<br/>ACCOUNT<br/>NUMBER</u> | <u>DESCRIPTION</u>            | <u>TOTAL<br/>2007 CAPITAL<br/>ESTIMATED</u> |
|-------------------------------------|-------------------------------|---|
| 301                                 | ORGANIZATION                  | \$0   |
| 302                                 | FRANCHISE AND CONSENTS        | \$0   |
| 303                                 | INTANGIBLE PLANT              | \$0   |
| 304                                 | LAND AND LAND RIGHTS          | \$0   |
| 305                                 | STRUCTURES AND IMPROVEMENTS   | \$0   |
| 311                                 | PROPANE PLANT                 | \$0   |
| 374                                 | LAND AND LAND RIGHTS          | \$0   |
| 375                                 | STRUCTURES AND IMPROVEMENTS   | \$635,000                                   |
| 376                                 | MAINS                         | \$2,336,030                                 |
| 378                                 | M & R STATIONS - GENERAL      | \$107,681                                   |
| 379                                 | M & R STATIONS - CITY GATE    | \$61,599                                    |
| 380                                 | SERVICES                      | \$1,220,562                                 |
| 381                                 | METERS                        | \$767,850                                   |
| 382                                 | METER INSTALLATIONS           | \$362,000                                   |
| 383                                 | HOUSE REGULATORS              | \$127,500                                   |
| 384                                 | REGULATOR INSTALLATIONS       | \$0   |
| 385                                 | INDUSTRIAL M & R STATION      | \$66,000                                    |
| 387                                 | OTHER EQUIPMENT               | \$91,750                                    |
| 389                                 | LAND AND LAND RIGHTS          | \$0   |
| 390                                 | STRUCTURES AND IMPROVEMENTS   | \$25,000                                    |
| 391                                 | OFFICE AND EQUIPMENT          | \$56,610                                    |
| 392                                 | TRANSPORTATION                | \$241,545                                   |
| 393                                 | STORES EQUIPMENT              | \$0   |
| 394                                 | TOOLS, SHOP, AND GARAGE EQUIP | \$10,000                                    |
| 395                                 | LABORATORY EQUIPMENT          | \$0   |
| 396                                 | POWER OPERATED EQUIPMENT      | \$0   |
| 397                                 | COMMUNICATION EQUIPMENT       | \$174,480                                   |
| 398                                 | MISCELLANEOUS EQUIPMENT       | \$7,500                                     |
| 399                                 | OTHER TANGIBLE PROPERTY       | \$0   |
| TOTAL CAPITAL EXPENDITURES          |                               | -----<br>\$6,291,107<br>=====               |

SOURCES AND USES OF FUNDS

The proceeds from stock and debt issuances will be used to administer the Company's Retirement Savings Plan, Performance Incentive Plan, Automatic Dividend Reinvestment and Stock Purchase Plan, Directors Stock Compensation Plan, Employee Awards Stock Plan, and Convertible Debentures, as well as for other corporate purposes including, but not limited to, working capital, retirement of short-term debt, retirement of long-term debt, capital improvements and/or acquisitions.

Baker Hostetler

Baker & Hostetler LLP

Capitol Square, Suite 2100  
65 East State Street  
Columbus, OH 43215-4260

T 614.228.1541  
F 614.462.2616  
www.bakerlaw.com

January 30, 2007

**CERTIFIED MAIL, RETURN RECEIPT REQUESTED**

Georgeann G. Peters  
direct dial: 614.462.4769  
gpeters@bakerlaw.com

Internal Revenue Service  
P.O. Box 192  
Covington, KY 41012-0192

Re: *Chesapeake Utilities Corporation (the "Company")*  
*EIN: 51-0064146*  
*Chesapeake Utilities Corporation Retirement Savings Plan (the "Plan")*

Dear Sir or Madam:

On behalf of the Company, we submit the following documents in application for a favorable determination letter for the Plan. **Please note that there are two separate plans that are a part of this submission.**

1. Form 8717 (*User Fee for Employee Plan Determination Letter Request*), and a check in the amount of \$1,000.00 made payable to the United States Treasury.
2. Form 2848 (*Power of Attorney and Declaration of Representative*) authorizing Leigh Ann Wilson or me to represent the Company in connection with the Plan's application for a favorable determination letter.
3. Form 5300 (*Application for Determination for Employee Benefit Plan*) with an executed original Page 1.
4. An attachment for various items to Form 5300.
5. Schedule Q (*Elective Determination Requests*) to Form 5300.
6. Form 5309 (*Application for Determination of Employee Stock Ownership Plan*) for the ESOP component of the Plan.
7. A copy of the following Plan documents and amendments executed since the Plan's last determination letter:

- A. Secretary's Certificate containing the Plan's good faith EGTRRA amendment effective as of January 1, 2002 and approved by the Company's Board of Directors on May 21, 2002.
  - B. Resolutions of the Board of Directors dated September 24, 2004 approving an amendment to the Plan effective January 1, 2005.
  - C. Secretary's Certificate containing an amendment to the Plan effective as of July 1, 2005 (March 28, 2005 where applicable) and approved by the Company's Board of Directors on May 5, 2005.
  - D. Amended and restated Plan document, effective July 1, 2005 and executed July 1, 2005.
  - E. Secretary's Certificate containing an amendment to the Plan effective July 1, 2006 and approved by the Company's Board of Directors on June 15, 2006.
  - F. Amended and restated Plan document, effective January 1, 2006 and executed December 29, 2006.
8. A copy of the latest favorable determination letter for the Plan, dated March 8, 2002.

A favorable determination is hereby requested on the Plan's qualification under the current provisions of Section 401 *et. seq.* and 501 *et. seq.* of the Internal Revenue Code of 1986, as amended. If, for any reason, you anticipate that an unfavorable determination may be issued with respect to the Plan's qualification, a conference is hereby requested prior to the issuance of any such unfavorable determination. If you have any questions or need additional information, please contact me.

Sincerely,



Georgeann G. Peters

Enclosures

cc: Beth W. Cooper, (w/ encl.)



As filed with the Securities and Exchange Commission on July 5, 2006

Registration No. 333-\_\_\_\_\_

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT  
UNDER  
THE SECURITIES ACT OF 1933

**Chesapeake Utilities Corporation**

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

**Delaware**

*(State or other jurisdiction of incorporation or organization)*

**51-0064146**

*(I.R.S. Employer Identification No.)*

**909 Silver Lake Boulevard  
Dover, Delaware 19904  
(302) 734-6799**

*(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)*

**Michael P. McMasters, Senior Vice President &  
Chief Financial Officer**

**Chesapeake Utilities Corporation  
909 Silver Lake Boulevard  
Dover, Delaware 19904  
(302) 734-6799**

*(Name, address, including zip code, and telephone number, including area code, of agent for service)*

*Copies to:*

**Jeffrey E. Decker, Esq.  
Baker & Hostetler LLP  
2300 SunTrust Center  
200 S. Orange Avenue  
Orlando, Florida 32801  
(407) 649-4000**

**Approximate date of commencement of proposed sale to the public:** From time to time after the effective date of this Registration Statement.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. [ ]

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [X]

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

\_\_\_\_\_

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) under the Securities Act, check the following box. [ ]

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If this form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) under the Securities Act, check the following box. [ ]

**CALCULATION OF REGISTRATION FEE**

| Title of each class of securities to be registered | Amount to be registered<br>(1) | Proposed maximum offering price per unit<br>(1) | Proposed maximum aggregate offering price<br>(1) | Amount of registration fee<br>(1) |
|--|--------------------------------|---|--|-----------------------------------|
| Common Stock, par value per share \$0.4867         |                                |   |  |                                   |
| <u>Debt Securities</u>                             |                                |   |  |                                   |
| TOTAL  |                                |   | \$40,000,000.00                                  | \$4,280.00                        |

- (1) The Registrant is registering an indeterminate aggregate initial offering price and number of shares of common stock, par value per share \$0.4867, and an indeterminate aggregate amount of debt securities, as may from time to time be offered at indeterminate prices. The maximum aggregate offering price for all securities that the Registrant is registering is \$40 million. Separate consideration may or may not be received for securities that are issuable on exercise, conversion or exchange of other securities. In accordance with Rule 457 (o), the Registrant is required to specify only the maximum aggregate offering price for all classes of securities being registered.

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The Registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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## PROSPECTUS

**Chesapeake Utilities Corporation****Common Stock and Debt Securities**

We may offer, from time to time in one or more offerings, in amounts, at prices and on terms that we will determine at the time of offering, shares of our common stock, par value per share \$0.4867 (the "Common Stock"), and/or debt securities. We will provide the specific terms of any offering of Common Stock and/or debt securities in supplements to this prospectus. The prospectus supplements will also describe the specific manner in which we will offer these securities and may also supplement, update or amend information contained in this prospectus. You should read this prospectus, the applicable prospectus supplement, and any documents incorporated by reference into this prospectus carefully before you invest.

We may sell Common Stock and/or debt securities on a continuous or delayed basis directly, through agents, dealers or underwriters as designated from time to time, or through a combination of these methods. If any agents, dealers or underwriters are involved in the sale of any securities, the applicable prospectus supplement will set forth any applicable commissions or discounts. Our net proceeds from the sale of securities also will be set forth in the applicable prospectus supplement.

Our Common Stock is listed on the New York Stock Exchange under the symbol, "CPK." The last reported sale price of our common shares on the New York Stock Exchange on [\_\_\_\_], 2006 was \$[\_\_\_\_] per share.

**These Securities have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission, nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.**

The date of this prospectus is [\_\_\_\_], 2006.

**We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained or incorporated by reference in this prospectus or any applicable supplement to this prospectus. You must not rely upon any information or representation not contained or incorporated by reference in this prospectus or any applicable supplement to this prospectus as if we had authorized it. This prospectus and any applicable prospectus supplement do not constitute an offer to sell or the solicitation of an offer to buy any securities other than the registered securities to which they relate. Nor do this prospectus and any accompanying prospectus supplement constitute an offer to sell or the solicitation of an offer to buy securities in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction. You should not assume that the information contained in this prospectus or any applicable prospectus supplement is correct on any date after its date, even though this prospectus or a supplement is delivered or securities are sold on a later date.**

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## FORWARD-LOOKING INFORMATION

This prospectus and the applicable prospectus supplements include and incorporate by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally identifiable by use of the words “believe,” “expect,” “intend,” “anticipate,” “plan,” “estimate,” “project” or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Actual results could differ materially from those in forward-looking statements because of, among other reasons, the factors described under the caption “Risk Factors” in the periodic reports that we file with the Securities and Exchange Commission. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission using a “shelf” registration process. Under this shelf process, we may sell any combination of our Common Stock and/or debt securities described in this prospectus in one or more offerings up to a total amount of \$40,000,000.00. This prospectus only provides you with a general description of the securities we may offer. Each time we sell securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and the applicable prospectus supplement together with additional information described under the headings, “Where You Can Find More Information” and “Incorporation of Certain Information by Reference.”

Unless otherwise indicated or unless the context requires otherwise, all references in this prospectus to “we,” “us,” “our,” the “Company,” the “Registrant” or “Chesapeake” mean Chesapeake Utilities Corporation and all entities owned or controlled by Chesapeake Utilities Corporation. When we refer to our “Certificate of Incorporation,” we mean Chesapeake Utilities Corporation’s Amended Certificate of Incorporation, and when we refer to our “Bylaws,” we mean Chesapeake Utilities Corporation’s Amended Bylaws.

### WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC") pursuant to the Exchange Act. Such filings are available to the public from the SEC's website at <http://www.sec.gov>. You may also read and copy any document we file with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain copies of any document filed by us at prescribed rates by writing to the Public Reference Section of the SEC at that address. You may obtain information about the operation of the SEC's Public Reference Room by calling the SEC at 1-800-SEC-0330. You may inspect reports and other information that we file at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005. Information about us, including our filings, is also available on our website at <http://www.chpk.com>; however, that information is not part of this prospectus or any accompanying prospectus supplement.

We have filed a registration statement, of which this prospectus is a part, and related exhibits with the SEC under the Securities Act. That registration statement contains additional information about us and the Common Stock and debt securities. You may inspect the registration statement and exhibits without charge at the SEC's Public Reference Room or at the SEC's web site set forth above, and you may obtain copies from the SEC at prescribed rates.

### INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC allows us to "incorporate by reference" the information contained in documents we file with the SEC, which means that we can disclose important information to you by referring to those documents. The information incorporated by reference is an important part of this prospectus. Any statement contained in a document that is incorporated by reference in this prospectus is automatically updated and superseded if information contained in this prospectus, or information that we later file with the SEC, modifies or replaces that information. Any statement made in this prospectus or any prospectus supplement concerning the contents of any contract, agreement or other document is only a summary of the actual contract, agreement or other document. If we have filed or incorporated by reference any contract, agreement or other document as an exhibit to the registration statement, you should read the exhibit for a more complete understanding of the document or matter involved. Each statement regarding a contract, agreement or other document is qualified in its entirety by reference to the actual document.

We incorporate by reference the following documents we filed, excluding any information contained therein or attached as exhibits thereto which has been furnished to, but not filed with, the SEC:

- (a) Our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, filed on March 7, 2006;
- (b) Our Current Report on Form 8-K dated March 11, 2006, filed on March 16, 2006;
- (c) Our definitive Proxy Statement on Schedule 14A filed on March 31, 2006;
- (d) Our Current Report on Form 8-K dated May 2, 2006, filed on May 3, 2006;
- (e) Our Current Report on Form 8-K dated May 1, 2006, filed on May 5, 2006;
- (f) Our Current Report on Form 8-K dated May 5, 2006, filed on May 5, 2006;

- (g) Our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed on May 10, 2006;
- (h) Our Current Report on Form 8-K dated May 31, 2006, filed on June 2, 2006;
- (i) Our Current Report on Form 8-K dated June 13, 2006, filed on June 19, 2006;
- (j) The description of our preferred stock purchase rights contained in our Registration Statement on Form 8-A filed on August 24, 1999, and all amendments or reports filed with the SEC for the purpose of updating such description, and further described in the section, "Description of Common Stock"; and
- (k) The description of our Common Stock contained in our registration statements filed pursuant to Section 12 of the Exchange Act, and all amendments or reports filed with the SEC for the purpose of updating such description, and further described in the section, "Description of Common Stock."

Any documents we file pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and prior to the termination of the offering of the securities to which this prospectus relates will automatically be deemed to be incorporated by reference in this prospectus and a part of this prospectus from the date of filing such documents; provided however, that we are not incorporating, in each case, any documents or information contained therein that has been furnished to, but not filed with, the SEC.

To receive a free copy of any of the documents incorporated by reference in this prospectus (other than exhibits, unless they are specifically incorporated by reference in any such documents), call or write Chesapeake Utilities Corporation, 909 Silver Lake Boulevard, Dover, Delaware 19904, Attention: Michael P. McMasters, Senior Vice President and Chief Financial Officer, telephone number (302) 734-6799. We also maintain a web site that contains additional information about us (<http://www.chpk.com>).

You should rely only on the information incorporated by reference or set forth in this prospectus or the applicable prospectus supplement. We have not authorized anyone else to provide you with different information. We may only use this prospectus to sell securities if it is accompanied by a prospectus supplement. We are offering these securities only in states where the offer is permitted.

You should not assume that the information in this prospectus or the applicable prospectus supplement is accurate as of any date other than the dates on the front pages of these documents.

## THE COMPANY

We are a diversified utility company engaged directly or through subsidiaries in natural gas distribution, transmission and marketing, propane distribution and wholesale marketing, advanced information services and other related businesses. We are a Delaware corporation that was formed in 1947. Our three natural gas distribution divisions serve approximately 54,800 residential, commercial and industrial customers in central and southern Delaware, Maryland's Eastern Shore and parts of Florida. Our natural gas transmission subsidiary, Eastern Shore Natural Gas Company, operates a 331-mile interstate pipeline system that transports gas from various points in Pennsylvania to our Delaware and Maryland distribution divisions, as well as to other utilities and industrial customers in southern Pennsylvania, Delaware and on the Eastern Shore of Maryland. Our propane distribution operation serves approximately 32,900 customers in central and southern Delaware, the Eastern Shore of Maryland and Virginia, southeastern Pennsylvania, and parts of Florida; and our wholesale propane marketing subsidiary markets propane to large independent and petrochemical companies, resellers and retail propane companies in the United States. Our advanced information services segment provides domestic and international clients with information technology-related business services and solutions for both enterprise and e-business applications.

Our principal executive office is located at 909 Silver Lake Boulevard, Dover, Delaware 19904, and our telephone number is (302) 734-6799. Our website address is <http://www.chpk.com>. Information on our website does not constitute part of this prospectus.

## USE OF PROCEEDS

Unless otherwise specified in a prospectus supplement, the net proceeds from the sale of Common Stock and/or debt securities will be added to our general corporate funds and may be used for general corporate purposes including, but not limited to, financing of capital expenditures, repayment of short-term debt, funding share repurchases, financing acquisitions, investing in subsidiaries and general working capital purposes. Prior to such application, all or a portion of the net proceeds may be invested in short-term investments.

## DESCRIPTION OF COMMON STOCK

Our Certificate of Incorporation authorizes us to issue up to 12,000,000 shares of Common Stock, par value per share \$0.4867. As of March 31, 2006, we had 5,931,487 shares of Common Stock outstanding. In addition, as of March 31, 2006, we have reserved 572,373 shares of Common Stock for issuance under our equity-based compensation plans and 30,000 shares of Common Stock for issuance upon the exercise of warrants. Our Certificate of Incorporation also authorizes us to issue up to 2,000,000 shares of preferred stock, par value per share \$0.01; however, no shares of preferred stock are outstanding. Our Common Stock is listed on the New York Stock Exchange under the symbol, "CPK." The transfer agent and registrar of the Common Stock is Computershare Trust Company, N.A., P.O. Box 43010, Providence, Rhode Island 02940-3010.

The following descriptions of our Common Stock and preferred stock set forth certain of their general terms and provisions. The following descriptions are in all respects subject to and qualified by reference to the applicable provisions of our Certificate of Incorporation and our Bylaws.



Holders of our Common Stock are entitled to receive dividends when, as and if declared by our Board of Directors, out of funds legally available therefor. If we are liquidated, dissolved or involved in any winding-up, the holders of our Common Stock are entitled to receive ratably any assets legally available for distribution to holders of Common Stock. Holders of our Common Stock possess ordinary voting rights, with each share entitling the holder to one vote. Directors are elected by a plurality of the votes cast by the holders of our Common Stock present in person or represented by proxy at the meeting and entitled to vote for the election of directors. Holders of our Common Stock do not have preemptive rights, which means that they have no right to acquire any additional shares of Common Stock that we may subsequently issue (other than pursuant to the Rights, described below). Holders of our Common Stock also do not have conversion or subscription rights, and the Common Stock is not subject to redemption by the Company.

All of our shares of Common Stock currently outstanding are, and any shares of Common Stock offered hereby when issued will be, fully paid and nonassessable.

We may issue preferred stock from time to time, by authorization of our Board of Directors and without the necessity of further action or authorization by our stockholders, in one or more series and with such voting powers, designations, preferences and relative, participating, optional or other special rights and qualifications as our Board may, in its discretion, determine, including, but not limited to (a) the distinctive designation of such series and the number of shares to constitute such series; (b) the dividends, if any, for such series; (c) the voting power, if any, of shares of such series; (d) the terms and conditions (including price), if any, upon which shares of such stock may be converted into or exchanged for shares of stock of any other class or any other series of the same class or any other securities or assets; (e) our right, if any, to redeem shares of such series and the terms and conditions of such redemption; (f) the retirement or sinking fund provisions, if any, of shares of such series and the terms and provisions relative to the operation thereof; (g) the amount, if any, which the holders of the shares of such series shall be entitled to receive in case of our liquidation, dissolution or winding-up; (h) the limitations and restrictions, if any, upon the payment of dividends or the making of other distributions on, and upon our purchase, redemption, or other acquisition of, our Common Stock; and (i) the conditions or restrictions, if any, upon the creation of indebtedness or upon the issuance of any additional stock.

Under our Certificate of Incorporation, the affirmative vote of not less than 75% of the total voting power of all outstanding shares of our stock is required to approve our merger or consolidation with, or the sale of all or substantially all of our assets or business to, any other corporation (other than a corporation 50% or more of the common stock of which we own), if such corporation or its affiliates singly or in the aggregate own or control directly or indirectly 5% or more of our outstanding shares of Common Stock, unless the transaction is approved by our Board of Directors prior to the acquisition by such corporation or its affiliates of ownership or control of 5% or more of our outstanding shares of Common Stock. In addition, our Certificate of Incorporation provides for a classified Board of Directors under which one-third of the members are elected annually for three-year terms. The supermajority voting requirement for certain mergers and consolidations and our classified Board of Directors may have the effect of delaying, deferring or preventing a change in control of the Company.

On August 25, 1999, we filed with the SEC a Registration Statement on Form 8-A with respect to Rights (defined below) to purchase our Series A Participating Cumulative Preferred Stock, par value per share \$0.01 (the "Preferred Shares"). On August 20, 1999, our Board of Directors declared a dividend distribution of one preferred share purchase right (a "Right") for each outstanding share of our Common Stock. The dividend was payable to the stockholders of record on September 3, 1999 (the "Record Date"). One Right will also be issued with each share of Common Stock issued thereafter until the Distribution Date (defined below) and, in certain circumstances, with each share of Common Stock issued after the Distribution Date. Except as set forth below, each Right, when it becomes exercisable, entitles the registered holder to purchase from the Company one-fiftieth of a Preferred Share at a price of \$54.56 (the "Purchase Price"), subject to adjustment. The description and terms of the Rights and the definition of the "Distribution Date" are set forth in a Rights Agreement (the "Rights Agreement") between the Corporation and Computershare Trust Company, N.A., successor to BankBoston, N.A., as Rights Agent (the "Rights Agent"), dated as of August 20, 1999. The Rights are not exercisable until the Distribution Date and will expire at the close of business on August 20, 2009, unless earlier redeemed by the Company. The Registration Statement on Form 8-A, and the Rights Agreement attached thereto as an exhibit, are incorporated herein by reference. This description of the Rights, the Rights Agreement and the Preferred Shares is in all respects subject to and qualified by reference to the Registration Statement on Form 8-A, the Rights Agreement attached thereto as an exhibit and the applicable provisions of our Certificate of Incorporation and our Bylaws.

The Preferred Shares purchasable upon exercise of the Rights will not be redeemable. Each Preferred Share will be entitled to a minimum preferential quarterly dividend payment equal to the greater of (i) \$13.00 per share (or \$0.26 per 1/50th of a Preferred Share) and (ii) an aggregate dividend per share of 50 times (subject to adjustment) the dividend declared per share of Common Stock. In the event of liquidation, the holders of the Preferred Shares will be entitled to a minimum preferential liquidation payment of \$900.00 per share (or \$18.00 per 1/50th of a Preferred Share); thereafter, and after the holders of the Common Stock receive a liquidation payment of \$18.00 per share, the holders of the Preferred Shares and the holders of the Common Stock will share the remaining assets in the ratio of 50 (subject to adjustment) to one for each Preferred Share and share of Common Stock so held, respectively. In the event of any merger, consolidation or other transaction in which Common Stock is exchanged, each Preferred Share will be entitled to receive 50 times (subject to adjustment) the amount received per share of Common Stock. The holders of Preferred Shares will be entitled to vote on all matters submitted to a vote of the Common Stock (with the Preferred Shares being entitled to 50 votes per share). In the event that the amount of accrued and unpaid dividends on the Preferred Shares is equivalent to six full quarterly dividends or more, the holders of the Preferred Shares shall have the right, voting as a class, to elect two directors in addition to the directors elected by the holders of the Common Stock until all cumulative dividends on the Preferred Shares have been paid through the last quarterly dividend payment date. These rights are protected by customary anti-dilution provisions.

Because of the nature of the dividend, liquidation and voting rights of the Preferred Shares, the value of a one-fiftieth interest in a Preferred Share purchasable upon the exercise of a Right should approximate the value of one share of Common Stock.

The Rights approved by the Board of Directors of the Company were designed to protect the value of the outstanding Common Stock in the event of an unsolicited attempt by an acquirer to take over the Company in a manner or on terms not approved by the Board of Directors. The Rights were not intended to prevent a takeover of the Company at a fair price and should not interfere with any merger or business combination approved by the Board of Directors. The Rights have no dilutive effect, nor do they affect reported earnings per share or change the way in which the Common Stock is traded.

The Rights may have the effect of rendering more difficult or discouraging an acquisition of the Company deemed undesirable by the Board of Directors. If a person or group attempts to acquire the Company on terms or in a manner not approved by the Board of Directors, then the Rights may cause such person's or group's ownership interest to become substantially diluted unless the offer includes, as a condition to the acquisition, a provision that the Rights will be purchased, redeemed or otherwise effectively eliminated.

### DESCRIPTION OF DEBT SECURITIES

A description of the debt securities that we may offer will be included in an applicable prospectus supplement.

### RATIO OF EARNINGS TO FIXED CHARGES

Our ratios of earnings to fixed charges for the fiscal years ended December 31, 2001 - 2005, were as follows:

| Time Period | Ratio |
|-------------|-------|
| 2001        | 3.23  |
| 2002        | 3.26  |
| 2003        | 3.66  |
| 2004        | 3.73  |
| 2005        | 4.10  |

Our ratio of earnings to fixed charges for the quarterly period ended March 31, 2006, was 7.38.

The ratio of earnings to fixed charges is computed by dividing fixed charges into earnings plus fixed charges. For purposes of computing this ratio, earnings have been calculated as pretax income from continuing operations before adjustment for minority interests in consolidated subsidiaries. Fixed charges include a portion of rents representative of the interest factor, interest on indebtedness and the amortization of debt discounts and expenses.

### PLAN OF DISTRIBUTION

We may sell securities offered pursuant to any applicable prospectus supplement to one or more underwriters for public offering and sale by them or we may sell such securities to investors directly or through agents, some of which may be dealers. We may also sell the securities through a combination of these methods. The name of any underwriter or agent involved in the offer and sale of such securities will be included in the applicable prospectus supplement.

The distribution of securities offered pursuant to any applicable prospectus supplement may occur:

- (a) at a fixed price or prices, which may be changed;
- (b) at market prices prevailing at the time of sale;
- (c) at prices related to prevailing market prices; or
- (d) at negotiated prices.

From time to time, we may also authorize underwriters acting as our agents to offer and sell securities upon the terms and conditions set forth in an applicable prospectus supplement. Underwriters may be deemed to have received compensation from us in the form of underwriting discounts or commissions in connection with the sale of securities offered pursuant to any applicable prospectus supplement. Underwriters may also receive commissions from purchasers of securities for whom such underwriters may act as agent. Underwriters may sell securities offered pursuant to any applicable prospectus supplement to or through dealers. Such dealers may receive compensation in the form of discounts, concessions from the underwriters or commissions from the purchasers for whom such dealers may act as agent.

We may enter into derivative transactions with third parties, or sell securities not covered by this prospectus to third parties in privately negotiated transactions. If the applicable prospectus supplement so indicates, in connection with those derivatives, the third parties may sell securities covered by this prospectus and the applicable prospectus supplement, including short sale transactions. If so, the third party may use securities pledged by us or borrowed from us or others to settle those sales or to close out any related open borrowings of common shares, and may use securities received from us in settlement of those derivatives to close out any related open borrowings of common shares. The third party in such sale transactions will be an underwriter and, if not identified in this prospectus, will be identified in the applicable prospectus supplement or a post-effective amendment to this registration statement.

We will describe in the applicable prospectus supplement any underwriting compensation we pay to underwriters or agents in connection with any offering of securities. Likewise, we will also describe any discounts, concessions or commissions allowed by underwriters to participating dealers in the applicable prospectus supplement. Underwriters, dealers and agents participating in the distribution of the securities may be deemed to be underwriters, and any discounts and commissions received by them and any profit realized by them on resale of the securities may be deemed to be underwriting discounts and commissions. We may enter into agreements to indemnify underwriters, dealers and agents against certain civil liabilities, including liabilities under the Securities Act, and to reimburse these persons for certain expenses. We will describe any indemnification agreements in the applicable prospectus supplement.

If indicated in the applicable prospectus supplement, we may authorize dealers acting as our agents to solicit offers by certain institutions to purchase the securities from us at the public offering price set forth in such prospectus supplement pursuant to delayed delivery contracts providing for payment and delivery on the date or dates stated in the prospectus supplement. Each delayed delivery contract will be for an amount not less than the respective amounts stated in the applicable prospectus supplement. Likewise, the aggregate principal amount of the securities sold pursuant to delayed delivery contracts will not be less or more than the respective amounts stated in the applicable prospectus supplement. We may make delayed delivery contracts with various institutions, including commercial and savings banks, insurance companies, pension funds, investment companies, educational and charitable institutions, and other institutions. Delayed delivery contracts will always be subject to our approval. Delayed delivery contracts will not be subject to any conditions except the following:

- (a) The purchase by an institution of the securities covered by its delayed delivery contracts shall not at the time of delivery be prohibited under the laws of any jurisdiction in the United States to which such institution is subject; and
- (b) If the securities are being sold to underwriters, we shall have sold to such underwriters the total principal amount of the offered securities less the principal amount covered by the delayed delivery contracts.

Certain of the underwriters or their affiliates may, but will not necessarily, be customers of, engage in transactions with or perform services for us or one or more of our subsidiaries in the ordinary course of our and/or their business. It is also possible that certain of the underwriters or their affiliates may be affiliates of banking institutions or other financial services firms with which we or one or more of our subsidiaries has a pre-existing business relationship.

#### **EXPERTS**

The consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control Over Financial Reporting) incorporated in this prospectus by reference to the Annual Report on Form 10-K for the year ended December 31, 2005, have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

#### **LEGAL MATTERS**

The validity of the Common Stock and debt securities will be passed upon for the Company by Baker & Hostetler LLP, Orlando, Florida. Any underwriters will also be advised about the validity of the securities and other legal matters by their own counsel, which will be named in the prospectus supplement.

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

The following table sets forth the fees and expenses in connection with the issuance and distribution of the securities being registered hereunder. Except for the SEC registration fee, all amounts are estimates. Certain amounts that cannot be presently estimated will be provided in amendments to this registration statement.

|   |                      |
|---|----------------------|
| SEC registration fee                                | \$ 4,280.00          |
| NYSE listing fee                                    | 5,000.00             |
| Accounting fees and expenses                        | 70,000.00            |
| Legal fees and expenses (other than Blue Sky)       | 50,000.00            |
| Blue Sky fees and expenses (including counsel fees) | 5,000.00             |
| Printing and engraving expenses                     | 20,000.00            |
| Transfer agent's and registrar's fees and expenses  | 10,000.00            |
| Rating Agency fees                                  | 50,000.00            |
| Miscellaneous expenses                              | 10,000.00            |
| Total   | <u>\$ 224,280.00</u> |

**Item 15. Indemnification of Directors and Officers.**

Under the Company's Bylaws, each person who was or is made a party or is threatened to be made a party to any action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact he is or was a director or officer of the Company, or is or was serving at the request of the Company as a director or officer of another corporation or of a partnership, joint venture, trust or other enterprise (including employee benefit plans), is entitled to indemnification and to be held harmless by the Company to the fullest extent permitted by the General Corporation Law of the State of Delaware (the "DGCL") against all expense, liabilities and loss (including attorneys' fees, judgments, fines or penalties and amounts paid in settlement) reasonably incurred or suffered by such person in connection therewith, including liabilities arising under the Securities Act. These indemnification rights include the right to be paid by the Company the expenses incurred in defending any action, suit or proceeding in advance of its final disposition, subject to the receipt by the Company of an undertaking by or on behalf of such person to repay all amounts so advanced if it is ultimately determined that such person is not entitled to be indemnified. These indemnification rights under the Bylaws are not exclusive of any other indemnification right which any person may have or acquire under any law, bylaw, agreement, vote of stockholders, disinterested directors or otherwise.

Under Section 145 of the DGCL, a corporation may indemnify any person who was or is a party, or is threatened to be made a party, to any action, suit, or proceeding by reason of the fact that he is or was a director or officer of such corporation if such person acted in good faith and in a manner he reasonably believed to be in and not opposed to the best interest of the corporation and, with respect to a criminal action or proceeding, such person had no reasonable cause to believe that his conduct was unlawful, except that, in the case of any action or suit by or in the right of the corporation (such as a derivative action), no indemnification is permitted if the person shall be adjudged liable to the corporation (other than indemnification for such expenses as a court shall determine such person is fairly and reasonably entitled).

Article Eleven of the Company's Certificate of Incorporation provides that a director of the Company shall not be personally liable to the Company or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (a) for breach of the director's duty of loyalty to the Company or its stockholders, (b) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (c) under Section 174 of the DGCL, or (d) for any transaction from which the director derived an improper personal benefit.

The Company has in effect liability insurance policies covering certain claims against any director or officer of the Company by reason of certain breaches of duty, neglect, error, misstatement, omission or other act committed by such person in his capacity as director or officer.

#### Item 16. Exhibits.

A list of exhibits filed herewith or incorporated by reference is contained in the Exhibit Index, which is incorporated herein by reference.

#### 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;
  - (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 a 20 percent change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective Registration Statement; and
  - (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 (i), (ii) and (iii) do not apply if the Registration Statement is on Form S-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 purpose 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.
- (4) That, for the purpose of determining liability under the Securities Act of 1933 to any purchaser:
- (i) (A) Each prospectus filed by the Registrant pursuant to Rule 424(b)(3) shall be deemed to be part of the registration statement as of the date the filed prospectus was deemed part of and included in the registration statement; and
- (B) Each prospectus required to be filed pursuant to Rule 424(b)(2), (b)(5) or (b)(7) as part of a registration statement in reliance on Rule 430B relating to an offering made pursuant to Rule 415(a)(1)(i), (vii) or (x) for the purpose of providing the information required by Section 10(a) of the Securities Act shall be deemed to be part of and included in the registration statement as of the earlier of the date such form of prospectus is first used after effectiveness or the date of the first contract of sale of securities in the offering described in the prospectus. As provided in Rule 430B, for liability purposes of the issuer and any person that is at that date an underwriter, such date shall be deemed to be a new effective date of the registration statement relating to the securities in the registration statement to which the prospectus relates, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. Provided, however, that no statement made in a registration statement or prospectus that is part of the registration statement or made in a document incorporated or deemed incorporated by reference into the registration statement or prospectus that is part of the registration statement will, as to a purchaser with a time of contract of sale prior to such effective date, supersede or modify any statement that was made in the registration statement or prospectus that was part of the registration statement or made in any such document immediately prior to such effective date; and
- (5) That, for the purpose of determining liability of the Registrant under the Securities Act to any purchaser in the initial distribution of the securities, in a primary offering of securities of the undersigned Registrant pursuant to this registration statement, regardless of the underwriting method used to sell the securities to the purchaser, if the securities are offered or sold to such purchaser by means of any of the following communications, the undersigned Registrant will be a seller to the purchaser and will be considered to offer or sell such securities to such purchaser:
- (i) Any preliminary prospectus or prospectus of the undersigned Registrant relating to the offering required to be filed pursuant to Rule 424;
- (ii) Any free writing prospectus relating to the offering prepared by or on behalf of the undersigned Registrant or used or referred to by the undersigned Registrant;
- (iii) The portion of any other free writing prospectus relating to the offering containing material information about the undersigned Registrant or its securities provided by or on behalf of the undersigned Registrant; and



(iv) Any other communication that is an offer in the offering made by the undersigned Registrant to the purchaser.

- (b) The undersigned Registrant undertakes that, for purposes of determining any liability under the Securities Act, each filing of the Registrant's annual report pursuant to Section 13(a) or Section 15(d) of the 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) Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers, and controlling persons of the Registrant pursuant to the foregoing provisions, or otherwise, the Registrant has been advised that, in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification 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 Securities Act and will be governed by the final adjudication of such issue.
- (d) The undersigned Registrant hereby undertakes to file an application for the purpose of determining the eligibility of the trustee to act under subsection (a) of Section 310 of the Trust Indenture Act in accordance with the rules and regulations prescribed by the Commission under Section 305(b)(2) of the Trust Indenture Act.

**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 Dover, State of Delaware, on June 15, 2006.

## CHESAPEAKE UTILITIES CORPORATION

By: /s/ John R. Schimkaitis

John R. Schimkaitis

President and Chief Executive Officer

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints John R. Schimkaitis, Michael P. McMasters and Beth W. Cooper, or any of them, his or her true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign any and all amendments to this Registration Statement, and to file same, with all exhibits thereto, and other documents in connection therewith, with the Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that the attorneys-in-fact and agents or any of them, or their substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

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

/s/ Ralph J. AdkinsRalph J. Adkins, Chairman of the Board  
and Director

Date: June 15, 2006

/s/ John R. SchimkaitisJohn R. Schimkaitis, President,  
Chief Executive Officer and Director

Date: June 15, 2006

/s/ Michael P. McMastersMichael P. McMasters, Senior Vice President  
and Chief Financial Officer

(Principal Financial and Accounting Officer)

Date: June 15, 2006

/s/ Eugene H. Bayard

Eugene H. Bayard, Director

Date: June 15, 2006

/s/ Richard Bernstein

Richard Bernstein, Director

Date: June 15, 2006

/s/ Thomas J. Bresnan

Thomas J. Bresnan, Director

Date: June 15, 2006

/s/ Walter J. Coleman

Walter J. Coleman, Director

Date: June 15, 2006

/s/ Thomas P. Hill, Jr.

Thomas P. Hill, Jr., Director

Date: June 15, 2006

/s/ J. Peter Martin

J. Peter Martin

Date: June 15, 2006

/s/ Joseph E. Moore

Joseph E. Moore, Esq., Director

Date: June 15, 2006

/s/ Calvert A. Morgan, Jr.

Calvert A. Morgan, Jr., Director

Date: June 15, 2006

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## CHESAPEAKE UTILITIES CORPORATION

## EXHIBIT INDEX

| Exhibit No. | Description   |
|-------------|---|
| 1.1         | Form of Underwriting Agreement for Common Stock *   |
| 1.2         | Form of Underwriting Agreement for debt securities *  |
| 4.1         | Amended Certificate of Incorporation of Chesapeake Utilities Corporation is incorporated herein by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1998, File No. 001-11590.  |
| 4.2         | Amended Bylaws of Chesapeake Utilities Corporation, effective February 24, 2005, are incorporated herein by reference to Exhibit 3 of the Company's Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-11590.  |
| 4.3         | Form of Trust Indenture between Chesapeake Utilities Corporation and the trustee for the debt securities *  |
| 4.4         | Form of debt securities *   |
| 5.1         | Opinion of Baker & Hostetler LLP **   |
| 12.1        | Computation of Ratio of Earnings to Fixed Charges is incorporated herein by reference to Exhibit 12 of each of the Company's Annual Reports on Form 10-K for the years ended December 31, 2005, 2004 and 2003, File No. 001-11590. Computation of Ratio of Earnings to Fixed Charges for the quarterly period ended March 31, 2006, is filed herewith. ** |
| 23.1        | Consent of PricewaterhouseCoopers LLP **  |
| 23.2        | Consent of Baker & Hostetler LLP (included in Exhibit 5.1)  |
| 24.1        | Power of Attorney (set forth on the signature page hereto)  |
| 25.1        | Statement of Eligibility on Form T-1 of [____], as trustee for the Chesapeake Utilities Corporation debt securities *   |

\* To be filed by amendment or as an exhibit to a document incorporated by reference into the registration statement.

\*\* Filed herewith

Filed Pursuant to Rule 424(B)(5)  
Registration No: 333-135602

PROSPECTUS SUPPLEMENT  
(To Prospectus dated November 9, 2006)



## Chesapeake Utilities Corporation

### 600,300 Shares of Common Stock

We are selling 600,300 shares of our common stock. Our common stock is listed on the New York Stock Exchange under the symbol "CPK." On November 15, 2006, the last reported sale price of our common stock on the New York Stock Exchange was \$30.25 per share.

Investing in our common stock involves risks. See "Risk Factors" beginning on page S-6 of this prospectus supplement for a description of various risks you should consider in evaluating an investment in our common stock.

|  | <u>Per Share</u> | <u>Total</u>  |
|--|------------------|---------------|
| Public offering price                  | \$ 30.100        | \$ 18,069,030 |
| Underwriting discounts and commissions | \$ 1.125         | \$ 675,338    |
| Proceeds, before expenses, to us       | \$ 28.975        | \$ 17,393,692 |

The underwriters have a 30-day option to purchase on a pro rata basis up to 90,045 additional shares of our common stock from us on the same terms set forth above to cover over-allotments, if any.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

**Robert W. Baird & Co.**

November 15, 2006

**A.G. Edwards**

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Table of Contents**ABOUT THIS PROSPECTUS SUPPLEMENT**

This document is in two parts. The first part is this prospectus supplement, which describes the specific terms of this offering. The second part, the accompanying prospectus, gives more general information, some of which may not apply to this offering. Before investing in our common stock, you should read in their entirety this prospectus supplement, the accompanying prospectus, including the information under the caption "Where You Can Find More Information," as well as the documents incorporated by reference. These documents contain information you should consider when making your investment decision. You should rely only on the information contained or incorporated by reference into this prospectus supplement or the accompanying prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different or additional information. If anyone provides you with different, additional or inconsistent information, you should not rely on it.

We are not, and the underwriters are not, making an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information in this prospectus supplement and the accompanying prospectus is accurate only as of their respective dates, or in the case of the documents incorporated by reference, the date of such documents regardless of the time of delivery of this prospectus supplement and the accompanying prospectus or any sales of our common stock. Our business, financial condition, results of operations and prospects may have changed since those dates.

References in this prospectus supplement to the "Company," "Chesapeake," "we," "us" and "our" refer to Chesapeake Utilities Corporation and its consolidated subsidiaries, unless the context indicates another meaning.

Unless expressly incorporated by reference, information contained on or made available through our Web site is not a part of this prospectus supplement.

**CAUTIONARY STATEMENTS CONCERNING FORWARD-LOOKING STATEMENTS**

This prospectus supplement, the accompanying prospectus and the documents we have incorporated by reference contain forward-looking statements within the meaning of the federal securities laws. We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Forward-looking statements are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "plan," "estimate," "project" or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Actual results could differ materially from those in forward-looking statements because of, among other reasons, the factors described below and described in the periodic reports that we file with the Securities and Exchange Commission (the "SEC") from time to time, including Forms 10-K, 10-Q and 8-K. The forward-looking statements are not guarantees of future performance. They are based on numerous assumptions that we believe are reasonable, but they are open to a wide range of uncertainties and business risks.

Factors that could cause actual results to be different than expected or anticipated include, but are not limited to:

- the temperature sensitivity of the natural gas and propane businesses;
- the effect of spot, forward and futures market prices on our distribution, wholesale marketing and energy trading businesses;
- the effect of competition on our non-regulated and regulated businesses;
- the effect of changes in federal, state or local regulatory and tax requirements, including

deregulation;

- the effect of accounting changes;
- the effect of changes in benefit plan assumptions;
- the effect of compliance with environmental regulations or the remediation of environmental damage;
- the effect of general economic conditions on us and our customers;
- the ability of our new and planned facilities and acquisitions to generate expected revenues;

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- our ability to obtain the rate relief and cost recovery requested from utility regulators and the timing of the requested regulatory actions; and
- the risks set forth herein under the caption "Risk Factors."

In light of these risks, uncertainties and assumptions, you are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this prospectus supplement or as of the date of any document incorporated by reference in this prospectus supplement or the accompanying prospectus, as applicable. When considering forward-looking statements, you should keep in mind the cautionary statements in this prospectus supplement, the accompanying prospectus and the documents incorporated by reference. We are not under any obligation, and we expressly disclaim any obligation, to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in or incorporated by reference in this prospectus supplement or the accompanying prospectus might not occur.

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**SUMMARY**

*This summary highlights information contained elsewhere or incorporated by reference in this prospectus supplement or the accompanying prospectus. Because this is a summary, it is not complete and does not contain all of the information that may be important to you. For a more complete understanding of us and this offering of our common stock, we encourage you to read in their entirety this prospectus supplement, the accompanying prospectus, including the information under the caption "Where You Can Find More Information", as well as the documents incorporated by reference.*

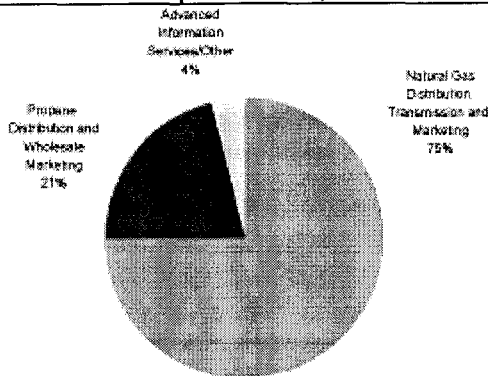
**Our Business**

We are a diversified gas utility company, incorporated and headquartered in Delaware, that operates both regulated and non-regulated businesses in three segments: natural gas distribution, transmission and marketing; propane distribution and wholesale marketing; and advanced information services.

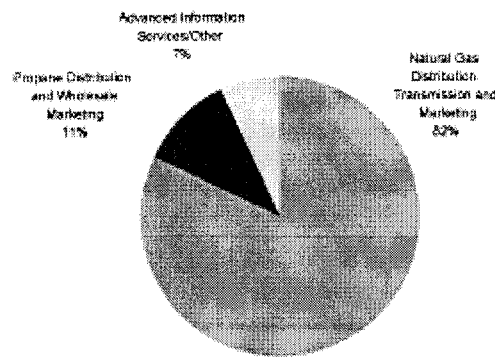
Regulated operations consist of our natural gas distribution and transmission businesses that operate in several states. Non-regulated operations consist of our natural gas marketing, propane distribution and wholesale marketing, and advanced information services businesses.

The following charts set forth the percentage of our total assets accounted for by each of our segments at September 30, 2006 and the percentage of our operating income accounted for by each of our segments for the twelve months ended September 30, 2006.

**Total Assets  
at September 30, 2006**



**Operating Income for the Twelve Months Ended  
September 30, 2006**



**Natural Gas Distribution, Transmission and Marketing**

*Natural Gas Distribution.* Our three natural gas distribution divisions serve approximately 58,000 residential, commercial and industrial customers in central and southern Delaware, Maryland's Eastern Shore and parts of Florida.

Our Delaware and Maryland utility divisions collectively serve approximately 44,500 customers, of whom approximately 44,300 are residential and commercial customers purchasing natural gas primarily for heating purposes. The remaining customers are industrial. Residential and commercial customers accounted for approximately 76 percent of the volume delivered by the divisions and 76 percent of the divisions' gross margin for the nine months ended September 30, 2006. The state Public Service Commissions of Delaware and Maryland regulate our natural gas distribution operations within these states.

Our Florida division distributes natural gas to approximately 13,400 residential and commercial

and 100 industrial customers in Polk, Osceola, Hillsborough, Gadsden, Gilchrist, Union, Holmes, Jackson, Desoto, Suwannee, Liberty, Citrus and Washington Counties. For the nine months ended September 30, 2006, industrial customers accounted for approximately 92 percent of the volume delivered by the Florida division and approximately 42 percent of the division's gross margin. We serve a diversity of industrial customers throughout the state of Florida. The Florida Public Service Commission regulates our Florida division.

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*Natural Gas Transmission.* Our natural gas transmission subsidiary, Eastern Shore Natural Gas Company ("ESNG"), operates a 331-mile interstate pipeline system that transports gas from various points in Pennsylvania to our Delaware and Maryland distribution divisions, as well as to other utilities and industrial customers in southern Pennsylvania, Delaware and on the Eastern Shore of Maryland. ESNG provides open access gas transportation and contract storage services for affiliated and non-affiliated companies. As an interstate pipeline, ESNG's rates and services are subject to regulation by the Federal Energy Regulatory Commission ("FERC").

*Natural Gas Marketing.* We market natural gas and offer supply management services in the state of Florida through our subsidiary Peninsula Energy Services Company, Inc. ("PESCO"). PESCO provides natural gas supply management services to approximately 284 customers of our Florida division, which operates as Central Florida Gas, and to an additional 463 customers of other natural gas distribution systems operating within the state of Florida.

### ***Propane Distribution and Wholesale Marketing***

Our propane distribution operations are conducted by Sharp Energy, Inc. and its subsidiaries. Our propane wholesale marketing operations are conducted by Xeron, Inc.

*Sharp Energy.* Based in Salisbury, Maryland, Sharp Energy sells, transports and distributes propane to approximately 32,600 customers in Delaware, Maryland, Virginia, Florida and Pennsylvania. We delivered approximately 16.4 million retail and wholesale gallons of propane during the nine months ended September 30, 2006.

*Xeron.* Based in Houston, Texas, Xeron is a natural gas liquids trading company. Xeron purchases from and sells to oil refineries, wholesalers, propane distributors, pipeline companies and other trading partners primarily in the southeastern region of the United States.

### ***Advanced Information Services***

*BravePoint.* Our advanced information services business, BravePoint, Inc., headquartered in Norcross, Georgia, provides domestic and international clients with information technology related business services and solutions for both enterprise and e-business applications.

### ***Other***

We own several subsidiaries that own and lease real estate to affiliates of Chesapeake.

## **Our Competitive Strengths**

Our competitive and strategic positions for our primary business segments are described below.

We are the only natural gas distribution utility in the franchised areas that we serve on the Delmarva Peninsula (a peninsula of the eastern United States separating the Chesapeake Bay from the Delaware Bay and the Atlantic Ocean that includes all of Delaware and parts of eastern Maryland and Virginia) and in Florida. We are expanding our distribution and transmission facilities to capture the growth occurring in our various service territories. For the year ended December 31, 2005, the number of residential customers for the Delaware and Maryland distribution divisions increased 8.7 percent, while our Florida division experienced a 7.4 percent increase in the number of residential customers served.

Our interstate pipeline is the only pipeline that transports natural gas to the high growth areas south of the Chesapeake & Delaware Canal in Delaware and on the Eastern Shore of Maryland.

Our natural gas marketing subsidiary in Florida provides natural gas procurement services to

commercial and industrial customers. We believe that our long-standing relationships with many of these customers are a competitive strength.

Our competitive strengths in the propane distribution industry include our size on the Delmarva Peninsula, expertise in constructing and servicing propane community gas systems, diverse supply base, storage capabilities and specialized pricing programs for our customers. Our community gas systems provide propane via underground piped propane systems, similar to how natural gas is delivered, primarily to new residential developments in locations where natural gas is not

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available. We believe our experience in the natural gas and propane distribution businesses has enabled us to be a market leader in building and servicing these systems in our current service territory on the Delmarva Peninsula.

**Our Strategy**

Our strategy is focused on growing earnings from a stable utility foundation and investing in related businesses and services that provide opportunities for returns greater than traditional regulated returns. The key elements of this strategy include:

- Executing a capital investment program in pursuit of organic growth opportunities that generate returns equal to or greater than our cost of capital
- Expanding our natural gas distribution and transmission business through expansion into new geographic areas in our current service territories
- Expanding our propane distribution business in existing and new markets through leveraging our community gas system service and our bulk delivery capabilities
- Utilizing our expertise across our various businesses to improve overall performance
- Enhancing marketing channels to attract new customers and providing reliable and responsive customer service to retain existing customers
- Maintaining a capital structure that enables us to access capital as needed
- Maintaining a consistent and competitive dividend

**Recent Developments**

On November 1, 2006, we initiated additional transportation services to several of our customers as part of the first phase of ESNG's 2006-2008 expansion project pursuant to which we expect to add 55 miles of pipeline to its existing system in the states of Delaware and Pennsylvania as well as two new delivery points. Our 2006 capital expenditures budget of \$54.4 million includes \$17.4 million associated with the first phase of ESNG's 2006-2008 expansion project. The total project is expected to cost approximately \$33.6 million and be completed in November 2008.

**Corporate Information**

Our principal executive office is located at 909 Silver Lake Boulevard, Dover, Delaware 19904 and our telephone number is (302) 734-6799. We maintain a Web site at [www.chpk.com](http://www.chpk.com) where certain additional information about us may be found. Unless expressly incorporated by reference, the information on our Web site is not a part of this prospectus supplement, the accompanying prospectus or the documents incorporated by reference, but is referenced and maintained as a convenience to investors and as otherwise required by applicable law.



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|  |   |
|--|---|
| Issuer   | Chesapeake Utilities Corporation  |
| Common stock offered                                       | 600,300 shares of our common stock (plus up to 90,045 additional shares that may be issued by us upon exercise of the underwriters' over-allotment option).   |
| Common stock outstanding after the offering <sup>(1)</sup> | 6,590,882 shares of our common stock. If the underwriters exercise their over-allotment option in full, we will issue an additional 90,045 shares, which will result in 6,680,927 shares outstanding. |
| Current indicated annual dividend per share <sup>(2)</sup> | \$1.16 (see the caption "Market Price, Dividends and Dividend Policy")  |
| NYSE symbol for common stock                               | CPK   |

(1) The number of shares of our common stock outstanding after the offering set forth above is based on 5,990,582 shares of our common stock outstanding as of October 31, 2006 and includes the shares to be sold by us in this offering. The number of shares outstanding after the offering does not include an aggregate of 1,372,750 shares of our common stock reserved as of October 31, 2006 for issuance under the following plans: the Performance Incentive Plan, the Employee Stock Award Plan, the Directors Stock Compensation Plan, the Dividend Reinvestment and Direct Stock Purchase Plan, and the Retirement Savings Plan, as well as upon the conversion of any outstanding 8.25% Convertible Debentures.

(2) Based upon the fourth quarter of 2006 dividend rate of \$0.29 per share annualized. Future dividends, if any, may be declared and paid at the discretion of our board of directors and will depend on our future earnings, financial condition and other factors.





Table of Contents**SUMMARY FINANCIAL INFORMATION**

In the table below, we provide you with certain summary financial information. We have derived the income statement data for each of the years in the three-year period ended December 31, 2005 and the balance sheet data as of December 31, 2004 and 2005 from our audited consolidated financial statements incorporated by reference in this prospectus supplement. We have derived the income statement data for the nine months ended September 30, 2005 and 2006 and the balance sheet data as of September 30, 2006 from our unaudited consolidated financial statements incorporated by reference in this prospectus supplement. The information is only a summary and should be read together with the financial information incorporated by reference in the accompanying prospectus. See the caption "Where You Can Find More Information" and "Incorporation of Certain Information by Reference" in the accompanying prospectus.

|   | <u>Fiscal Year Ended</u> |                  |                  | <u>Nine Months Ended</u> |                  |
|---|--------------------------|------------------|------------------|--------------------------|------------------|
|   | <u>Dec. 31,</u>          | <u>Dec. 31,</u>  | <u>Dec. 31,</u>  | <u>Sept. 30,</u>         | <u>Sept. 30,</u> |
|   | <u>2003</u>              | <u>2004</u>      | <u>2005</u>      | <u>2005</u>              | <u>2006</u>      |
|   |                          |                  |                  | (Unaudited)              |                  |
| <i>(\$ in thousands, except per share amounts)</i>    |                          |                  |                  |                          |                  |
| <b>Income Statement Data:</b>                         |                          |                  |                  |                          |                  |
| Revenues  |                          |                  |                  |                          |                  |
| Natural gas   | \$110,247                | \$124,246        | \$166,582        | \$112,478                | \$127,040        |
| Propane   | 41,029                   | 41,500           | 48,976           | 33,400                   | 34,339           |
| Advanced information services and other               | 12,292                   | 12,209           | 14,072           | 9,343                    | 9,017            |
| Total revenues  | <u>\$163,568</u>         | <u>\$177,955</u> | <u>\$229,630</u> | <u>\$155,221</u>         | <u>\$170,396</u> |
| Operating income                                      |                          |                  |                  |                          |                  |
| Natural gas   | \$ 16,653                | \$ 17,091        | \$ 17,236        | \$ 12,117                | \$ 13,256        |
| Propane   | 3,875                    | 2,364            | 3,209            | 1,814                    | 1,166            |
| Advanced information services and other               | 1,051                    | 515              | 1,085            | (201)                    | 383              |
| Total operating income                                | <u>\$ 21,579</u>         | <u>\$ 19,970</u> | <u>\$ 21,530</u> | <u>\$ 13,730</u>         | <u>\$ 14,805</u> |
| Net income from continuing operations                 | \$ 10,079                | \$ 9,550         | \$ 10,468        | \$ 6,335                 | \$ 6,572         |
| Average common shares outstanding (basic)             | 5,611                    | 5,735            | 5,836            | 5,823                    | 5,945            |
| Average common shares outstanding (diluted)           | 5,802                    | 5,908            | 5,993            | 5,982                    | 6,070            |
| Basic earnings per share from continuing operations   | \$ 1.80                  | \$ 1.66          | \$ 1.79          | \$ 1.09                  | \$ 1.11          |
| Diluted earnings per share from continuing operations | \$ 1.76                  | \$ 1.64          | \$ 1.77          | \$ 1.07                  | \$ 1.10          |
| <b>Cash Flow Data:</b>                                |                          |                  |                  |                          |                  |
| Cash dividends declared per share                     | \$ 1.10                  | \$ 1.12          | \$ 1.14          | \$ 0.85                  | \$ 0.87          |
| Capital expenditures                                  | \$ 11,790                | \$ 17,784        | \$ 33,008        | \$ 19,940                | \$ 28,335        |

|   | <u>At Dec. 31,</u> |                  | <u>At Sept. 30,</u> |                  |
|---|--------------------|------------------|---------------------|------------------|
|   | <u>2004</u>        | <u>2005</u>      | <u>2005</u>         | <u>2006</u>      |
|   |                    |                  | (Unaudited)         |                  |
| <i>(\$ in thousands)</i>  |                    |                  |                     |                  |
| <b>Balance Sheet Data:</b>  |                    |                  |                     |                  |
| Gross property, plant and equipment                                     | \$250,267          | \$280,345        | \$266,561           | \$309,555        |
| Net property, plant and equipment                                       | \$177,053          | \$201,504        | \$189,036           | \$225,950        |
| Total assets  | \$241,938          | \$295,980        | \$254,030           | \$301,961        |
| Total stockholders' equity  | \$ 77,962          | \$ 84,757        | \$ 81,592           | \$ 88,536        |
| Long-term debt, net of current maturities                               | 66,190             | 58,991           | 62,083              | 56,792           |
| Total capitalization  | <u>\$144,152</u>   | <u>\$143,748</u> | <u>\$143,675</u>    | <u>\$145,328</u> |
| Current portion of long-term debt                                       | \$ 2,909           | \$ 4,929         | \$ 4,929            | \$ 4,929         |
| Short-term borrowing  | 5,002              | 35,482           | 10,624              | 51,314           |
| Total capitalization and short-term borrowing                           | <u>\$152,063</u>   | <u>\$184,159</u> | <u>\$159,228</u>    | <u>\$201,571</u> |
| Equity as a percentage of total capitalization                          | 54%                | 59%              | 57%                 | 61%              |
| Equity as a percentage of total capitalization and short-term borrowing | 51%                | 46%              | 51%                 | 44%              |



## RISK FACTORS

***Fluctuations in weather have the potential to adversely affect our results of operations, cash flows and financial condition.***

Our utility and propane distribution operations are sensitive to fluctuations in weather, and weather conditions directly influence the volume of natural gas and propane delivered by our utility and propane distribution operations to customers. A significant portion of our utility and propane distribution operations' revenues are derived from the delivery of natural gas and propane to residential and commercial heating customers during the five-month peak heating season of November through March. If the weather is warmer than normal, we deliver less natural gas and propane to customers, and earn less revenue. In addition, hurricanes or other extreme weather conditions could damage production or transportation facilities, which could result in decreased supplies of natural gas and propane, increased supply costs and higher prices for customers.

***Regulation of the Company, including changes in the regulatory environment in general, may adversely affect our results of operations, cash flows and financial condition.***

The state Public Service Commissions of Delaware, Maryland and Florida regulate our natural gas distribution operations. ESNG, our natural gas transmission subsidiary, is regulated by the FERC. These regulatory commissions set the rates in their respective jurisdictions that we can charge customers for our rate-regulated services. Changes in these rates, as ordered by regulatory commissions, affect our financial performance. Our ability to obtain timely future rate increases and rate supplements to maintain current rates of return depends on regulatory discretion, and there can be no assurance that our divisions and ESNG will be able to obtain rate increases or supplements or continue receiving currently authorized rates of return.

***The amount and availability of natural gas and propane supplies are difficult to predict, which may reduce our earnings.***

Natural gas and propane production can be impacted by factors outside of our control, such as weather and refinery closings. If we are unable to obtain sufficient natural gas and propane supplies to meet demand, our results of operation may be negatively impacted.

***We rely on having access to interstate pipelines' transportation and storage capacity. If these pipelines or storage facilities were not available, it may impair our ability to meet our customers' full requirements.***

We must acquire both sufficient natural gas supplies and interstate pipeline and storage capacity to meet customer requirements. We must contract for reliable and adequate delivery capacity for our distribution system, while considering the dynamics of the interstate pipeline and storage capacity market, our own on-system resources, as well as the characteristics of our customer base. Local natural gas distribution companies, including us, and other participants in the energy industry, have raised concerns regarding the future availability of additional upstream interstate pipeline and storage capacity. Additional available pipeline and storage capacity is a business issue that must be managed by us, as our customer base grows.

***Natural gas and propane commodity price changes may affect the operating costs and competitive positions of our natural gas and propane distribution operations, which may adversely affect our results of operations, cash flows and financial condition.***

*Natural Gas.* Over the last four years, natural gas costs have increased significantly and become more volatile. In addition, the hurricane activity in 2005 reduced the natural gas available from the Gulf Coast region, further contributing to the volatility of natural gas prices. Higher natural gas prices can result in significant increases in the cost of gas billed to customers during the winter heating season. Under our regulated gas cost recovery mechanisms, we record cost of gas expense equal to the cost of gas recovered in revenues from customers. Therefore, an increase in the cost of gas due to an increase in the

price of the natural gas commodity generally has no direct effect on our revenues and net income. However, our net income may be reduced due to higher expenses that may be incurred for uncollectible customer accounts, as well as lower volumes of natural gas deliveries to customers due to lower natural gas consumption caused

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by customer conservation. Increases in the price of natural gas also can affect our operating cash flows, as well as the competitiveness of natural gas as an energy source.

*Propane.* The level of profitability in the retail propane business is largely dependent on the difference between the cost of propane and the revenues derived from our sale of propane to our customers. Propane costs are subject to volatile changes as a result of product supply or other market conditions, including, economic and political factors impacting crude oil and natural gas supply or pricing. Propane cost changes can occur rapidly over a short period of time and can impact profitability. There is no assurance that we will be able to pass on propane cost increases fully or immediately, particularly when propane costs increase or decrease rapidly. Therefore, average retail sales prices can vary significantly from year to year as product costs fluctuate with propane, fuel oil, crude oil and natural gas commodity market conditions. In addition, in periods of sustained higher commodity prices, retail sales volumes may be negatively impacted by customer conservation efforts and increased amounts of uncollectible accounts.

***We compete in a competitive environment and may be faced with losing customers to a competitor.***

We compete with third-party suppliers to sell gas to industrial customers. As it relates to transportation services, our competitors include the interstate transmission company if the distribution customer is located close enough to the transmission company's pipeline to make a connection economically feasible.

Our propane distribution operations compete with several other propane distributors in their service territories, primarily on the basis of service and price, emphasizing reliability of service and responsiveness. Some of our competitors have significantly greater resources. The retail propane industry is mature, and we foresee only modest growth in total demand. Given this limited growth, we expect that year-to-year industry volumes will be principally affected by weather patterns. Therefore, our ability to grow the propane distribution business is contingent upon execution of our community gas systems strategy to capture market share and to employ pricing programs that retain and grow our customer base. Any failure to retain and grow our customer base would have an adverse effect on our results.

The propane wholesale marketing operation competes against various marketers, many of which have significantly greater resources and are able to obtain price or volumetric advantages.

The advanced information services business faces significant competition from a number of larger competitors having substantially greater resources available to them to compete on the basis of technological expertise, reputation and price.

***Costs of compliance with environmental laws may be significant.***

We are subject to federal, state and local laws and regulations governing environmental quality and pollution control. These evolving laws and regulations may require expenditures over a long timeframe to control environmental effects at current and former operating sites, including former gas manufactured sites that we have acquired from third parties. Compliance with these legal requirements requires us to commit capital toward environmental compliance. If we fail to comply with environmental laws and regulations, even if such failure is caused by factors beyond our control, we may be assessed civil or criminal penalties and fines.

To date, we have been able to recover through approved rate mechanisms the costs of recovery associated with the remediation of former gas manufactured sites. However, there is no guarantee that we will be able to recover future remediation costs in the same manner or at all. A change in our approved rate mechanisms for recovery of environmental remediation costs at former manufacturer gas sites could adversely affect our results of operations, cash flows and financial condition.

Further, existing environmental laws and regulations may be revised or new laws and regulations seeking to protect the environment may be adopted or become applicable to us. Revised or additional laws and regulations could result in additional operating restrictions on our facilities or increased compliance costs which may not be fully recoverable by us.

***A change in the economic conditions and interest rates may adversely affect our results of operations and cash flows.***

A downturn in the economies of the regions in which we operate, which we cannot accurately predict, might adversely affect our ability to grow our customer base and our businesses at the same rate they have grown in the recent

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past. Further, an increase in interest rates without the recovery of the higher cost of debt in the sales and/or transportation rates we charge our utility customers, could adversely affect future earnings. An increase in short-term interest rates would negatively affect our results of operations, which depend on short-term debt to finance accounts receivable, storage gas inventories, and to temporarily finance capital expenditures.

***Inflation may impact our results of operations, cash flows and financial position.***

Inflation affects the cost of supply, labor, products and services required for operations, maintenance and capital improvements. While the impact of inflation has remained low in recent years, natural gas and propane prices are subject to rapid fluctuations. To help cope with the effects of inflation on our capital investments and returns, we seek rate relief from regulatory commissions for regulated operations while monitoring the returns of our non-regulated business operations. There can be no assurance that we will be able to obtain adequate and timely rate relief to offset the effects of inflation. To compensate for fluctuations in propane gas prices, we adjust our propane selling prices to the extent allowed by the market. However, there can be no assurance that we will be able to increase propane sales prices sufficiently to fully compensate for such fluctuations in the cost of propane gas to us.

***Changes in technology may adversely affect our advanced information services segment's results of operations, cash flows and financial condition.***

Our advanced information services segment participates in a market that is characterized by rapidly changing technology and accelerating product introduction cycles. The success of our advanced information services segment depends upon our ability to address the rapidly changing needs of our customers by developing and supplying high-quality, cost-effective products, product enhancements and services on a timely basis, and by keeping pace with technological developments and emerging industry standards. There can be no assurance that we will be able to keep up with technological advancements necessary to make our products competitive.

***Our energy marketing subsidiaries have credit risk and credit requirements that may adversely affect our results of operations, cash flows and financial condition.***

Xeron, our propane wholesale and marketing subsidiary, and PESCO, our natural gas marketing subsidiary in Florida, extend credit to counter-parties. While we believe Xeron and PESCO utilize prudent credit policies, each of these subsidiaries is exposed to the risk that it may not be able to collect amounts owed to it. If the counter-party to such a transaction fails to perform and any underlying collateral is inadequate, we could experience financial losses.

Our subsidiaries Xeron and PESCO are dependent upon the availability of credit to buy propane and natural gas for resale or to trade. If the financial condition of these subsidiaries declines, or if our financial condition declines, then the cost of credit available to these subsidiaries could increase. If credit is not available, or if credit is more costly, our results of operations, cash flows and financial condition may be adversely affected.

***Our use of derivative instruments may adversely affect our results of operations.***

Fluctuating commodity prices cause our earnings and financing costs to be impacted. Our propane distribution and wholesale marketing segment uses derivative instruments, including forwards, swaps and puts, to hedge price risk. In addition, we may decide, after further evaluation, to utilize derivative instruments to hedge price risk for our Delaware and Maryland divisions, as well as PESCO. While we have a risk policy and operating procedures in place to control our exposure to risk, if we purchase derivative instruments that are not properly matched to our exposure, our results of operations, cash flows, and financial conditions may be adversely impacted.

***Inability to access the capital markets may impair our future growth.***

We rely on access to both short-term and longer-term capital markets as a significant source of liquidity for capital requirements not satisfied by the cash flow from our operations. Currently, \$65 million of the total \$80 million of short-term lines of credit utilized to satisfy our short-term financing requirements



are discretionary, uncommitted lines of credit. We utilize discretionary lines of credit to reduce the cost associated with these short-term financing requirements. We are committed to maintaining a sound capital structure and strong credit ratings to provide the financial flexibility needed to access the capital

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markets when required. However, if we are not able to access capital at competitive rates, our ability to implement our strategic plan, undertake improvements and make other investments required for our future growth may be limited.

***We are subject to operating and litigation risks that may not be covered by insurance.***

Our operations are subject to the operating hazards and risks normally incidental to handling, storing, transporting and otherwise providing natural gas and propane to end users. As a result, we are sometimes a defendant in legal proceedings and litigation arising in the ordinary course of business. We maintain insurance policies with insurers in such amounts and with such coverages and deductibles as we believe are reasonable and prudent. There can be no assurance, however, that such insurance will be adequate to protect us from all material expenses related to potential future claims for personal injury and property damage or that such levels of insurance will be available in the future at economical prices.

## USE OF PROCEEDS

As a result of this offering, we will receive approximately \$17.2 million in net proceeds from the sale of our common stock, after deducting an aggregate of approximately \$900,000 in underwriting discounts and commissions and estimated offering expenses. If the underwriters' over-allotment option is exercised in full, we estimate that our net proceeds will be approximately \$19.8 million.

We will use the net proceeds from this offering to repay a portion of our short-term debt under unsecured revolving lines of credit with two financial institutions. The weighted-average interest rate for the nine months ended September 30, 2006 related to borrowing under these lines of credit was 5.40%, with 4.75% being the lowest rate and 6.11% being the highest rate charged to us during this period. Our short-term debt has been used in part to finance a portion of ESNG's expansion projects.

Prior to such application, all or a portion of the net proceeds may be invested in short-term interest-bearing securities.

Table of Contents**CAPITALIZATION**

The following table sets forth our consolidated capitalization as of September 30, 2006, on an actual basis and on an as adjusted basis to reflect the private placement of \$20 million of unsecured senior notes in October 2006 and the sale of 600,300 shares of our common stock at the offering price of \$30.10 per share.

You should read this table in conjunction with the detailed information and financial statements appearing in the documents incorporated by reference in this prospectus supplement and the accompanying prospectus.

|  | <u>At September 30, 2006 (Unaudited)</u> |                |                             |                |
|--|--|----------------|-----------------------------|----------------|
|  | <u>Actual</u>                            |                | <u>As Adjusted</u>          |                |
|  | <u>Amount</u>                            | <u>Percent</u> | <u>Amount</u>               | <u>Percent</u> |
| <i>(\$ in thousands)</i>                       |  |                |                             |                |
| Total stockholders' equity                     | \$ 88,536                                | 44%            | \$105,705 <sup>(1)</sup>    | 53%            |
| Long-term debt, net of current maturities      | <u>56,792</u>                            | <u>28%</u>     | <u>76,792<sup>(2)</sup></u> | <u>38%</u>     |
| Total capitalization                           | \$145,328                                | 72%            | \$182,497                   | 91%            |
| Current portion of long-term debt              | 4,929                                    | 2%             | 4,929                       | 2%             |
| Short-term borrowing                           | <u>51,314</u>                            | <u>26%</u>     | <u>14,145</u>               | <u>7%</u>      |
| Total capitalization and short-term borrowing  | <u>\$201,571</u>                         | <u>100%</u>    | <u>\$201,571</u>            | <u>100%</u>    |
| Equity as a percentage of total capitalization |  | 61%            |                             | 58%            |

(1) Includes the approximately \$17.2 million of estimated net proceeds of this offering.

(2) Includes the \$20 million of 5.50% unsecured senior notes issued on October 12, 2006.

Table of Contents**MARKET PRICE, DIVIDENDS AND DIVIDEND POLICY**

Our common stock is listed on the New York Stock Exchange under the symbol "CPK", as stated previously. The following table sets forth the high and low closing prices of our common stock on the New York Stock Exchange and the cash dividends declared on our common stock for the periods indicated.

| <u>Period</u>                              | <u>High</u> | <u>Low</u> | <u>Dividends</u> |
|--|-------------|------------|------------------|
| <b>2004:</b>                               |             |            |                  |
| First Quarter                              | \$26.5100   | \$24.3000  | \$ 0.2750        |
| Second Quarter                             | 26.2000     | 20.4200    | 0.2800           |
| Third Quarter                              | 25.4000     | 22.1000    | 0.2800           |
| Fourth Quarter                             | 27.5500     | 24.5000    | 0.2800           |
| <b>2005:</b>                               |             |            |                  |
| First Quarter                              | \$27.5900   | \$25.8300  | \$ 0.2800        |
| Second Quarter                             | 30.9500     | 23.6000    | 0.2850           |
| Third Quarter                              | 35.6000     | 29.5000    | 0.2850           |
| Fourth Quarter                             | 35.7799     | 30.3227    | 0.2850           |
| <b>2006:</b>                               |             |            |                  |
| First Quarter                              | \$32.4690   | \$29.9700  | \$ 0.2850        |
| Second Quarter                             | 31.2000     | 27.9001    | 0.2900           |
| Third Quarter                              | 35.6499     | 29.5100    | 0.2900           |
| Fourth Quarter (through November 15, 2006) | 31.3100     | 29.5500    | 0.2900           |

On November 15, 2006, the last reported closing price of our common stock on the New York Stock Exchange was \$30.25 per share and on October 31, 2006, we had approximately 1,981 holders of record of our common stock.

We have paid a quarterly cash dividend on our common stock for 45 consecutive years. We pay dividends four times a year: January, April, July and October. Dividends are declared at the discretion of our board of directors, and future dividends will depend upon future earnings, cash flow, financial requirements and other factors. We cannot assure you that we will pay a dividend at any time in the future or that we will raise the level of dividends in the future. Our board of directors can elect at any time, and for an indefinite duration, not to declare dividends on our common stock.

On November 7, 2006, our board of directors declared a quarterly dividend of \$0.29 per share of our common stock. The dividend will be paid on January 5, 2007, to shareholders of record at the close of business on December 18, 2006 (the "record date"). Purchasers of our common stock in this offering who maintain ownership through the record date will be entitled to receive this dividend.

Table of Contents**UNDERWRITING**

We have entered into an underwriting agreement, dated November 15, 2006, with the underwriters named below with respect to the shares of common stock to be offered pursuant to this prospectus supplement. Subject to the terms and conditions contained in the underwriting agreement, we have agreed to sell and each underwriter has severally agreed to purchase from us the number of shares of our common stock set forth opposite its name in the following table:

| <u>Underwriters</u>                | <u>Number of Shares</u> |
|------------------------------------|-------------------------|
| Robert W. Baird & Co. Incorporated | 360,180                 |
| A.G. Edwards & Sons, Inc.          | 240,120                 |
| Total                              | <u>600,300</u>          |

**Over-Allotment Option**

We have granted to the underwriters a 30-day option, exercisable from the date of this prospectus supplement, to purchase on a pro rata basis up to 90,045 additional shares of our common stock at the public offering price less the underwriting discounts and commissions.

We will be obligated to sell these shares of our common stock to the underwriters to the extent the over-allotment option is exercised. The underwriters may exercise this option only to cover over-allotments made in connection with the sale of our common stock offered by this prospectus supplement.

**Discounts and Commissions**

The underwriters propose to offer the shares of our common stock initially at the public offering price on the cover page of this prospectus supplement and to certain dealers at that price less a concession not in excess of \$0.675 per share. The underwriters may allow, and the dealers may reallow, a concession not to exceed \$0.10 per share on sales to other dealers. After the public offering, the underwriters may change the public offering price and concessions to dealers.

The following table summarizes the compensation to be paid to the underwriters. The information assumes either no exercise or full exercise by the underwriters of their over-allotment option.

|  | <u>Per Share</u> | <u>Total</u>                  |                            |
|--|------------------|-------------------------------|----------------------------|
|  |                  | <u>Without Over-Allotment</u> | <u>With Over-Allotment</u> |
| Public offering price                                | \$ 30.100        | \$ 18,069,030                 | \$20,779,385               |
| Underwriting discounts and commissions payable by us | 1.125            | 675,338                       | 776,639                    |
| Proceeds, before expenses, to us                     | <u>\$ 28.975</u> | <u>\$ 17,393,692</u>          | <u>\$20,002,746</u>        |

The underwriting fee will be an amount equal to the offering price per share to the public of our common stock, less the amount paid by the underwriters to us per share of common stock. The underwriters' compensation was determined through arms' length negotiations between the underwriters and us.

We estimate that the expenses payable by us in connection with this offering, other than the underwriting discounts and commissions referred to above, will be approximately \$225,000. Estimated expenses include SEC filing fees, New York Stock Exchange listing fees, printing, legal, accounting, transfer agent and registrar fees, and other miscellaneous fees and expenses.

**Lock-Up Arrangement**

We and our directors and officers have agreed not to sell, transfer, pledge, offer or contract to sell, transfer or pledge, or file with the SEC a registration statement under the Securities Act, relating to any additional shares of our common stock or securities convertible into or exchangeable or exercisable for any shares of our common stock without the prior written consent of Robert W. Baird & Co. Incorporated for a period of 90 days after the date of this prospectus

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supplement. These restrictions will not apply to shares issued pursuant to employee benefit plans or other employee, executive or director compensation plans, pursuant to our Dividend Reinvestment and Direct Stock Purchase Plan or upon the conversion of our 8.25% convertible debentures.

The 90-day period may be extended under certain circumstances when we announce earnings or material news or a material event during the last 17 days of the 90-day period, or if prior to the expiration of the 90-day period we announce that we will release earnings within the 16-day period after the last day of the 90-day period.

## **Indemnity**

We have agreed to indemnify the underwriters against certain liabilities under the Securities Act or to contribute to payments that the underwriters may be required to make in that respect.

## **Our Relationship with the Underwriters**

The underwriters and their affiliates may provide advisory and investment banking services to us in the future, for which they would receive customary compensation.

## **Stabilization**

The underwriters may engage in over-allotment transactions, stabilizing transactions and syndicate covering transactions in accordance with Regulation M under the Exchange Act.

- Over-allotment involves sales by the underwriters of shares in excess of the number of shares the underwriters are obligated to purchase, which creates syndicate short positions.
- Stabilizing transactions permit bids to purchase shares of our common stock so long as the stabilizing bids do not exceed a specified maximum.
- Syndicate covering transactions involve purchases of our common stock in the open market after the distribution has been completed to cover syndicate short positions.

These stabilizing transactions and syndicate covering transactions may cause the price of our common stock to be higher than the price that might otherwise exist in the open market. These transactions may be effected on the New York Stock Exchange or otherwise. Neither we nor either of the underwriters makes any representation that the underwriters will engage in any of the transactions described above, and these transactions, if commenced, may be discontinued at any time without notice. Neither we nor either of the underwriters makes any representation or prediction as to the effect that the transactions described above, if commenced, may have on the market price of our common stock.

## **EXPERTS**

The consolidated financial statements and management's assessment of the effectiveness of internal control over financial reporting (which is included in Management's Report on Internal Control Over Financial Reporting) incorporated in this prospectus supplement by reference to the Annual Report on Form 10-K for the year ended December 31, 2005, have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

## **LEGAL MATTERS**

Certain legal matters will be passed upon for the Company by Baker & Hostetler LLP, Cincinnati, Ohio. Certain legal matters will be passed upon for the underwriters by Foley & Lardner LLP, Milwaukee,

Wisconsin.

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## PROSPECTUS



## Chesapeake Utilities Corporation

### Common Stock and Debt Securities

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We may offer, from time to time in one or more offerings, in amounts, at prices and on terms that we will determine at the time of offering, shares of our common stock, par value per share \$0.4867 (the "Common Stock"), and/or debt securities. We will provide the specific terms of any offering of Common Stock and/or debt securities in supplements to this prospectus. The prospectus supplements will also describe the specific manner in which we will offer these securities and may also supplement, update or amend information contained in this prospectus. You should read this prospectus, the applicable prospectus supplement, and any documents incorporated by reference into this prospectus carefully before you invest.

We may sell Common Stock and/or debt securities on a continuous or delayed basis directly, through agents, dealers or underwriters as designated from time to time, or through a combination of these methods. If any agents, dealers or underwriters are involved in the sale of any securities, the applicable prospectus supplement will set forth any applicable commissions or discounts. Our net proceeds from the sale of securities also will be set forth in the applicable prospectus supplement.

Our Common Stock is listed on the New York Stock Exchange under the symbol "CPK".

**These Securities have not been approved or disapproved by the Securities and Exchange Commission or any state securities commission, nor has the Securities and Exchange Commission or any state securities commission passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.**

**We have not authorized any dealer, salesman or other person to give any information or to make any representation other than those contained or incorporated by reference in this prospectus or any applicable supplement to this prospectus. You must not rely upon any information or representation not contained or incorporated by reference in this prospectus or any applicable supplement to this prospectus as if we had authorized it. This prospectus and any applicable prospectus supplement do not constitute an offer to sell or the solicitation of an offer to buy any securities other than the registered securities to which they relate. Nor do this prospectus and any accompanying prospectus supplement constitute an offer to sell or the solicitation of an offer to buy securities in any jurisdiction to any person to whom it is unlawful to make such offer or solicitation in such jurisdiction. You should not assume that the information contained in this prospectus or any applicable prospectus supplement is correct on any date after its date, even though this prospectus or a supplement is delivered or securities are sold on a later date.**

The date of this prospectus is November 9, 2006.

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## FORWARD-LOOKING INFORMATION

This prospectus and the applicable prospectus supplements include and incorporate by reference forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). We intend such forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are generally identifiable by use of the words "believe," "expect," "intend," "anticipate," "plan," "estimate," "project" or similar expressions. Our ability to predict results or the actual effect of future plans or strategies is inherently uncertain. Actual results could differ materially from those in forward-looking statements because of, among other reasons, the factors described under the caption "Risk Factors" in the periodic reports that we file with the Securities and Exchange Commission. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission using a "shelf" registration process. Under this shelf process, we may sell any combination of our Common Stock and/or debt securities described in this prospectus in one or more offerings up to a total amount of \$40,000,000.00. This prospectus only provides you with a general description of the securities we may offer. Each time we sell securities, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. You should read both this prospectus and the applicable prospectus supplement together with additional information described under the headings, "Where You Can Find More Information" and "Incorporation of Certain Information by Reference."

Unless otherwise indicated or unless the context requires otherwise, all references in this prospectus to "we," "us," "our," the "Company," the "Registrant" or "Chesapeake" mean Chesapeake Utilities Corporation and all entities owned or controlled by Chesapeake Utilities Corporation. When we refer to our "Certificate of Incorporation," we mean Chesapeake Utilities Corporation's Amended Certificate of Incorporation, and when we refer to our "Bylaws," we mean Chesapeake Utilities Corporation's Amended Bylaws.

## WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and special reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC") pursuant to the Exchange Act. Such filings are available to the public from the SEC's website at <http://www.sec.gov>. You may also read and copy any document we file with the SEC at the SEC's Public



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Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain copies of any document filed by us at prescribed rates by writing to the Public Reference Section of the SEC at that address. You may obtain information about the operation of the SEC's Public Reference Room by calling the SEC at 1-800-SEC-0330. You may inspect reports and other information that we file at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005. Information about us, including our filings, is also available on our website at <http://www.chpk.com>. Unless expressly incorporated by reference, information contained on or made available through our website is not a part of this prospectus or any accompanying prospectus supplement.

We have filed a registration statement, of which this prospectus is a part, and related exhibits with the SEC under the Securities Act. That registration statement contains additional information about us and the Common Stock and debt securities. You may inspect the registration statement and exhibits without charge at the SEC's Public Reference Room or at the SEC's web site set forth above, and you may obtain copies from the SEC at prescribed rates.

## INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC allows us to "incorporate by reference" the information contained in documents we file with the SEC, which means that we can disclose important information to you by referring to those documents. The information incorporated by reference is an important part of this prospectus. Any statement contained in a document that is incorporated by reference in this prospectus is automatically updated and superseded if information contained in this prospectus, or information that we later file with the SEC, modifies or replaces that information. Any statement made in this prospectus or any prospectus supplement concerning the contents of any contract, agreement or other document is only a summary of the actual contract, agreement or other document. If we have filed or incorporated by reference any contract, agreement or other document as an exhibit to the registration statement, you should read the exhibit for a more complete understanding of the document or matter involved. Each statement regarding a contract, agreement or other document is qualified in its entirety by reference to the actual document.

We incorporate by reference the following documents we filed, excluding any information contained therein or attached as exhibits thereto which has been furnished to, but not filed with, the SEC:

- (a) Our Annual Report on Form 10-K for the fiscal year ended December 31, 2005, filed on March 7, 2006;
- (b) Our definitive Proxy Statement on Schedule 14A filed on March 31, 2006;
- (c) Our Current Report on Form 8-K dated March 11, 2006, filed on March 16, 2006;
- (d) Our Current Report on Form 8-K dated May 2, 2006, filed on May 3, 2006;
- (e) Our Current Report on Form 8-K dated May 1, 2006, filed on May 5, 2006;
- (f) Our Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2006, filed on May 10, 2006;
- (g) Our Current Report on Form 8-K dated May 31, 2006, filed on June 2, 2006;
- (h) Our Current Report on Form 8-K dated June 13, 2006, filed on June 19, 2006;
- (i) Our Current Report on Form 8-K dated August 1, 2006, filed on August 7, 2006;
- (j) Our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2006, filed on August 9, 2006;
- (k) Our Current Report on Form 8-K dated August 31, 2006, filed on September 7, 2006;
- (l) Our Current Report on Form 8-K dated September 19, 2006, filed on September 22, 2006;
- (m) Our Current Report on Form 8-K dated September 26, 2006, filed on October 2, 2006;
- (n) Our Current Report on Form 8-K dated October 12, 2006, filed on October 17, 2006;
- (o) Our Current Report on Form 8-K dated October 31, 2006, filed on November 6, 2006;
- (p) The description of our preferred stock purchase rights contained in our Registration Statement

on Form 8-A filed on August 24, 1999, and all amendments or reports filed with the SEC for the purpose of updating such description, and further described in the section, "Description of Common Stock"; and

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(q) The description of our Common Stock contained in our registration statements filed pursuant to Section 12 of the Exchange Act, and all amendments or reports filed with the SEC for the purpose of updating such description, and further described in the section, "Description of Common Stock."

Any documents we file pursuant to Sections 13(a), 13(c), 14 or 15(d) of the Exchange Act after the date of this prospectus and prior to the termination of the offering of the securities to which this prospectus relates will automatically be deemed to be incorporated by reference in this prospectus and a part of this prospectus from the date of filing such documents; provided however, that we are not incorporating, in each case, any documents or information contained therein that has been furnished to, but not filed with, the SEC.

To receive a free copy of any of the documents incorporated by reference in this prospectus (other than exhibits, unless they are specifically incorporated by reference in any such documents), call or write Chesapeake Utilities Corporation, 909 Silver Lake Boulevard, Dover, Delaware 19904, Attention: Michael P. McMasters, Senior Vice President and Chief Financial Officer, telephone number (302) 734-6799. We also maintain a web site that contains additional information about us (<http://www.chpk.com>).

You should rely only on the information incorporated by reference or set forth in this prospectus or the applicable prospectus supplement. We have not authorized anyone else to provide you with different information. We may only use this prospectus to sell securities if it is accompanied by a prospectus supplement. We are offering these securities only in states where the offer is permitted. You should not assume that the information in this prospectus or the applicable prospectus supplement is accurate as of any date other than the dates on the front pages of these documents.

## THE COMPANY

We are a diversified utility company engaged directly or through subsidiaries in natural gas distribution, transmission and marketing, propane distribution and wholesale marketing, advanced information services and other related businesses. We are a Delaware corporation that was formed in 1947. As of June 30, 2006, our three natural gas distribution divisions served approximately 56,800 residential, commercial and industrial customers in central and southern Delaware, Maryland's Eastern Shore and parts of Florida. Our natural gas transmission subsidiary, Eastern Shore Natural Gas Company, operates a 331-mile interstate pipeline system that transports gas from various points in Pennsylvania to our Delaware and Maryland distribution divisions, as well as to other utilities and industrial customers in southern Pennsylvania, Delaware and on the Eastern Shore of Maryland. As of June 30, 2006, our propane distribution operation served approximately 32,700 customers in central and southern Delaware, the Eastern Shore of Maryland and Virginia, southeastern Pennsylvania, and parts of Florida; and our wholesale propane marketing subsidiary markets propane to large independent and petrochemical companies, resellers and retail propane companies in the United States. Our advanced information services segment provides domestic and international clients with information technology-related business services and solutions for both enterprise and e-business applications. Our principal executive office is located at 909 Silver Lake Boulevard, Dover, Delaware 19904, and our telephone number is (302) 734-6799. Our website address is <http://www.chpk.com>. Unless expressly incorporated by reference, information contained on or made available through our website is not a part of this prospectus or any accompanying prospectus supplement.

## USE OF PROCEEDS

Unless otherwise specified in a prospectus supplement, the net proceeds from the sale of Common Stock and/or debt securities will be added to our general corporate funds and may be used for general corporate purposes including, but not limited to, financing of capital expenditures, repayment of short-term debt, funding share repurchases, financing acquisitions, investing in subsidiaries and general working capital purposes. Prior to such application, all or a portion of the net proceeds may be invested in short-term investments.

## DESCRIPTION OF COMMON STOCK

Our Certificate of Incorporation authorizes us to issue up to 12,000,000 shares of Common Stock, par value per share \$0.4867. As of June 30, 2006, we had 5,957,627 shares of Common Stock outstanding. In addition, as of June 30,

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2006, we have reserved 487,950 shares of Common Stock for issuance under our equity-based compensation plans and 30,000 shares of Common Stock for issuance upon the exercise of warrants. Our Certificate of Incorporation also authorizes us to issue up to 2,000,000 shares of preferred stock, par value per share \$0.01; however, no shares of preferred stock are outstanding. Our Common Stock is listed on the New York Stock Exchange under the symbol, "CPK." The transfer agent and registrar of the Common Stock is Computershare Trust Company, N.A., P.O. Box 43010, Providence, Rhode Island 02940-3010.

The following descriptions of our Common Stock and preferred stock set forth certain of their general terms and provisions. The following descriptions are in all respects subject to and qualified by reference to the applicable provisions of our Certificate of Incorporation and our Bylaws.

Holders of our Common Stock are entitled to receive dividends when, as and if declared by our Board of Directors, out of funds legally available therefor. If we are liquidated, dissolved or involved in any winding-up, the holders of our Common Stock are entitled to receive ratably any assets legally available for distribution to holders of Common Stock. Holders of our Common Stock possess ordinary voting rights, with each share entitling the holder to one vote. Directors are elected by a plurality of the votes cast by the holders of our Common Stock present in person or represented by proxy at the meeting and entitled to vote for the election of directors. Holders of our Common Stock do not have preemptive rights, which means that they have no right to acquire any additional shares of Common Stock that we may subsequently issue (other than pursuant to the Rights, described below). Holders of our Common Stock also do not have conversion or subscription rights, and the Common Stock is not subject to redemption by the Company.

All of our shares of Common Stock currently outstanding are, and any shares of Common Stock offered hereby when issued will be, fully paid and nonassessable.

We may issue preferred stock from time to time, by authorization of our Board of Directors and without the necessity of further action or authorization by our stockholders, in one or more series and with such voting powers, designations, preferences and relative, participating, optional or other special rights and qualifications as our Board may, in its discretion, determine, including, but not limited to (a) the distinctive designation of such series and the number of shares to constitute such series; (b) the dividends, if any, for such series; (c) the voting power, if any, of shares of such series; (d) the terms and conditions (including price), if any, upon which shares of such stock may be converted into or exchanged for shares of stock of any other class or any other series of the same class or any other securities or assets; (e) our right, if any, to redeem shares of such series and the terms and conditions of such redemption; (f) the retirement or sinking fund provisions, if any, of shares of such series and the terms and provisions relative to the operation thereof; (g) the amount, if any, which the holders of the shares of such series shall be entitled to receive in case of our liquidation, dissolution or winding-up; (h) the limitations and restrictions, if any, upon the payment of dividends or the making of other distributions on, and upon our purchase, redemption, or other acquisition of, our Common Stock; and (i) the conditions or restrictions, if any, upon the creation of indebtedness or upon the issuance of any additional stock.

Under our Certificate of Incorporation, the affirmative vote of not less than 75% of the total voting power of all outstanding shares of our stock is required to approve our merger or consolidation with, or the sale of all or substantially all of our assets or business to, any other corporation (other than a corporation 50% or more of the common stock of which we own), if such corporation or its affiliates singly or in the aggregate own or control directly or indirectly 5% or more of our outstanding shares of Common Stock, unless the transaction is approved by our Board of Directors prior to the acquisition by such corporation or its affiliates of ownership or control of 5% or more of our outstanding shares of Common Stock. In addition, our Certificate of Incorporation provides for a classified Board of Directors under which one-third of the members are elected annually for three-year terms. The supermajority voting requirement for certain mergers and consolidations and our classified Board of Directors may have the effect of delaying, deferring or preventing a change in control of the Company.

On August 25, 1999, we filed with the SEC a Registration Statement on Form 8-A with respect to Rights (defined below) to purchase our Series A Participating Cumulative Preferred Stock, par value per share \$0.01 (the "Preferred Shares"). On August 20, 1999, our Board of Directors declared a dividend distribution of one preferred share purchase right (a "Right") for each outstanding share of our Common Stock. The dividend was payable to the stockholders of record on September 3, 1999 (the "Record Date"). One Right will also be issued with each share of Common Stock issued thereafter until the Distribution



Date (defined below) and, in certain circumstances, with each share of Common Stock issued after the Distribution Date. Except as set forth below, each Right, when it becomes exercisable, entitles the

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registered holder to purchase from the Company one-fiftieth of a Preferred Share at a price of \$54.56 (the "Purchase Price"), subject to adjustment. The description and terms of the Rights and the definition of the "Distribution Date" are set forth in a Rights Agreement (the "Rights Agreement") between the Corporation and Computershare Trust Company, N.A., successor to BankBoston, N.A., as Rights Agent (the "Rights Agent"), dated as of August 20, 1999. The Rights are not exercisable until the Distribution Date and will expire at the close of business on August 20, 2009, unless earlier redeemed by the Company. The Registration Statement on Form 8-A, and the Rights Agreement attached thereto as an exhibit, are incorporated herein by reference. This description of the Rights, the Rights Agreement and the Preferred Shares is in all respects subject to and qualified by reference to the Registration Statement on Form 8-A, the Rights Agreement attached thereto as an exhibit and the applicable provisions of our Certificate of Incorporation and our Bylaws.

The Preferred Shares purchasable upon exercise of the Rights will not be redeemable. Each Preferred Share will be entitled to a minimum preferential quarterly dividend payment equal to the greater of (i) \$13.00 per share (or \$0.26 per 1/50th of a Preferred Share) and (ii) an aggregate dividend per share of 50 times (subject to adjustment) the dividend declared per share of Common Stock. In the event of liquidation, the holders of the Preferred Shares will be entitled to a minimum preferential liquidation payment of \$900.00 per share (or \$18.00 per 1/50th of a Preferred Share); thereafter, and after the holders of the Common Stock receive a liquidation payment of \$18.00 per share, the holders of the Preferred Shares and the holders of the Common Stock will share the remaining assets in the ratio of 50 (subject to adjustment) to one for each Preferred Share and share of Common Stock so held, respectively. In the event of any merger, consolidation or other transaction in which Common Stock is exchanged, each Preferred Share will be entitled to receive 50 times (subject to adjustment) the amount received per share of Common Stock. The holders of Preferred Shares will be entitled to vote on all matters submitted to a vote of the Common Stock (with the Preferred Shares being entitled to 50 votes per share). In the event that the amount of accrued and unpaid dividends on the Preferred Shares is equivalent to six full quarterly dividends or more, the holders of the Preferred Shares shall have the right, voting as a class, to elect two directors in addition to the directors elected by the holders of the Common Stock until all cumulative dividends on the Preferred Shares have been paid through the last quarterly dividend payment date. These rights are protected by customary anti-dilution provisions. Because of the nature of the dividend, liquidation and voting rights of the Preferred Shares, the value of a one-fiftieth interest in a Preferred Share purchasable upon the exercise of a Right should approximate the value of one share of Common Stock. The Rights approved by the Board of Directors of the Company were designed to protect the value of the outstanding Common Stock in the event of an unsolicited attempt by an acquirer to take over the Company in a manner or on terms not approved by the Board of Directors. The Rights were not intended to prevent a takeover of the Company at a fair price and should not interfere with any merger or business combination approved by the Board of Directors. The Rights have no dilutive effect, nor do they affect reported earnings per share or change the way in which the Common Stock is traded.

The Rights may have the effect of rendering more difficult or discouraging an acquisition of the Company deemed undesirable by the Board of Directors. If a person or group attempts to acquire the Company on terms or in a manner not approved by the Board of Directors, then the Rights may cause such person's or group's ownership interest to become substantially diluted unless the offer includes, as a condition to the acquisition, a provision that the Rights will be purchased, redeemed or otherwise effectively eliminated.

## DESCRIPTION OF THE DEBT SECURITIES

The following description of the terms of the debt securities sets forth general terms that may apply to the debt securities and provisions of the indentures that will govern the debt securities. The description is not intended to be complete, as we will describe the particular terms of any debt securities in the prospectus supplement relating to those debt securities.

The debt securities will be either our senior debt securities or our subordinated debt securities. The senior debt securities will be issued under an indenture between us and the trustee. We refer to this indenture as the "senior indenture." The subordinated debt securities will be issued under an indenture between us and the trustee. We refer to this indenture as the "subordinated indenture" and to the senior indenture and the subordinated indenture together as the "indentures."

The following is a summary of some provisions of the indentures. The summary does not purport to be complete, and is subject to, and qualified in its entirety by reference to, all of the provisions of each indenture. Copies of the entire

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indentures are exhibits to the registration statement of which this prospectus is a part. Parenthetical section references under this heading are references to sections to each of the indentures unless we indicate otherwise.

**General Terms**

Neither indenture limits the amount of debt securities that we may issue. (Section 301). Each indenture provides that debt securities may be issued up to the principal amount authorized by us from time to time. The senior debt securities will be unsecured and will have the same rank as all of our other unsecured and unsubordinated debt. The subordinated debt securities will be unsecured and will be subordinated to all senior indebtedness as set forth below. None of our subsidiaries will have any obligations with respect to the debt securities. Therefore, our rights and the rights of our creditors, including holders of senior debt securities and subordinated debt securities, to participate in the assets of any subsidiary will be subject to the prior claims of the creditors of our subsidiaries.

We may issue the debt securities in one or more separate series of senior debt securities and/or subordinated debt securities. (Section 301). The prospectus supplement relating to the particular series of debt securities being offered will specify the particular amounts, prices and terms of those debt securities. These terms may include:

- the title of the debt securities and the series in which the debt securities will be included;
- the authorized denominations and aggregate principal amount of the debt securities;
- the date or dates on which the principal and premium, if any, are payable;
- the rate or rates per annum at which the debt securities will bear interest, if there is any interest, or the method or methods of calculating interest and the date from which interest will accrue;
- the place or places where the principal of and any premium and interest on the debt securities will be payable;
- the dates on which the interest will be payable and the corresponding record dates;
- the period or periods within which, the price or prices at which, and the terms and conditions on which, the debt securities may be redeemed, in whole or in part, at our option;
- any obligation to redeem, repay or purchase debt securities pursuant to any sinking fund or analogous provisions or at the option of a holder;
- the portion of the principal amount of the debt securities payable upon declaration of the acceleration of the maturity of the debt securities;
- the person to whom any interest on any debt security will be payable if other than the person in whose name the debt security is registered on the applicable record date;
- any events of default, covenants or warranties applicable to the debt securities;
- if applicable, provisions related to the issuance of debt securities in book-entry form;
- the currency, currencies or composite currency of denomination of the debt securities;
- the currency, currencies or composite currencies in which payments on the debt securities will be payable and whether the holder may elect payment to be made in a different currency;

- whether and under what conditions we will pay additional amounts to holders of the debt securities;
- the terms and conditions of any conversion or exchange provisions in respect of the debt securities;
- the terms pursuant to which our obligation under the indenture may be terminated through the deposit of money or government obligations;
- whether the debt securities will be subordinated in right of payment to senior indebtedness and the terms of any such subordination; and
- any other specific terms of the debt securities not inconsistent with the applicable indenture. (Section 301).

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Unless otherwise specified in the applicable prospectus supplement, the debt securities will not be listed on any securities exchange.

Unless the applicable prospectus supplement specifies otherwise, we will issue the debt securities in fully registered form without coupons. If we issue debt securities of any series in bearer form, the applicable prospectus supplement will describe the special restrictions and considerations, including special offering restrictions and special federal income tax considerations, applicable to those debt securities and to payment on and transfer and exchange of those debt securities.

### **U.S. Federal Income Tax Considerations**

We may issue the debt securities as original issue discount securities, bearing no interest or bearing interest at a rate, which, at the time of issuance, is below market rates, to be sold at a substantial discount below their principal amount. We will describe some special U.S. federal income tax and other considerations applicable to any debt securities that are issued as original issue discount securities in the applicable prospectus supplement. We encourage you to consult with your own competent tax and financial advisors on these important matters.

### **Payment, Registration, Transfer and Exchange**

Subject to any applicable laws or regulations, we will make payments on the debt securities at a designated office or agency, unless the applicable prospectus supplement otherwise sets forth. At our option, however, we may also make interest payments on the debt securities in registered form:

- by checks mailed to the persons entitled to interest payments at their registered addresses; or
- by wire transfer to an account maintained by the person entitled to interest payments as specified in the security register.

Unless the applicable prospectus supplement otherwise indicates, we will pay any installment of interest on debt securities in registered form to the person in whose name the debt security is registered at the close of business on the regular record date for that installment of interest. (Section 307). If a holder wishes to receive a payment by wire transfer, the holder should provide the paying agent with written wire transfer instructions at least 15 days prior to the payment date.

Unless the applicable prospectus supplement otherwise sets forth, debt securities issued in registered form will be transferable or exchangeable at the agency we may designate from time to time. Debt securities may be transferred or exchanged without service charge, other than any tax or other governmental charge imposed in connection with the transfer or exchange. (Section 305).

### **Book-Entry Procedures**

The applicable prospectus supplement for each series of debt securities will state whether those debt securities will be subject to the following provisions.

Unless debt securities in physical form are issued, the debt securities will be represented by one or more fully-registered global certificates, in denominations of \$1,000 or any integral multiple of \$1,000. Each global certificate will be deposited with, or on behalf of, The Depository Trust Company ("DTC"), and registered in its name or in the name of Cede & Co. or other nominee of DTC. No holder of debt securities initially issued as a global certificate will be entitled to receive a certificate in physical form, except as set forth below.

DTC has advised us that:

- DTC is:

- a “banking organization” within the meaning of the New York banking law;
- a limited purpose trust company organized under the New York banking law;
- a member of the Federal Reserve System;
- a “clearing corporation” within the meaning of the New York Uniform Commercial Code; and

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- a “clearing agency” registered pursuant to Section 17A of the Exchange Act.
- DTC holds securities for DTC participants and facilitates the settlement of securities transactions between DTC participants through electronic book-entry transfers, thereby eliminating the need for physical movement of certificates.
- DTC participants include securities brokers and dealers, banks, trust companies and clearing corporations.
- Access to DTC’s book-entry system is also available to others, such as banks, brokers and dealers, and trust companies and clearing corporations that clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly.

Holders that are not DTC participants but desire to purchase, sell or otherwise transfer ownership of, or other interests in, the debt securities may do so only through DTC participants. In addition, holders of the debt securities will receive all distributions of principal and interest from the trustee through DTC participants. Under the rules, regulations and procedures creating and affecting DTC and its operation, DTC is required to make book-entry transfers of debt securities among DTC participants on whose behalf it acts and to receive and transmit distributions of principal of, and interest on, the debt securities. Under the book-entry system, holders of debt securities may experience some delay in receipt of payments, since the trustee will forward such payments to Cede & Co., as nominee for DTC, and DTC, in turn, will forward the payments to the appropriate DTC participants.

DTC participants will be responsible for distributions to holders of debt securities, which distributions will be made in accordance with customary industry practices. Although holders of debt securities will not have possession of the debt securities, the DTC rules provide a mechanism by which those holders will receive payments and will be able to transfer their interests. Although the DTC participants are expected to convey the rights represented by their interests in any global security to the related holders, because DTC can act only on behalf of DTC participants, the ability of holders of debt securities to pledge the debt securities to persons or entities that are not DTC participants or to otherwise act with respect to the debt securities may be limited due to the lack of physical certificates for the debt securities.

Neither we nor the trustee under the applicable indenture nor any agent of either of them will be responsible or liable for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the debt securities or for supervising or reviewing any records relating to such beneficial ownership interests. Since the only “holder of debt securities,” for purposes of the indenture, will be DTC or its nominee, the trustee will not recognize beneficial holders of debt securities as “holders of debt securities,” and beneficial holders of debt securities will be permitted to exercise the rights of holders only indirectly through DTC and DTC participants. DTC has advised us that it will take any action permitted to be taken by a holder of debt securities under the indenture only at the direction of one or more DTC participants to whose accounts with DTC the related debt securities are credited.

All payments we make to the trustee will be in immediately available funds and will be passed through to DTC in immediately available funds.

Physical certificates will be issued to holders of a global security, or their nominees, if:

- DTC advises the trustee in writing that DTC is no longer willing, able or eligible to discharge properly its responsibilities as depository and we are unable to locate a qualified successor; or
- We decide in our sole discretion to terminate the book-entry system through DTC. (Section 305).

In such event, the trustee under the applicable indenture will notify all holders of debt securities through DTC participants of the availability of such physical debt securities. Upon surrender by DTC of a definitive global note representing the debt securities and receipt of instructions for reregistration, the trustee will reissue the debt securities in physical form to holders or their nominees. (Section 305).



Debt securities in physical form will be freely transferable and exchangeable at the office of the trustee upon compliance with the requirements set forth in the applicable indenture.

No service charge will be imposed for any registration of transfer or exchange, but payment of a sum sufficient to cover any tax or other governmental charge may be required. (Section 305).

Table of Contents**Consolidation, Merger or Sale by the Company**

Each indenture generally permits a consolidation or merger between us and another U.S. corporation. It also permits the sale or transfer by us of all or substantially all of our property and assets and the purchase by us of all or substantially all of the property and assets of another corporation. These transactions are permitted if:

- the resulting or acquiring corporation, if other than us, assumes all of our responsibilities and liabilities under the indenture, including the payment of all amounts due on the debt securities and performance of the covenants in the indenture; and
- immediately after the transaction, no event of default exists. (Section 801).

Even though each indenture contains the provisions described above, we are not required by either indenture to comply with those provisions if we sell all of our property and assets to another U.S. corporation if, immediately after the sale, that corporation is one of our wholly-owned subsidiaries. (Section 803).

If we consolidate or merge with or into any other corporation or sell all or substantially all of our assets according to the terms and conditions of each indenture, the resulting or acquiring corporation will be substituted for us in the indentures with the same effect as if it had been an original party to the indentures. As a result, the successor corporation may exercise our rights and powers under each indenture, in our name or in its own name and we will be released from all our liabilities and obligations under each indenture and under the debt securities. (Section 802).

**Events of Default, Notice and Certain Rights on Default**

Unless otherwise stated in the applicable prospectus supplement, an "event of default," when used with respect to any series of debt securities, means any of the following:

- failure to pay interest on any debt security of that series for 30 days after the payment is due;
- failure to pay the principal of or any premium on any debt security of that series when due;
- failure to deposit any sinking fund payment on debt securities of that series when due;
- failure to perform any other covenant in the applicable indenture that applies to debt securities of that series for 90 days after we have received written notice of the failure to perform in the manner specified in the indenture;
- default under any debt, including other series of debt securities, or under any mortgage, lien or other similar encumbrance, indenture or instrument, including the indentures, which secures any debt, and which results in acceleration of the maturity of an outstanding principal amount of debt greater than \$50 million, unless the acceleration is rescinded, or the debt is discharged, within 10 days after we have received written notice of the default in the manner specified in the indenture;
- certain events in bankruptcy, insolvency or reorganization; or
- any other event of default that may be specified for the debt securities of that series when that series is created. (Section 501).

If an event of default for any series of debt securities occurs and continues, the trustee or the holders of at least 25% in aggregate principal amount of the outstanding debt securities of the series may declare the entire principal of all the debt securities of that series to be due and payable immediately. If a declaration occurs, the holders of a majority of the aggregate principal amount of the outstanding debt

securities of that series can, subject to certain conditions, rescind the declaration. (Section 502).

The prospectus supplement relating to each series of debt securities which are original issue discount securities will describe the particular provisions that relate to the acceleration of maturity of a portion of the principal amount of that series when an event of default occurs and continues.

An event of default for a particular series of debt securities does not necessarily constitute an event of default for any other series of debt securities issued under either indenture.

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Each indenture requires us to file an officers' certificate with the trustee each year that states that certain defaults do not exist under the terms of the indenture. The trustee will transmit by mail to the holders of debt securities of a series notice of any default.

Other than its duties in the case of a default, a trustee is not obligated to exercise any of its rights or powers under an indenture at the request, order or direction of any holders, unless the holders offer the trustee indemnification satisfactory to the trustee. (Section 603). If indemnification satisfactory to the trustee is provided, then, subject to certain other rights of the trustee, the holders of a majority in principal amount of the outstanding debt securities of any series may, with respect to the debt securities of that series, direct the time, method and place of:

- conducting any proceeding for any remedy available to the trustee; or
- exercising any trust or power conferred upon the trustee. (Section 512).

The holder of a debt security of any series will have the right to begin any proceeding with respect to the applicable indenture or for any remedy only if:

- the holder has previously given the trustee written notice of a continuing event of default with respect to that series;
- the holders of at least 25% in aggregate principal amount of the outstanding debt securities of that series have made a written request of, and offered reasonable indemnification to, the trustee to begin the proceeding;
- the trustee has not started the proceeding within 60 days after receiving the request; and
- the trustee has not received directions inconsistent with the request from the holders of a majority in aggregate principal amount of the outstanding debt securities of that series during those 60 days. (Section 507).

The holders of not less than a majority in aggregate principal amount of any series of debt securities, by notice to the trustee for that series, may waive, on behalf of the holders of all debt securities of that series, any past default or event of default with respect to that series and its consequences. (Section 513). A default or event of default in the payment of the principal of, or premium or interest on, any debt security and certain other defaults may not, however, be waived. (Sections 508 and 513).

## **Modification of the Indentures**

We, as well as the trustee for a series of debt securities, may enter into one or more supplemental indentures, without the consent of the holders of any of the debt securities, in order to:

- evidence the succession of another corporation to us and the assumption of our covenants by a successor;
- add to our covenants or surrender any of our rights or powers;
- add additional events of default for any series;

**Exhibit F**

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF DELAWARE**

**IN THE MATTER OF THE APPLICATION OF )  
CHESAPEAKE UTILITIES CORPORATION )  
FOR APPROVAL OF THE ISSUANCE OF ) P.S.C. DOCKET NO. 06-  
COMMON STOCK AND/OR DEBT SECURITIES )**

Chesapeake Utilities Corporation (hereinafter sometimes called "Chesapeake" or "Applicant") pursuant to 26 Del. C. section 215, makes the following application for approval by the Delaware Public Service Commission ("Commission") of the issuance of up to \$40,000,000 ("\$40 million") in common stock and/or debt securities. In support of this Application, Chesapeake states the following:

1. Chesapeake is a Delaware public utility with its principal place of business at 909 Silver Lake Boulevard, Dover, Delaware 19904. All communications should be addressed to Applicant at the following address, Attention: Jennifer A. Clausius, Manager of Pricing and Regulation, 350 South Queen Street, P.O. Box 1769, Dover, Delaware 19904 or at the following e-mail address: [jclausius@chpk.com](mailto:jclausius@chpk.com). The respective telephone number and facsimile number are 302.738.7818 and 302.734.6011.

2. Counsel for the Applicant is William A. Denman, Esquire, Parkowski, Guerke & Swayze P.A., 116 West Water Street, P.O. Box 598, Dover, Delaware 19903. Correspondence and other communications concerning this Application

should be directed to counsel at the foregoing address, or at the following e-mail address: [wdenman@pgslegal.com](mailto:wdenman@pgslegal.com). The respective telephone number and facsimile number are 302.678.3262 and 302.678.9415.

3. Chesapeake is a corporation incorporated under the laws of the State of Delaware. The voting stock of Chesapeake is publicly owned. Shares of common stock, par value \$0.4867, 5,957,719 of which were outstanding as of June 30, 2006, are the only voting securities of Chesapeake. Each share is entitled to one vote.

4. On February 23, 2006, the Board of Directors of Chesapeake authorized the officers of Chesapeake to prepare and file the registration statement for a \$40 million shelf offering for common stock and/or debt securities.

5. On June 21, 2006, Chesapeake filed a shelf registration statement with the Securities and Exchange Commission (the "SEC") notifying the SEC of the possibility of Chesapeake issuing up to \$40 million in common stock and/or debt securities. The shelf registration statement is effective for a three-year period from the effective date. Filing a shelf registration statement provides the SEC with notice of the possibility of security issuances. As a result of the filing of the shelf registration, the Company may consummate multiple transactions under the shelf registration statement over the three-year period, as long as the transactions in the aggregate do not exceed \$40 million. Each transaction would require the preparation and submission of a prospectus supplement with the SEC, outlining the specific details regarding the securities to be issued.

6. For any securities that are issued, Chesapeake expects to utilize the proceeds to repay short-term debt, which is being utilized to temporarily finance the Company's capital expenditure program. For the ten-year period from January 1, 1996 through December 31, 2005, the Company's average annual capital expenditures were \$18.8 million. The Company's capital expenditures budget for 2006 is \$54.4 million.

7. In terms of common stock, the Company's articles of incorporation authorize the Company to issue up to 12,000,000 shares of common stock. Any common stock issued under the shelf registration statement, after taking into account the shares of common stock of the Company that have heretofore been issued, would be well below the authorized amount. In this application, the Company is requesting authority to issue common stock of up to \$40 million.

8. In terms of debt, the form of the securities has not been determined. The Company has historically completed private placements of unsecured Senior Notes. The Company desires the flexibility of issuing up to \$40 million of long-term debt in the form that is most advantageous from the Company's standpoint in regards to terms and conditions, as well as, cost. The possible forms of debt include, but are not limited to, unsecured Senior Notes, public debt securities issued under a prospectus supplement and the shelf registration statement, and tax-exempt financing. Regardless of the form of the debt securities, the Company is requesting authority to issue debt securities that have a coupon rate of no more than 7 percent.

9. In summary, the Company is requesting authority from the

Commission to issue common stock and/or debt securities in an amount not to exceed \$40 million.

10. A copy of the opinion of counsel for Chesapeake with respect to the legality of the proposed issuance of common stock and/or debt securities is attached hereto as Attachment A.

11. Attached hereto as Attachment B and incorporated herein by reference is a schedule setting forth Chesapeake's balance sheet and income statement for the twelve (12) months ended June 30, 2006, before the issuance of the common stock and/or debt securities. Attachment B also shows the impact on the balance sheet and income statement under three assumptions: (a) the issuance of \$40,000,000 of common stock, at a market price of \$30.00 per share less an estimated discount of 5 percent (Scenario 1); (b) the issuance of new debt in the amount of \$40,000,000 at a current market interest rate of 6.50 percent (for unsecured Senior Notes with terms and conditions comparable to the Company's outstanding unsecured Senior Notes) (Scenario 2); and (c) the issuance of \$20,000,000 of new debt at a current market interest rate of 6.50 percent (for unsecured Senior Notes with terms and conditions comparable to the Company's outstanding unsecured Senior Notes) and \$20,000,000 of common stock, at a market price of \$30.00 per share less an estimated discount of 5 percent (Scenario 3). Attachment B is being presented to illustrate the potential range of the impact on the Company's earnings and capital structure as a result of issuing the securities under the assumptions provided in the various scenarios.



12. Attached hereto as Attachment C is a copy of Chesapeake's annual report on Form 10-K for the calendar year ended December 31, 2005. Attached hereto as Attachment D is Chesapeake's most recent quarterly report on Form 10-Q. Also attached hereto as Attachment E is a copy of Chesapeake's shelf registration statement. All three reports have been filed with the Securities and Exchange Commission.

13. Pursuant to the Commission's Minimum Filing Requirements – Part (D), attached hereto and incorporated herein by reference are the following schedules:

- a) Schedule No. 1 – Capitalization ratios, actual and pro forma as of June 30, 2006, for each of the scenarios described in paragraph 11 above.
- b) Schedule No. 2 – Rate of return, actual and pro forma for the twelve (12) months ended June 30, 2006, for each of the scenarios described in paragraph 11 above.
- c) Schedule No. 3 – Fixed charge coverage ratios for the twelve (12) months ended June 30, 2006, for each of the scenarios described in paragraph 11 above.

14. Chesapeake represents that the proposed issuance of common stock and/or debt securities is in accordance with law, for a proper purpose, and consistent with the public interest.

WHEREFORE, Chesapeake prays as follows:

- A. That the Commission file this Application and make such investigation in this matter as it deems necessary;
- B. That the Commission authorizes the Company to issue up to \$40,000,000 of common stock and/or debt securities consistent with the terms and conditions described herein.

CHESAPEAKE UTILITIES CORPORATION

By: *Beth W. Cooper*  
Beth W. Cooper  
Vice President, Treasurer, and Corporate  
Secretary

PARKOWSKI, GUERKE & SWAYZE, P.A.

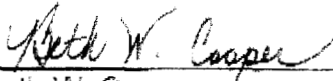
By: *William A. Denman*  
William A. Denman  
116 West Water Street  
Dover, DE 19903  
Attorney for Applicant

DATED: October 16, 2006

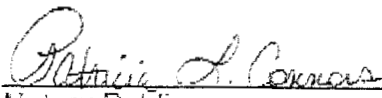
DATED: October 16, 2006

STATE OF DELAWARE )  
 )  
COUNTY OF KENT )

BE IT REMEMBERED that on this 16th day of October, 2006, personally appeared before me, a notary public for the State and County aforesaid, Beth W. Cooper, who being by me duly sworn, did depose and say that she is Vice President, Treasurer, and Corporate Secretary of Chesapeake Utilities Corporation, a Delaware corporation, and that insofar as the Application of Chesapeake Utilities Corporation states facts, and insofar as those facts are within her personal knowledge, they are true; and insofar as those facts are not within her personal knowledge, she believes them to be true; and that the attachments accompanying this application and attached hereto are true and correct copies of the originals of the aforesaid attachments, and that she has executed this Application on behalf of the Company and pursuant to the authorization of its Board of Directors.

  
\_\_\_\_\_  
Beth W. Cooper  
Vice President, Treasurer, and  
Corporate Secretary

SWORN TO AND SUBSCRIBED before me the day and year above written.

  
\_\_\_\_\_  
Patricia L. Commons  
Notary Public  
My Commission Expires: 2/1/10

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF )  
CHESAPEAKE UTILITIES CORPORATION FOR )  
APPROVAL OF THE ISSUANCE OF UP TO ) PSC DOCKET NO. 06-339  
\$40 MILLION IN COMMON STOCK AND/OR )  
DEBT SECURITIES )  
(FILED OCTOBER 16, 2006) )

ORDER NO. 7065

AND NOW, to-wit, this 31<sup>st</sup> day of October, 2006;

WHEREAS, Chesapeake Utilities Corporation ("Chesapeake" or "the Company") has applied to the Commission for approval, under 26 Del. C. § 215(e), of a three-year financing plan whereby the Company plans to issue over such period \$40,000,000 ("\$40 million") in common stock and/or debt securities, with the exact aggregate principal amounts, the interest rate(s) payable, the dates of interest payments, and other particulars of such financings to be determined from time to time by the officers authorized to do so; and

WHEREAS, under 26 Del. C. § 215(e)(2), the Commission may make such investigation and hold such hearings in this matter as it deems necessary, and thereafter may approve the plan in whole or in part with such modification and upon such terms and conditions as it deems appropriate; and

WHEREAS, the Commission is required to approve any financing plan when the proposed financings are to be made in accordance with law, for proper purposes, and are consistent with the public interest; and

WHEREAS, under the provisions of 26 Del. C. § 215(e)(2), the Commission may also review the plan for consistency with efficient and reasonable financing principles; and

WHEREAS, under 26 Del. C. § 215(e)(2), the Commission may require the filing of periodic reports as to the action taken pursuant to the plan and shall approve, modify, refuse, or prescribe appropriate terms and conditions with respect to any such plan within thirty (30) days of its filing or, in the absence of such action within such period of time, the proposed financing plan will be deemed to be approved as filed as if the Commission itself had acted favorably thereon; and

WHEREAS, the Commission Staff has reviewed and examined the proposed financing plan and the schedules and exhibits appended thereto, and has determined that the proposed plan is consistent with efficient and reasonable financing principles, is for a proper purpose, is consistent with the public interest, and has recommended Commission approval of said proposed financing plan; now, therefore,

IT IS ORDERED:

1. That, the Commission having independently reviewed this matter and having determined that public notice and hearing are not required, finds that the three-year financing plan filed by Chesapeake Utilities Corporation with the Commission on October 16, 2006 is consistent with efficient and reasonable financing principles, is for a proper purpose, is in accordance with law, is consistent with the public interest, and is, therefore, hereby approved.

2. That, nothing in this Order shall be construed as a guarantee, warranty, or representation by the State of Delaware or by any agency, commission, or department thereof with respect to the indebtedness of Chesapeake Utilities Corporation, which may be issued or incurred under the financing plan herein approved.

3. That Chesapeake Utilities Corporation, shall, no later than fifteen (15) days after the issuance of any indebtedness or equity under the approval herein granted, file with the Commission a report describing in detail the exact nature of the issued financing, including the amount, term, rate, issuance costs, the date of issuance, revised capitalization ratios, and an opinion of counsel that said issuance was made for a proper purpose, in accordance with law, and consistent with the authority granted herein.

4. That the approval of this application by the Commission is not to be construed as approving any capitalization ratios which result therefrom for any purposes or in any proceedings involving the rates of this utility, nor is the burden of proof as imposed by statute upon the utility affected by this approval.

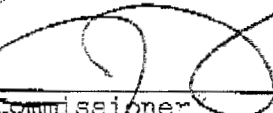
5. That the Commission reserves the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

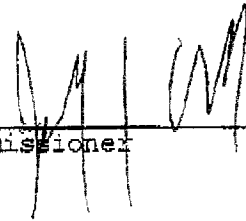
  
 Chair

  
 Commissioner

  
 Commissioner

  
 Commissioner

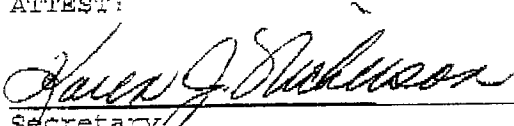
PSC Docket No. 06-339, Order No. 7065 Cont'd.




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Commissioner

ATTEST:




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Secretary