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850 224 9634 tel 850 222 0103 fax

November 6, 2006

VIA HAND DELIVERY

Blanca S. Bayó, Director  
Division of Commission Clerk and Administrative Services  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399-0850

RECEIVED 11:00  
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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 2007.

060728-64

Dear Ms. Bayó:

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 2007, along with a copy of the pleading on diskette in Word format.

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Enclosures

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Blanca S. Bayó, Director

November 6, 2006

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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

**ORIGINAL**

**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 2007 )

**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 2007**

Chesapeake Utilities Corporation (Chesapeake, the Company or Applicant) respectfully files this Application, pursuant to Section 366.04 (1), Florida Statutes, seeking authority in 2007 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 2007, 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

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 par value of \$.4867.
- b) Amount authorized: 12,000,000 shares.
- c) Amount outstanding as of June 30, 2006: 5,957,719
- d) Amount held in Treasury: 92.
- 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 par value of \$.01.
- b) Amount authorized: 2,000,000 shares.
- c) Amount outstanding as of June 30, 2006: 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, 2006, there is a remaining balance of \$2,092,000 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, 2006, there is a remaining balance of \$2,000,000 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, 2006 there is a remaining balance of \$4,545,454 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, 2006, there is a remaining balance of \$6,000,000 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, 2006, there is a remaining balance of \$18,000,000 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, 2006, there is a remaining balance of \$30,000,000 on this issue.

- (b) The amounts authorized are set forth above.
- (c) The amounts outstanding at June 30, 2006 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 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. 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 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 2006, Docket No. 050630-GU, dated September 21, 2005, and is hereby incorporated. A copy of the \$20,000,000 Note Agreement for the 5.50% Unsecured Notes is included herewith at Exhibit C.

(h)2 As of the filing date, the Company had two unsecured committed bank line 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 lines 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, 2006, the total short-term borrowing outstanding under the bank lines of credit was \$33,003,405.

5. Authorizations Requested

Chesapeake requests authorization from the FPSC to issue up to 833,836 new shares of its common stock during 2007 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>
91,450	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.
122,986	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 2007 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 2007 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 2007 to issue up to 3,366,164 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 2007. 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 2007, 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 2007 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 2007, 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 million.

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, 2006, the RSP had 328 active participants; a total market valuation of \$33,713,457 and 475,453 shares of the Company's common stock. True and correct copies of the current RSP Plan Document and Adoption Agreement have been previously filed with the FPSC as Exhibits A and B of the Application for Modification of Authority to Issue Common Stock During the Twelve Months Ending December 31, 1999, Docket No. 981213-GU, dated June 25, 1999, and are hereby incorporated by reference. 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 408,550 new shares of common stock for the RSP as of June 30, 2006. Thus, there remains to be issued 91,450 shares as authorized by the Delaware Public Service Commission.

The FPSC approved the issuance and sale of up to 123,872 shares of common stock for the Plan during 2006 by Order No. PSC-05-1103-FOF-GU issued on November 3, 2005. Chesapeake now seeks FPSC authorization to issue up to 91,450 new shares of Chesapeake common stock for the purpose of administering Chesapeake's Retirement Savings Plan during 2007.

(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. 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. 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. 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 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, 2006, Chesapeake had 97 shares of treasury stock, which can be reissued from the Performance Incentive Plan to satisfy outstanding awards.

Pursuant to the PIP, Chesapeake has issued 130,185 new shares of common stock as of June 30, 2006. The FPSC approved the issuance and sale of up to 200,000 shares of common stock for the PIP during 2006 by Order No. PSC-05-1103-FOF-GU, issued on November 3, 2005. 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, would be issued under the authority of the pre-existing PIP. Stock awards granted in 2006 through 2014, to the extent earned and awarded in such years, were 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 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. 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 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.

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 2007. The 200,000 shares should be adequate to cover any shares issued in 2007 pursuant to awards granted to executives and other key officers of the Company and its subsidiaries for 2006.

(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, 2006, the DRP had 1,363 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 554,927 new shares of common stock as of June 30, 2006. Thus, there remains to be issued 695,073 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 2006 by Order No. PSC-05-1103-FOF-GU, issued on November 3, 2005.

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 2007.

(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, 2006, \$2,092,000 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 122,986. 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, 2006, a cumulative \$1,983,000 of the Convertible Debentures has been converted. The FPSC approved the issuance and sale of up to 144,797 new shares of Chesapeake common stock for the purpose of honoring conversion rights pursuant to the Company's Convertible Debentures during 2006, by Order No.PSC-05-1103-FOF-GU, issued on September 21, 2005. Chesapeake now seeks FPSC authorization to issue up to 122,986 new shares of Chesapeake common stock for the purpose of honoring these conversion rights during 2007.

(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.

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. 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 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. The FPSC approved the issuance of up to 14,400 shares of common stock for the DSCP during 2006 by Order No. PSC-05-1103-FOF-GU, issued on November 3, 2005. Pursuant to the DSCP, Chesapeake has issued 11,700 new shares of common stock as of June 30, 2006. Thus, there remains to be issued 63,300 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 2007. The 14,400 shares should be adequate to cover any awards granted to non-employee directors of the Company in 2007.

(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.

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. 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 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. The FPSC approved the issuance of up to 5,000 shares of common stock for the ESAP during 2006 by Order No. PSC-05-1103-FOF-GU, issued on November 3, 2005. Pursuant to the ESAP, Chesapeake has issued 350 shares of common stock as of June 30, 2006. Thus, there remains to be issued 24,650 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 2007. The 5,000 shares should be adequate to cover any awards granted to managers and employees of the Company and its subsidiaries in 2007.

(g) In 2000 and 2001, the Company entered into agreements with an investment banking firm to provide consulting services. Under the agreements, the Company issued warrants to the investment banking firm to purchase shares of Chesapeake common stock. On March 31, 2000, the Company issued warrants to the investment banker to purchase 15,000

shares of Company stock at a strike price of \$18.00 per share. On March 31, 2001, the Company issued warrants to the investment banker to purchase another 15,000 shares of Company stock at a strike price of \$18.25 per share. Per the agreements, the warrants are exercisable during a seven-year period after the date granted. Upon exercise, the investment banker will surrender each warrant along with payment in full, by cash, check or wire transfer of the purchase price payable, in respect of the number of shares of stock purchased upon such exercise. In addition, the Company may satisfy any exercised warrants by issuing new shares, purchasing shares of common stock in the open market, or reissuing out of treasury to the extent available.

On December 21, 2004, the Delaware Public Service Commission issued Order No. 6543 approving the issuance of 30,000 shares of new common stock to satisfy 30,000 outstanding warrants. A copy of the Application and Order have been previously filed with the FPSC within Exhibit H 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.

On August 2, 2006, the respective investment banking firm exercised the 30,000 outstanding warrants for a share price of \$31.405. The firm requested that the Company perform a "net cash" settlement of the warrants by issuing cash in lieu of shares of stock, to which the Company's management agreed. On September 14, 2006, the Company finalized the agreement and paid \$434,782 to the firm. The Company recorded the payment as a reduction to additional paid-in capital. As of June 30, 2006, the Company has zero (0) outstanding warrants.



(h) Chesapeake is seeking FPSC approval to issue up to 800,000 shares of Chesapeake stock, or an equity-linked instrument equivalent in value in 2007 to permanently finance Chesapeake's ongoing 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.

(i) Chesapeake seeks FPSC authorization to issue during 2007 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. 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 2006 by Order No. PSC-05-1103-FOF-GU, issued November 3, 2005. As discussed previously, Chesapeake issued \$20 million of 5.50% Unsecured Senior Notes on October 12, 2006, which are due October 12, 2020.

(j) Chesapeake seeks further FPSC authorization to issue during 2007 up to an additional 3,366,164 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 4,281,931 shares of common stock and \$40,000,000 in secured and/or unsecured long-term debt for this purpose during 2006 by Order No. PSC-05-1103-FOF-GU, issued on November 3, 2005.

(k) Chesapeake seeks FPSC authorization to issue up to 1,000,000 shares of Chesapeake preferred stock during 2007 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, 2006, 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 2006 by Order No. PSC-05-1103-FOF-GU, issued on November 3, 2005.

(l) Chesapeake is also requesting authority during 2007 to enter into 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. 050630-GU, 030942-GU, 991631-GU, 981213-GU, 961194-GU and 931112-GU, respectively, are incorporated in the instant Application by reference:

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. 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. 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).

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. 981213-GU

Exhibit C: Chesapeake Utilities Corporation Amended Performance Incentive Plan.

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. 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.

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, 2005.

A(2) Chesapeake Utilities Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.

Exhibit B: Sources and Uses of Funds Statement and Construction Budget.

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

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 2007 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: November 6, 2006

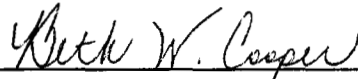


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(850) 224-9634  
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Attorneys for  
Chesapeake Utilities Corporation

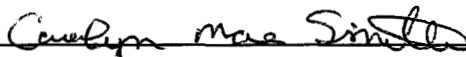
STATE OF DELAWARE \*  
\*  
COUNTY OF KENT \* SS

BE IT REMEMBERED that on this the day of November 6, 2006, 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:

## **EXHIBIT A**

- A(1) Chesapeake Utilities Corporation Annual Report on Form 10-K for the year ended December 31, 2005.
- A(2) Chesapeake Utilities Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2006.

**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, 2005 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, 2005, 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 \$170 million.

As of March 2, 2006, 5,925,945 shares of common stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2006 Annual Meeting of Stockholders are incorporated by reference in Part III.

CHESAPEAKE UTILITIES CORPORATION  
FORM 10-K

YEAR ENDED DECEMBER 31, 2005

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## PART I

### Safe Harbor for Forward-Looking Statements

References in this document to “Chesapeake,” “the Company,” “we,” “us” and “our” mean Chesapeake Utilities Corporation and/or its wholly owned subsidiaries, as appropriate. Chesapeake Utilities Corporation has made statements in this Form 10-K 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 margins, capital expenditures, environmental remediation costs, regulatory approvals, 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.

#### 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 54,800 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 331-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 32,900 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 and transmission, 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 and Transmission

###### 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 42,000 customers, of which approximately 41,800 are residential and commercial customers purchasing gas primarily for heating purposes. The remainder are industrial customers. For the year 2005, residential and commercial customers accounted for approximately 75% of the volume delivered by the divisions and 68% of the divisions’ revenue.

Florida. The Florida division distributes natural gas to approximately 13,100 residential and commercial and 100 industrial customers in Polk, Osceola, Hillsborough, Gadsden, Gilchrist, Union, Holmes, Jackson, Desoto, Suwannee, Liberty and Citrus Counties. Currently the industrial customers, which purchase and transport gas on a firm basis, account for approximately 90% of the volume delivered by the Florida division and 45% of the revenues. These customers are primarily engaged in the citrus and phosphate industries and in electric cogeneration. PESCO provides natural gas supply management services to 285 customers on the Company's Florida division, which operates as Central Florida Gas and an additional 424 customers on the Peoples Gas system, a subsidiary of TECO Energy, headquartered in Tampa, Florida. During 2005, Chesapeake formed a new wholly owned subsidiary, Peninsula Pipeline Company, Inc. to deliver natural gas 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 which 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 six (6) months notice for termination; (b) firm transportation capacity of 311 Dt per day for December through February, expiring in 2006; (c) firm transportation capacity of 174 Dt per day, which expires in 2008; (d) firm transportation capacity of 1,842 Dt, currently released from Eastern Shore, which expires in 2006; (e) firm storage service, providing a total capacity of 142,830 Dt, with provisions to continue from year to year, subject to six (6) months notice for termination; and (f) firm storage service, providing a total capacity of 17,967 Dt, currently released from Eastern Shore, which expires in 2006.

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 43,787 Dt per day for the period December through February, 42,565 Dt per day for the months of November, March and April, and 33,489 Dt per day for the period May through October, with various expiration dates ranging from 2005 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, which expires in 2006.

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 29,700 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 from year to year, subject to six (6) months notice for termination; (b) firm transportation capacity of 155 Dt per day for December through February, expiring in 2006; (c) firm transportation capacity of 973 Dt, currently released from Eastern Shore, which expires in 2006; (d) firm storage service providing a total capacity of 33,120 Dt, with provisions to continue from year to year, subject to six months notice for termination ; and (e) firm storage service, providing a total capacity of 5,489 Dt, currently released from Eastern Shore, which expires in 2006.

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; and (e) firm storage service providing a peak day entitlement of 521 Dt and a total capacity of 46,881 Dt, which expires in 2018. 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 16,278 Dt per day for the period December through February, 15,554 Dt per day for the months of November, March and April and 10,993 Dt per day for the period May through October, with various expiration dates ranging from 2006 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, which expires in 2006.

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 7,500 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 transportation service from Florida Gas Transmission Company ("FGT"), a major interstate pipeline. Chesapeake has contracts with FGT for: (a) daily firm transportation capacity of 27,579 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.

The Florida division also began receiving transportation service from Gulfstream Natural Gas System ("Gulfstream"), beginning in June 2002. Chesapeake has a contract with Gulfstream for daily firm transportation capacity of 10,000 Dt daily. The contract with Gulfstream expires May 31, 2022.

PESCO currently has a contract with Eagle Energy Partners for the purchase of firm natural gas supply. This contract provides the availability of a maximum firm daily entitlement of 7,500 MMBtus. The gas purchase contract expires in April 2006.

*Eastern Shore.* Eastern Shore has 2,720 thousand cubic feet ("Mcf") of firm transportation capacity under contract with Transco, which expires in 2008. Eastern Shore also has contracts with Transco for: (a) 5,406 Mcf of firm peak day entitlements and total storage capacity of 267,981 Mcf, which expires in 2013; and (b) 1,640 Mcf of firm peak day entitlements and total storage capacity of 10,283 Mcf, which expires in 2006.

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 2005, our propane distribution operations served approximately 32,900 propane customers on the Delmarva Peninsula, southeastern Pennsylvania and in Florida and delivered approximately 26 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 domestic oil companies and independent producers of gas liquids and oil. 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 in portable cylinders or 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 wholly owned subsidiary, 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, 2005, Chesapeake had 423 employees, including 185 in natural gas, 140 in propane and 60 in advanced information services. The remaining 38 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 58) 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.

Paul M. Barbas (age 49) Mr. Barbas is Chief Operating Officer of Chesapeake Utilities Corporation. He was appointed to his current position effective January 1, 2006. He previously served as Executive Vice President and President of Chesapeake Service Company. He was appointed Executive Vice President in 2004 and served as Vice President and President of Chesapeake Service Company since joining the company in 2003. Prior to joining Chesapeake, Mr. Barbas was Executive Vice President of Allegheny Power. Mr. Barbas joined Allegheny Energy as President of Allegheny Ventures in 1999 and was appointed Executive Vice President of Allegheny Power in 2001. Prior to 1999 Mr. Barbas held a variety of executive positions within G.E. Capital.

Michael P. McMasters (age 47) 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 45) 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 39) 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 53) 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 25-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 ("the 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 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 the company's results of operations, cash flows and financial condition.***

The Company's regulated utility and propane distribution operations are weather sensitive, with a significant portion of its revenues derived from the delivery of natural gas and propane to residential and commercial heating customers during the winter season. Generally, weather conditions directly influence the volume of natural gas and propane delivered by the regulated utility and propane distribution operations.

***Regulation of Chesapeake, including changes in the regulatory environment in general, may adversely affect the company's results of operations, cash flows and financial condition.***

The state Public Service Commissions of Delaware, Maryland and Florida regulate the natural gas distribution operations. The Company's natural gas transmission operation is regulated by the FERC. These regulatory commissions set the rates in their respective jurisdictions that the Company can charge customers for its rate-regulated services. Changes in these rates, as ordered by regulatory commissions, affect the Company's financial performance.

The Company expects that regulatory commissions will continue to set the prices for delivery service that give it an opportunity to earn a just and reasonable rate of return on the capital invested in its distribution system and to recover reasonable operating expenses.

***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 the Company's control, such as weather and refinery closings. The Company believes it has adequate resources to meet its customer's needs. See discussion on adequacy of resources in Item 1 under the heading "Business — Narrative Description of Business."

***Chesapeake relies on direct connections to interstate pipelines and storage capacity. If these pipelines or storage facilities were unable to deliver for any reason it could impair Chesapeake's ability to meet its customers' full requirements.***

Chesapeake is responsible for acquiring both sufficient natural gas supplies and interstate pipeline and storage capacity to meet customer requirements. As such, Chesapeake must contract for reliable and adequate delivery capacity to its distribution system, while considering the dynamics of the interstate pipeline and storage capacity market, its own on-system peak-shaving facilities, as well as the characteristics of its customer base.

Local distribution companies, including Chesapeake, along with other participants in the energy industry, have raised concerns regarding the gradual depletion in the availability of additional upstream interstate pipeline and storage capacity. Diminishing pipeline and storage capacity is a business issue that must be managed by the Company, whose



customer base has grown at an annual rate between seven and nine percent. This rate of growth is expected to continue. To help maintain the adequacy of pipeline and storage capacity for its growing customer base, the Company has contracted with various interstate pipeline and storage companies for the acquisition of additional existing capacity, as well as, the construction of new capacity by ESNG. The Company will continue to monitor other opportunities to acquire or participate in obtaining additional pipeline and storage capacity that will improve or maintain the high level of service expected by its customer base.

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

#### Natural Gas

Increased prices of natural gas are being driven by increased demand that is exceeding the growth in available supply. As discussed above, the fall 2005 hurricane season significantly reduced the current and anticipated availability of natural gas supply from the Gulf Coast region, causing a dramatic rise in natural gas prices during the fourth quarter of fiscal year 2005. The higher natural gas prices resulted in significant increases in the cost of gas billed to customers during the upcoming 2005-2006 winter heating season. Under its regulated gas cost recovery mechanisms, Chesapeake records cost of gas expense equal to the cost of gas recovered in revenues from customers. Accordingly, an increase in the cost of gas due to an increase in the purchase price of the natural gas commodity generally has no direct effect on the regulated utility's net revenues and net income. However, 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 firm customers that may result due to lower natural gas consumption caused by customer conservation. Increases in the price of natural gas also can affect the Company's 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 retail sales price and product cost. The unit cost of propane is subject to volatile changes as a result of product supply or other market conditions, including, but not limited to, economic and political factors impacting crude oil and natural gas supply or pricing. Product cost changes can occur rapidly over a short period of time and can impact profitability. There is no assurance that the Company will be able to pass on product cost increases fully or immediately, particularly when product 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, as was experienced in fiscal 2005, retail sales volumes may be negatively impacted by customer conservation efforts and increased amounts of uncollected accounts.

***The replacement of less efficient gas appliances with more energy efficient appliances will result in a decline of consumption per customer, which will lead to reduced revenues.***

Natural gas and propane supply requirements may be affected by changes in natural gas and propane consumption by end-use customers. Natural gas and propane usage per customer will decline as customers replace older, less efficient gas appliances with more efficient appliances. In addition, homebuilders in each of the growth areas are installing the newer, more efficient appliances in the homes they build.

***Each of Chesapeake's segments competes in a competitive environment and may be faced with losing customers to a competitor.***

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

***A change in Chesapeake's approved rate mechanisms for recovery of environmental remediation costs at former manufacturer gas sites could adversely affect the company's results of operations, cash flows and financial condition.***

The Company and its subsidiaries are subject to federal, state and local laws and regulations related to environmental matters. These evolving laws and regulations may require expenditures over a long time frame to control environmental effects. Refer to Note M of the Notes to Consolidated Financial Statements for a further discussion of these matters.

***A change in the economic conditions and interest rates could adversely affect the company's results of operations and cash flows.***

The Company and its subsidiaries operate in one of the fastest growing regions in the nation. The continued prosperity of this region, supported by a relatively low interest-rate environment, has allowed our regulated utility to expand its delivery services to its customer base at a rate of growth approximately twice the national industry average during the past five years. A downturn in the economy of the region in which we operate, or a significant increase in interest rates, which cannot be predicted with accuracy, might adversely affect the Company's ability to grow its regulated utility customer base and other businesses at the same rate they have grown in the recent past.

The Company has been operating in a relatively low interest-rate environment in the recent past as it relates to long-term debt financings. Short-term interest rates had been relatively low in relation to historical levels; however, actions and communications by the Federal Reserve in the past year have resulted in increases in short-term interest rates. A rise in interest rates without the recovery of the higher cost of debt in the sales and/or transportation rates the Company charges its utility customers could adversely affect future earnings. A rise in short-term interest rates would negatively affect the results of operations, which depend on short-term debt to finance accounts receivable and storage gas inventories.

***Inflation / Deflation conditions may impact Chesapeake's results of operations, cash flows, and financial position.***  
See discussion on competition in Item 7 under the heading "Management's Discussion and Analysis — Inflation."

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

The 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.

***The Company's propane wholesale and marketing operation has credit risk that could adversely affect the Company's results of operations, cash flows, and financial condition.***

The propane wholesale and marketing operation extends credit to its counter-parties. Despite prudent credit policies, the Company 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 collateral the Company has secured is inadequate, the Company could experience financial losses.

***Chesapeake's use of derivative instruments could adversely affect the company's results of operations.***

The Company's propane distribution operation uses derivative instruments, including forwards, swaps, and puts, to hedge propane price risk. Fluctuating propane prices cause earnings and financing costs of Chesapeake to be impacted. The use of derivative instruments that are not perfectly matched to the exposure could adversely affect the Company's results of operations, cash flows, and financial conditions.

**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 Atlanta,

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 880 miles of natural gas distribution mains (together with related service lines, meters and regulators) located in its Delaware and Maryland service areas and 695 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 331 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 2005 and 2004 were as follows:

Quarter Ended	High	Low	Close	Dividends Declared Per Share
<b>2005</b>				
March 31	\$27.5900	\$25.8300	\$26.6000	\$0.2800
June 30	30.9500	23.6000	30.5800	0.2850
September 30	35.6000	29.5000	35.1620	0.2850
December 31	35.7799	30.3227	30.8000	0.2850
<b>2004</b>				
March 31	\$26.5100	\$24.3000	\$25.6200	\$0.2750
June 30	26.2000	20.4200	22.7000	0.2800
September 30	25.4000	22.1000	25.1000	0.2800
December 31	27.5500	24.5000	26.7000	0.2800

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 2005 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.

At December 31, 2005, there were approximately 2,026 shareholders of record of the Common Stock.

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, 2005.

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, 2005 through October 31, 2005 <sup>(1)</sup>	295	\$36.00	0	0
November 1, 2005 through November 30, 2005	0	\$0.00	0	0
December 1, 2005 through December 31, 2005	0	\$0.00	0	0
<b>Total</b>	<b>295</b>	<b>\$36.00</b>	<b>0</b>	<b>0</b>

<sup>(1)</sup> Chesapeake purchased shares of stock on the open market to add to shares held in a Rabbi Trust to adjust the balance to the contractual value. 295 shares were purchased through executive dividend deferrals.

<sup>(2)</sup> Chesapeake has no publicly announced plans or programs to repurchase its shares.

See discussion on compensation plans of Chesapeake and its subsidiaries under which shares of Chesapeake common stock are authorized for issuance in Item 12 under the heading "Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

ITEM 6. SELECTED FINANCIAL DATA

For the Years Ended December 31,	2005	2004	2003
<b><u>Operating (in thousands of dollars)</u></b> <sup>(3)</sup>			
Revenues			
Natural gas distribution and transmission	\$166,582	\$124,246	\$110,247
Propane	48,976	41,500	41,029
Advanced informations systems	14,140	12,427	12,578
Other and eliminations	(68)	(218)	(286)
Total revenues	\$229,630	\$177,955	\$163,568
Operating income			
Natural gas distribution and transmission	\$17,236	\$17,091	\$16,653
Propane	3,209	2,364	3,875
Advanced informations systems	1,197	387	692
Other and eliminations	(112)	128	359
Total operating income	\$21,530	\$19,970	\$21,579
Net income from continuing operations	\$10,468	\$9,550	\$10,079
<b><u>Assets (in thousands of dollars)</u></b>			
Gross property, plant and equipment	\$280,345	\$250,267	\$234,919
Net property, plant and equipment <sup>(4)</sup>	\$201,504	\$177,053	\$167,872
Total assets <sup>(4)</sup>	\$295,980	\$241,938	\$222,058
Capital expenditures <sup>(3)</sup>	\$33,423	\$17,830	\$11,822
<b><u>Capitalization (in thousands of dollars)</u></b>			
Stockholders' equity	\$84,757	\$77,962	\$72,939
Long-term debt, net of current maturities	58,991	66,190	69,416
Total capitalization	\$143,748	\$144,152	\$142,355
Current portion of long-term debt	\$4,929	\$2,909	\$3,665
Short-term debt	35,482	5,002	3,515
Total capitalization and short-term financing	\$184,159	\$152,063	\$149,535

<sup>(1)</sup> The years 2002, 2001, 2000 and 1999 have been restated in order to reflect the Company's Delaware and Maryland natural gas divisions on the "accrual" rather than the "as billed" revenue recognition method.

<sup>(2)</sup> The years 1998, 1997, and 1996 have not been restated to reflect the "accrual" revenue recognition method due to the immateriality of the impact on the Company's financial results.

<sup>(3)</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>(4)</sup> The years 2005, 2004, 2003, 2002 and 2001 reflect the results of adopting SFAS 143.

2002 <sup>(1)</sup>	2001 <sup>(1)</sup>	2000 <sup>(1)</sup>	1999 <sup>(1)</sup>	1998 <sup>(2)</sup>	1997 <sup>(2)</sup>	1996 <sup>(2)</sup>
\$93,588	\$107,418	\$101,138	\$75,637	\$68,770	\$88,108	\$90,044
29,238	35,742	31,780	25,199	23,377	28,614	36,727
12,764	14,104	12,390	13,531	10,331	7,786	7,230
(334)	(113)	(131)	(14)	(15)	(182)	(243)
\$135,256	\$157,151	\$145,177	\$114,353	\$102,463	\$124,326	\$133,758
\$14,973	\$14,405	\$12,798	\$10,388	\$8,820	\$9,240	\$9,627
1,052	913	2,135	2,622	965	1,137	2,668
343	517	336	1,470	1,316	1,046	1,056
237	386	816	495	485	558	560
\$16,605	\$16,221	\$16,085	\$14,975	\$11,586	\$11,981	\$13,911
\$7,535	\$7,341	\$7,665	\$8,372	\$5,329	\$5,812	\$7,764
\$229,128	\$216,903	\$192,925	\$172,068	\$152,991	\$144,251	\$134,001
\$166,846	\$161,014	\$131,466	\$117,663	\$104,266	\$99,879	\$94,014
\$223,721	\$222,229	\$211,764	\$166,958	\$145,029	\$145,719	\$155,786
\$13,836	\$26,293	\$22,057	\$21,365	\$12,516	\$13,471	\$15,399
\$67,350	\$67,517	\$64,669	\$60,714	\$56,356	\$53,656	\$50,700
73,408	48,409	50,921	33,777	37,597	38,226	28,984
\$140,758	\$115,926	\$115,590	\$94,491	\$93,953	\$91,882	\$79,684
\$3,938	\$2,686	\$2,665	\$2,665	\$520	\$1,051	\$3,526
10,900	42,100	25,400	23,000	11,600	7,600	12,735
\$155,596	\$160,712	\$143,655	\$120,156	\$106,073	\$100,533	\$95,945

For the Years Ended December 31,	2005	2004	2003
<b>Common Stock Data and Ratios</b>			
Basic earnings per share from continuing operations <sup>(3)</sup>	\$1.79	\$1.66	\$1.80
Diluted earnings per share from continuing operations <sup>(3)</sup>	\$1.77	\$1.64	\$1.76
Return on average equity from continuing operations <sup>(3)</sup>	12.9%	12.7%	14.4%
Common equity / total capitalization	59.0%	54.1%	51.2%
Common equity / total capitalization and short-term financing	46.0%	51.3%	48.8%
Book value per share	\$14.41	\$13.49	\$12.89
Market price:			
High	\$35.780	\$27.550	\$26.700
Low	\$23.600	\$20.420	\$18.400
Close	\$30.800	\$26.700	\$26.050
Average number of shares outstanding	5,836,463	5,735,405	5,610,592
Shares outstanding at year-end	5,845,571	5,730,801	5,612,935
Registered common shareholders	2,026	2,026	2,069
Cash dividends declared per share	\$1.14	\$1.12	\$1.10
Dividend yield (annualized) <sup>(4)</sup>	3.7%	4.2%	4.2%
Payout ratio from continuing operations <sup>(3)(5)</sup>	63.7%	67.5%	61.1%
<b>Additional Data</b>			
Customers			
Natural gas distribution and transmission	54,786	50,878	47,649
Propane distribution	35,367	34,888	34,894
Volumes			
Natural gas deliveries (in MMCF)	34,981	31,430	29,375
Propane distribution (in thousands of gallons)	26,178	24,979	25,147
Heating degree-days (Delmarva Peninsula)	4,792	4,553	4,715
Propane bulk storage capacity (in thousands of gallons)	2,315	2,045	2,195
Total employees <sup>(3)</sup>	423	426	439

<sup>(1)</sup> The years 2002, 2001, 2000 and 1999 have been restated in order to reflect the Company's Delaware and Maryland natural gas divisions on the "accrual" rather than the "as billed" revenue recognition method.

<sup>(2)</sup> The years 1998, 1997, and 1996 have not been restated to reflect the "accrual" revenue recognition method due to the immateriality of the impact on the Company's financial results.

<sup>(3)</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>(4)</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>(5)</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.



2002 <sup>(1)</sup>	2001 <sup>(1)</sup>	2000 <sup>(1)</sup>	1999 <sup>(1)</sup>	1998 <sup>(2)</sup>	1997 <sup>(2)</sup>	1996 <sup>(2)</sup>
\$1.37	\$1.37	\$1.46	\$1.63	\$1.05	\$1.17	\$1.58
\$1.37	\$1.35	\$1.43	\$1.59	\$1.04	\$1.15	\$1.54
11.2%	11.1%	12.2%	14.3%	9.7%	11.1%	16.1%
47.8%	58.2%	55.9%	64.3%	60.0%	58.4%	63.6%
43.3%	42.0%	45.0%	50.5%	53.1%	53.4%	52.8%
\$12.16	\$12.45	\$12.21	\$11.71	\$11.06	\$10.72	\$10.26
\$21.990	\$19.900	\$18.875	\$19.813	\$20.500	\$21.750	\$18.000
\$16.500	\$17.375	\$16.250	\$14.875	\$16.500	\$16.250	\$15.125
\$18.300	\$19.800	\$18.625	\$18.375	\$18.313	\$20.500	\$16.875
5,489,424	5,367,433	5,249,439	5,144,449	5,060,328	4,972,086	4,912,136
5,500,357	5,394,516	5,290,001	5,186,546	5,093,788	5,004,078	4,939,515
2,130	2,171	2,166	2,212	2,271	2,178	2,213
\$1.10	\$1.10	\$1.07	\$1.03	\$1.00	\$0.97	\$0.93
6.0%	5.6%	5.8%	5.7%	5.5%	4.7%	5.5%
80.3%	80.3%	73.3%	63.2%	95.2%	82.9%	58.9%
45,133	42,741	40,854	39,029	37,128	35,797	34,713
34,566	35,530	35,563	35,267	34,113	33,123	31,961
27,935	27,264	30,830	27,383	21,400	23,297	24,835
21,185	23,080	28,469	27,788	25,979	26,682	29,975
4,161	4,368	4,730	4,082	3,704	4,430	4,717
2,151	1,958	1,928	1,926	1,890	1,866	1,860
455	458	471	466	431	397	338

## Management's Discussion and Analysis

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

#### Business Description

Chesapeake Utilities Corporation ("Chesapeake" or "the Company") is a diversified utility company engaged in natural gas distribution, transmission and marketing, propane distribution and wholesale marketing, advanced information services and other related businesses.

#### 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, 2005, Chesapeake had recorded regulatory assets of \$5.6 million, including \$4.0 million for under-recovered purchased gas costs, \$712,000 for tax-related regulatory assets, and \$304,000 for conservation cost recovery. The Company has recorded regulatory liabilities totaling \$19.3 million, including \$16.7 million for accrued asset removal cost, \$1.4 million for self-insurance, \$483,000 for cash in/cash out, and \$328,000 for tax-related regulatory assets at December 31, 2005. 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 gas manufacturing 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 state 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, 2005, Chesapeake had recorded environmental regulatory assets of \$195,000 and a regulatory liability of \$298,000 for over-collections and an additional liability of \$353,000 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, 2005, these contracts had net unrealized gains of \$46,000 that was recorded in the financial statements. At December 31, 2004, these contracts had net unrealized losses of \$182,000 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 of the jurisdictions in which we operate. The natural gas transmission operation's revenues are based on rates approved by the Federal Energy Regulatory Commission ("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.

### **Goodwill Impairment**

In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," Chesapeake no longer amortizes goodwill. Instead, 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 initial test was performed upon adoption of SFAS No. 142 on January 1, 2002, and again at the end of each subsequent year. These tests were based on subjective measurements, including discounted cash flows of expected future operating results and market valuations of similar businesses. The propane unit had \$674,000 in goodwill at both December 31, 2005 and 2004. Testing for 2005 and 2004 has indicated that no impairment has occurred.

## **Results of Operations**

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

<b>For the Years Ended December 31,</b>	<b>2005</b>	<b>2004</b>	<b>Increase (decrease)</b>	<b>2004</b>	<b>2003</b>	<b>Increase (decrease)</b>
<b>Net Income *</b>						
Continuing operations	\$10,468	\$9,550	\$918	\$9,550	\$10,080	(\$530)
Discontinued operations	-	(121)	121	(121)	(788)	667
<b>Total Net Income</b>	<b>\$10,468</b>	<b>\$9,429</b>	<b>\$1,039</b>	<b>\$9,429</b>	<b>\$9,292</b>	<b>\$137</b>
<b>Diluted Earnings Per Share</b>						
Continuing operations	\$1.77	\$1.64	\$0.13	\$1.64	\$1.76	(\$0.12)
Discontinued operations	-	(0.02)	0.02	(0.02)	(0.13)	0.11
<b>Total Earnings Per Share</b>	<b>\$1.77</b>	<b>\$1.62</b>	<b>\$0.15</b>	<b>\$1.62</b>	<b>\$1.63</b>	<b>(\$0.01)</b>

\* Dollars in thousands.

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

Net income from continuing operations for 2004 was \$9.6 million, or \$1.64 per share (diluted), a decline of \$530,000 compared to net income from continuing operations of \$10.1 million, or \$1.76 per share (diluted), for 2003.

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 years 2004 and 2003. Discontinued operations experienced losses of \$0.02 and \$0.13 per share (diluted) for 2004 and 2003, respectively.

### Operating Income Summary (in thousands)

For the Years Ended December 31,	2005	2004	Increase (decrease)	2004	2003	Increase (decrease)
<b>Business Segment:</b>						
Natural gas distribution & transmission	\$17,236	\$17,091	\$145	\$17,091	\$16,653	\$438
Propane	3,209	2,364	845	2,364	3,875	(1,511)
Advanced information services	1,197	387	810	387	692	(305)
Other & eliminations	(112)	128	(240)	128	359	(231)
<b>Total Operating Income</b>	<b>\$21,530</b>	<b>\$19,970</b>	<b>\$1,560</b>	<b>\$19,970</b>	<b>\$21,579</b>	<b>(\$1,609)</b>

The improvement in results for 2005 was primarily driven by:

- The Lightweight Association Management Processing Systems ("LAMPSTM") 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 LAMPSTM product was an internally developed software that was developed and marketed specifically for REALTOR® Associations.
- The Delmarva and Florida natural gas distribution operations experienced strong residential customer growth of 8.7 percent and 7.4 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 of 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.

Improvement in Chesapeake's 2005 overall results compared to 2004 was primarily related to a \$924,000 pre-tax gain on the sale of its LAMPSTM by the Company's advanced information service operation, continued strong customer growth, and colder weather, which led to increased contributions from the Company's natural gas and propane operations. The Company's natural gas operations experienced an increase of 7.9 percent in residential customers. Weather, measured in heating degree-days, was 5 percent colder than 2004. The gross margin increases from growth and weather was partially offset by energy conservation efforts by customers in light of increased natural gas and propane costs and also, an increase in operating expenses.

Chesapeake's 2004 results reflected strong customer growth, warmer weather as compared to 2003, customers' energy conservation and costs incurred to comply with Sarbanes-Oxley. Weather, measured in heating degree-days, was 4 percent warmer than 2003. Management estimates that warmer weather negatively impacted gross margin by \$566,000. The natural gas segment was able to offset the impact of warmer weather through customer growth of 7 percent. Additionally, the Company incurred approximately \$600,000 of expenses through December 31, 2004 related to compliance with Section 404 of Sarbanes-Oxley. These costs include incremental audit fees, expansion of the Internal Audit Department and the temporary hiring of an outside consultant. The increase in operating income from the Company's natural gas operations was more than offset by decreases in the propane and advanced information services businesses.

The following discussions of 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.

### Natural Gas Distribution and Transmission

The natural gas distribution and transmission segment earned operating income of \$17.2 million for 2005, \$17.1 million for 2004, and \$16.7 million for 2003, resulting in increases of \$145,000 for 2005 and \$438,000 for 2004.

#### Natural Gas Distribution and Transmission (in thousands)

For the Years Ended December 31,	2005	2004	Increase (decrease)	2004	2003	Increase (decrease)
Revenue	\$166,582	\$124,246	\$42,336	\$124,246	\$110,247	\$13,999
Cost of gas	116,178	77,456	38,722	77,456	65,495	11,961
Gross margin	50,404	46,790	3,614	46,790	44,752	2,038
Operations & maintenance	23,874	21,129	2,745	21,129	19,893	1,236
Depreciation & amortization	5,682	5,418	264	5,418	5,188	230
Other taxes	3,612	3,152	460	3,152	3,018	134
Other operating expenses	33,168	29,699	3,469	29,699	28,099	1,600
<b>Total Operating Income</b>	<b>\$17,236</b>	<b>\$17,091</b>	<b>\$145</b>	<b>\$17,091</b>	<b>\$16,653</b>	<b>\$438</b>

#### Natural Gas Heating Degree-Day (HDD) and Customer Analysis

For the Years Ended December 31,	2005	2004	Increase (decrease)	2004	2003	Increase (decrease)
Heating degree-day data — Delmarva						
Actual HDD	4,792	4,553	239	4,553	4,715	(162)
10-year average HDD	4,436	4,383	53	4,383	4,409	(26)
Estimated gross margin per HDD	\$2,234	\$1,800	\$434	\$1,800	\$1,680	\$120
Estimated dollars per residential customer added:						
Gross margin	\$372	\$372	\$0	\$372	\$360	\$12
Other operating expenses	\$106	\$104	\$2	\$104	\$100	\$4
Average number of residential customers						
Delmarva	37,346	34,352	2,994	34,352	31,996	2,356
Florida	11,717	10,910	807	10,910	10,189	721
<b>Total</b>	<b>49,063</b>	<b>45,262</b>	<b>3,801</b>	<b>45,262</b>	<b>42,185</b>	<b>3,077</b>

### 2005 Compared to 2004

Revenue and cost of gas increased in 2005 compared to 2004, primarily due to changes in natural gas commodity prices. Increased prices of natural gas costs are being driven by increased demand that is exceeding the growth of available supply. The fall 2005 hurricane season significantly reduced the current and anticipated availability of natural gas supply from the Gulf Coast region, causing a dramatic rise in natural gas prices during the fourth quarter of 2005. Commodity cost changes are passed on to the ratepayers through a gas cost recovery or purchased gas cost adjustment in all jurisdictions; therefore, they have limited impact on the Company's profitability. However, higher commodity prices may cause customers to reduce their energy consumption through conservation efforts and may cause the Company to have higher uncollectible accounts.

## Management's Discussion and Analysis

Natural gas gross margin increased \$3.6 million, or 7.7 percent, for 2005 compared to 2004. 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. These additional contracts will contribute approximately \$53,000 monthly to gross margins. An increase of \$980,000 in other operating expenses partially offset the increased gross margin. The factors contributing to the increase in expenses are associated with higher customer counts caused by continued economic growth, as well as higher depreciation and property taxes due to an increase in the level of capital investments.

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 the number of customers is attributed to the additional customers that are on the Peoples Gas system for which the Company provides services. 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.

Gross margin for the Delaware and Maryland distribution divisions increased \$1.2 million, as temperatures in 2005 were 5 percent colder 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.

### **2004 Compared to 2003**

Gross margin grew by \$2.0 million in 2004 compared to 2003. The Company estimates that warmer weather reduced gross margin by \$292,000. After adjusting for the effect of weather, gross margin would have increased 5.3 percent. The Company estimates that residential and commercial growth for the distribution operations generated \$1.1 million of gross margin increase. The Company added 3,077 residential customers, an increase of 7 percent, in 2004. This growth was net of lower consumption per customer, which reflects customer conservation efforts in light of higher energy costs and a higher mix of apartments rather than single family homes in the customer additions for some divisions. Additionally, the natural gas supply and management services operation increased gross margin by \$565,000, primarily through industrial customer growth and resale of seasonal excess capacity on upstream pipelines. The natural gas transmission operation also achieved gross margin growth of \$716,000, due to additional transportation services provided to its firm customers.

Higher other operating expenses partially offset the gross margin increase. Operating expenses increased \$1.6 million, or 5.7 percent, which includes \$382,000 of expenses related to Sarbanes-Oxley Section 404 compliance implementation. The higher other operating expenses reflect the costs to support customer growth.

### **Propane**

During 2005, the propane segment increased operating income by \$845,000, or 36 percent, over 2004. In addition, gross margin increased \$2.6 million, which more than offset the increase of \$1.7 million of operating expenses. During 2004, the propane segment experienced a decrease of \$1.5 million in operating income compared to 2003, reflecting a gross margin decrease of \$1.9 million, partially offset by a decrease in operating expenses of \$411,000.

#### **Propane (in thousands)**

For the Years Ended December 31,			Increase			Increase
	2005	2004	(decrease)	2004	2003	(decrease)
Revenue	\$48,976	\$41,500	\$7,476	\$41,500	\$41,029	\$471
Cost of sales	30,041	25,155	4,886	25,155	22,762	2,393
Gross margin	18,935	16,345	2,590	16,345	18,267	(1,922)
Operations & maintenance	13,355	11,718	1,637	11,718	12,053	(335)
Depreciation & amortization	1,574	1,524	50	1,524	1,506	18
Other taxes	797	739	58	739	833	(94)
Other operating expenses	15,726	13,981	1,745	13,981	14,392	(411)
<b>Total Operating Income</b>	<b>\$3,209</b>	<b>\$2,364</b>	<b>\$845</b>	<b>\$2,364</b>	<b>\$3,875</b>	<b>(\$1,511)</b>

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

For the Years Ended December 31,			Increase			Increase
	2005	2004	(decrease)	2004	2003	(decrease)
Heating degree-days						
Actual	4,792	4,553	239	4,553	4,715	(162)
10-year average	4,436	4,383	53	4,383	4,409	(26)
Estimated gross margin per HDD	\$1,743	\$1,691	\$52	\$1,691	\$1,670	\$21

### **2005 Compared to 2004**

The increases in revenues and cost of sales in 2005 compared to 2004 were caused both by increases in volumes and by increases in the commodity prices of propane. Commodity price changes are passed on to the customer, subject to competitive market conditions.

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 will reverse 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 are 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 start-up costs accounted for \$722,000, or approximately 49 percent, of the increase in operating expenses.

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. The higher expenses of \$147,000 were attributed to business growth, such as payroll, vehicle fuel and maintenance, insurance, and depreciation expense.

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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.

### **2004 Compared to 2003**

Increases in revenues and cost of sales in 2004 were caused by an increase in the commodity prices of propane, partially offset by lower sales volumes due to warmer weather. Commodity price changes are generally passed on to the customer, subject to competitive market conditions. High commodity prices may cause customers to reduce their energy consumption through conservation efforts and may cause higher bad debt expense.

Propane distribution gross margin declined \$1.2 million and propane wholesale marketing gross margin fell by \$710,000. The Company estimates that warmer weather negatively impacted gross margin by \$274,000. After adjusting for the impact of weather, gross margin decreased 9 percent. Lower retail gross margin per gallon in the distribution business reduced gross margin by approximately \$493,000. In addition, lower sales volumes, not attributable to the weather, reduced gross margin by approximately \$197,000, including \$172,000 related to customers in the poultry industry. The closing of a poultry processing plant in the fourth quarter of 2003 is estimated to have reduced gross margin by \$129,000. The plant is not expected to reopen. An outbreak of avian influenza on the Delmarva Peninsula in the first quarter of 2004 also contributed to the lower sales volumes. The influenza outbreak was contained. Volumes were also down partially due to customers conserving energy in light of higher energy costs. Finally, gross margin earned from a non-recurring service project in 2003 contributed \$192,000 to the decline in gross margin.

The Company's propane wholesale marketing operation contributed \$373,000 to operating income; however, this was a decrease of \$533,000 compared to 2003. This reflects a conservative strategy taken in the wholesale marketing operation, due to the high level of energy prices.

Other operating expenses decreased \$411,000 despite additional costs of \$142,000 associated with the implementation of Sarbanes-Oxley Section 404 compliance procedures. The decrease included reductions in incentive compensation, revenue-related taxes and lower delivery costs.

### **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 \$1.2 million for 2005, \$387,000 for 2004, and \$692,000 for 2003.

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

<b>For the Years Ended December 31,</b>	<b>2005</b>	<b>2004</b>	<b>Increase (decrease)</b>	<b>2004</b>	<b>2003</b>	<b>Increase (decrease)</b>
Revenue	\$14,140	\$12,427	\$1,713	\$12,427	\$12,578	(\$151)
Cost of sales	7,181	7,015	166	7,015	7,018	(3)
Gross margin	6,959	5,412	1,547	5,412	5,560	(148)
Operations & maintenance	5,129	4,405	724	4,405	4,196	209
Depreciation & amortization	123	138	(15)	138	191	(53)
Other taxes	510	482	28	482	481	1
Other operating expenses	5,762	5,025	737	5,025	4,868	157
<b>Total Operating Income</b>	<b>\$1,197</b>	<b>\$387</b>	<b>\$810</b>	<b>\$387</b>	<b>\$692</b>	<b>(\$305)</b>



### **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. The sale 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 account for the decrease in revenue when compared to 2004. This decrease is 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 is related to the sale of the webproEX software to QAD that took place in 2003. As part of the sale agreement, Chesapeake receives a percentage of revenues after certain annual revenue and performance targets have been reached by QAD.

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 is attributed to the LAMPS™ product. The 2005 and 2004 cost of sales figures includes \$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 is attributed to the increase of costs relating to the LAMPS™ product. The costs associated with the LAMPS™ product for 2005 and 2004 are \$1.2 million and \$575,000 respectively. The remaining increase is 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.

### **2004 compared to 2003**

The decrease in gross margin and operating income in 2004 was due to the non-recurring revenue recorded in 2003 on the sale of some rights to one of the Company's internally-developed software products to a third party software provider. Absent the sale, gross margin would have increased by \$351,000; however, the increase was partially offset by higher costs associated with continued investment in the Company's LAMPS™ product and Sarbanes-Oxley compliance costs of \$60,000.

### **Other Operations and Eliminations**

Other operations and eliminating entries generated an operating loss of \$112,000 for 2005 compared to income of \$128,000 for 2004. Other operations consist primarily of subsidiaries that own real estate leased to other Company subsidiaries. In addition, in August 2004 the Company formed OnSight Energy, LLC ("OnSight") to provide distributed energy services. The increase in revenues in 2005 is primarily attributed to OnSight completing its first contract in the second quarter of 2005. Other operating expenses increased in 2005 as a result of a full year of operation by OnSight, compared to a partial year in 2004. Eliminations are entries required to eliminate activities between business segments from the consolidated results.

#### **Other Operations & Eliminations (in thousands)**

<b>For the Years Ended December 31,</b>	<b>2005</b>	<b>2004</b>	<b>Increase (decrease)</b>	<b>2004</b>	<b>2003</b>	<b>Increase (decrease)</b>
Revenue	\$763	\$647	\$116	\$647	\$702	(\$55)
Cost of sales	116	-	116	-	-	-
Gross margin	647	647	-	647	702	(55)
Operations & maintenance	472	279	193	279	79	200
Depreciation & amortization	220	210	10	210	238	(28)
Other taxes	97	63	34	63	55	8
Other operating expenses	789	552	237	552	372	180
Operating Income — Other	(\$142)	\$95	(\$237)	\$95	\$330	(\$235)
Operating Income — Eliminations	\$30	\$33	(\$3)	\$33	\$29	\$4
<b>Total Operating Income (Loss)</b>	<b>(\$112)</b>	<b>\$128</b>	<b>(\$240)</b>	<b>\$128</b>	<b>\$359</b>	<b>(\$231)</b>

## Management's Discussion and Analysis

### 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, compared to a net loss of \$788,000 for 2003. The Company did not have any discontinued operations in 2005.

### Income Taxes

Operating income taxes increased in 2005 compared to 2004, due to increased taxable income. Operating income taxes decreased in 2004 compared to 2003, due to decreased income. The effective current federal income tax rate for 2005 was 35%, whereas the rate for both 2004 and 2003 was 34%. During 2005, 2004 and 2003, the Company benefited of \$223,000, \$205,000, and 197,000, 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 \$383,000, \$549,000 and \$238,000 for the years 2005, 2004 and 2003, respectively. The other income amounts for the years 2005 and 2003 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 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 7.2 percent, compared to \$71.3 million with a weighted average interest rate of 7.2 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 3.7 percent for 2004 to 4.6 percent for 2005.

Total interest expense for 2004 decreased approximately \$438,000, or 8 percent, compared to 2003. The decrease reflects the decrease in the average long-term debt balance. The average long-term debt balance during 2004 was \$71.3 million with a weighted average interest rate of 7.2 percent, compared to \$75.4 million with a weighted average interest rate of 7.2 percent in 2003. The average short-term borrowing balance in 2004 was \$870,000, a decrease from \$3.5 million in 2003. The weighted average interest rate for short-term borrowing increased from 2.4 percent for 2003 to 3.7 percent for 2004.

### 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 and short-term borrowing to meet normal working capital requirements and to temporarily finance capital expenditures. During 2005, net cash provided by operating activities was \$13.3 million, cash used by investing activities was \$32.8 million and cash provided by financing activities was \$20.4 million.

During 2004, net cash provided by operating activities was \$23.4 million, cash used by investing activities was \$16.9 million and cash used by financing activities was \$8.0 million.

As of December 31, 2005, the Board of Directors has authorized the Company to borrow up to \$50.0 million of short-term debt from various banks and trust companies. On December 31, 2005, Chesapeake had five unsecured bank lines of credit with three financial institutions, totaling \$65.0 million. 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 three lines are subject to the banks'

availability of funds. The outstanding balances of short-term borrowing at December 31, 2005 and 2004 were \$35.5 million and \$5.0 million, respectively. In 2005 and 2004, Chesapeake used funds provided by operations and financing to fund net investing.

Chesapeake has budgeted \$54.4 million for capital expenditures during 2006. This amount includes \$20.8 million for natural gas distribution, \$26.7 million for natural gas transmission, \$5.7 million for propane distribution and wholesale marketing, \$178,000 for advanced information services and \$1.0 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 2006 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 \$300,000 in 2006 and \$25,000 in 2007 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.

### **Capital Structure**

As of December 31, 2005, common equity represented 59.0 percent of total capitalization, compared to 54.1 percent in 2004. 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 46.0 percent and 51.3 percent, respectively. 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.

### **Cash Flows from Operating Activities**

The primary drivers for the Company's operating cash flows are cash payments received from gas customers, offset by payments made by the Company for gas costs, operation and maintenance expenses, taxes and interest costs.

Net cash provided by operating activities totaled \$13.3 million, \$23.4 million and \$23.0 million for fiscal years 2005, 2004 and 2003, respectively. A description of certain material changes in working capital from December 31, 2004 to December 31, 2005 is listed below:

- Accounts receivable and accrued revenue increased \$16.8 million. The increase in receivables is attributed to higher gas and propane sale invoices in response to the higher natural gas and propane prices.
- Propane inventory, storage gas and other inventory increased \$5.7 million, primarily due to higher propane and natural gas prices.
- The Company 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".
- Accounts payable and other accrued liabilities increased \$15.3 million largely to fund the higher natural gas and propane purchases due mostly to higher prices.

During 2004, propane inventory, storage gas, and other inventory rose \$1.7 million due to higher natural gas costs and increased storage capacity. During 2004 and 2003, Accounts receivable and accrued revenue increased \$11.7 million and

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\$3.6 million, respectively, primarily in response to higher gas and propane sale invoices in response to the higher natural gas and propane prices. Accounts payable and other accrued liabilities increased \$11.1 million and \$564,000, respectively, in 2004 and 2003 due to higher natural gas and propane purchases.

### Cash Flows Used in Financing Activities

Cash flows received from financing totaled \$20.4 million for 2005 and the cash used in financing activities totaled \$8.0 million and \$16.4 million for fiscal years 2004 and 2003, respectively. During fiscal year 2005, the Company increased the net amount of cash borrowed under its short-term lines of credits by \$29.6 million. Additionally, the Company paid common stock dividends totaling \$5.8 million and reduced its outstanding long-term notes payable balance by \$4.8 million.

Cash flows used in financing activities during year 2004 reflected a \$3.7 million repayment of long-term notes payable, coupled with common stock dividend payments totaling \$5.6 million. Additionally during year 2004, the Company increased the net amount of cash borrowed from its short-term lines of credits by \$1.2 million. During year 2003, cash flows used in financing activities reflected a \$3.9 million repayment of long-term notes payable, a \$7.4 million net repayment of short-term lines of credit, and payment of common stock dividends totaling \$5.4 million.

On June 29, 2005, the Company entered into an agreement in principle with Prudential Investment Management Inc. Subsequently, the Company executed a Note Agreement, dated October 18, 2005, with three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company), pursuant to which the investors agreed, subject to certain conditions, to purchase from the Company \$20 million in principal of 5.5 percent Senior Notes (the "Notes") issued by the Company; provided, that the Company elects to effect the sale of the Notes at any time prior to January 15, 2007. The terms of the Notes will require annual principal repayments of \$2 million beginning on the fifth anniversary of the issuance of the Notes.

## Cash Flows Used in Investing Activities

Net cash flows used in investing activities totaled \$32.8 million, \$16.9 million and \$5.9 million during fiscal years 2005, 2004 and 2003, respectively. In fiscal years 2005, 2004 and 2003, \$33.0 million, \$17.8 million and \$11.8 million, respectively, of cash was utilized for capital expenditures. Additions to property, plant and equipment in 2005 were primarily for natural gas transmission (\$15.0 million), natural gas distribution (\$13.3 million) and propane distribution (\$3.8 million). In both 2005 and 2004, 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. Additionally, cash of \$240,000, \$370,000 and \$2.2 million was received in years 2005, 2004, and 2003, respectively, for the recovery of environmental costs through rates charged to customers. The year 2003 included cash proceeds of \$3.7 million received from the sale of discontinued operations.

## Contractual Obligations

We have the following contractual obligations and other commercial commitments as of December 31, 2005:

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>	\$4,929,091	\$15,312,727	\$13,312,727	\$30,364,909	\$63,919,454
Operating leases <sup>(2)</sup>	645,576	1,062,394	692,741	2,376,302	4,777,013
Purchase obligations <sup>(3)</sup>					
Transmission capacity	7,585,816	12,497,472	11,890,259	25,015,062	56,988,609
Storage — Natural Gas	1,422,987	2,709,353	2,696,217	6,518,563	13,347,120
Commodities	20,012,976	-	-	-	20,012,976
Forward purchase contracts — Propane <sup>(4)</sup>	21,622,201	-	-	-	21,622,201
Unfunded benefits <sup>(5)</sup>	259,399	528,995	551,782	2,678,755	4,018,931
Funded benefits <sup>(6)</sup>	68,680	129,697	111,081	1,376,178	1,685,636
<b>Total Contractual Obligations</b>	<b>\$56,546,726</b>	<b>\$32,240,638</b>	<b>\$29,254,807</b>	<b>\$68,329,769</b>	<b>\$186,371,940</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 \$4.5 million, \$7.7 million, \$5.7 million and \$7.2 million, respectively, for the periods indicated above. Expected interest payments for all periods total \$25.1 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 \$4.0 million at December 31, 2005 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 \$1.7 million at December 31, 2005 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, 2005. 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, advanced information services, and the Florida natural gas supply and management services subsidiary. These

## Management's Discussion and Analysis

corporate guarantees provide for the payment of propane and natural gas purchases and office rent in the event of the subsidiaries' default. The liabilities for these purchases are included in our Consolidated Financial Statements. The guarantees at December 31, 2005, totaled \$11.2 million and expire on various dates in 2006.

The Company has issued a letter of credit to its main insurance company for \$694,000, which expires May 31, 2006. The letter of credit was provided as security for claims amounts below the deductibles on the Company's policies.

### Regulatory Activities

The Company's natural gas distribution operations are subject to regulation by the Delaware, Maryland and Florida Public Service Commissions. The natural gas transmission operation is subject to regulation by the FERC.

Delaware. On October 3, 2005, the Delaware division filed its annual Gas Sales Service Rates ("GSR") application that was effective for service rendered on and after November 1, 2005 with the Delaware Public Service Commission ("Delaware PSC"). On October 11, 2005, the Delaware PSC approved the GSR charges, subject to full evidentiary hearings and a final decision. An evidentiary hearing is currently scheduled for April 6, 2006, with a final decision by the Delaware PSC expected during the second or third quarter of 2006.

On November 1, 2005, the Delaware division filed with the Delaware PSC its annual Environmental Rider ("ER") Rate application that was effective for service rendered on and after December 1, 2005. The Delaware PSC granted approval of the ER rate at its regularly scheduled meeting on November 8, 2005, subject to full evidentiary hearings and a final decision. An evidentiary hearing is currently scheduled for April 5, 2006, with a final decision by the Delaware PSC expected during the second or third quarter of 2006.

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 and traditional ratemaking processes, natural gas has not been extended to 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 during the first half of 2006.

Maryland. On December 8, 2005, the Maryland Public Service Commission ("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, 2005. On January 12, 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. The Maryland PSC did not receive any appeals or written exceptions to the proposed findings and as a result a final order was issued on February 14, 2006.

Florida. On August 25, 2004, the Florida division filed a petition with the Florida Public Service Commission ("Florida PSC") for authorization to restructure rates and establish new customer classifications. The filing was revenue-neutral, but would allow the Florida division to collect a greater percentage of revenues from fixed charges, rather than variable charges based upon consumption. On February 1, 2005, the Florida PSC voted to approve the petition, as modified by the PSC staff. The Florida PSC issued a final order on February 22, 2005.

On May 16, 2005, the Florida division filed 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 Public Service Commission approved the Company’s request on July 19, 2005, and service to the existing WCI facility is expected to begin during the first quarter of 2006. WCI is located in Washington County in the Florida panhandle and would become 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 FPSC 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. A determination that PPC does qualify as a natural gas transmission company would provide opportunities for investment to deliver gas service to industrial customers in Florida by an intra-state pipeline, instead of through Chesapeake Utilities Corporation, to certain niche markets.

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. Chesapeake understands that the other matter has now been resolved and Eastern Shore intends to resubmit its gas supply realignment filing during first quarter of 2006.

On April 1, 2003, Eastern Shore filed an application for a Certificate of Public Convenience and Necessity (“Application”) before the FERC requesting authorization to construct the necessary facilities to enable Eastern Shore to provide additional daily firm transportation capacity of 15,100 dekatherms over a three-year period commencing November 1, 2003. On October 8, 2003, the FERC issued an order granting Eastern Shore the authority to construct and operate certain pipeline and measurement facilities in its service territories as requested. Phases I and II of the Application began providing services November 1, 2003 and 2004, respectively. On December 22, 2004, Eastern Shore filed to amend the above-referenced Application to seek FERC authorization to construct and operate new pipeline facilities to provide an additional 7,450 dekatherms of daily firm transportation service, as requested by its customers, to be available November 1, 2005. On June 27, 2005, the FERC issued an Order Amending Certificate, granting approval to Eastern Shore to construct and operate the additional pipeline facilities requested. Phase III began November 1, 2005.

On December 9, 2005, Eastern Shore filed revised tariff sheets to replace its existing fixed price penalties with penalties that are the higher of a fixed price or a multiple of a daily index price. The revised penalties are applicable to customers who violate operational Flow Orders and customers who take unauthorized overrun quantities that could threaten the operational integrity of the pipeline, or to Eastern Shore’s ability to render reliable service. By letter order dated January 6, 2006, the FERC accepted Eastern Shore’s proposed changes, effective December 21, 2005.

Eastern Shore is also following the FERC’s recent rulemaking pertaining to creditworthiness standards for customers of interstate natural gas pipelines. FERC has not yet issued its final rules in this proceeding. Upon such issuance, Eastern Shore will evaluate its currently effective tariff creditworthiness provisions to determine whether any actions will need to be taken to conform to the FERC’s final rules.

### **Environmental Matters**

The Company continues to work with federal and state environmental agencies to assess the environmental impact and explore corrective action at three other 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 first mortgage

## Management's Discussion and Analysis

bonds, 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 and was not entered into for trading purposes. The carrying value of the Company's long-term debt, including current maturities, was \$63.9 million at December 31, 2005, as compared to a fair value of \$68.5 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.

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, 2005, the propane distribution operation had entered into a put contract to protect the value of 2.1 million gallons of propane inventory from a drop in fair value. The Company settled the put in January 2006, which resulted in a benefit of \$28,000.

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 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 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, 2005 and 2004 is shown in the following charts.



<b>At December 31, 2005</b>	<b>Quantity in gallons</b>	<b>Estimated Market Prices</b>	<b>Weighted Average 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 expire in 2006.*

<b>At December 31, 2004</b>	<b>Quantity in gallons</b>	<b>Estimated Market Prices</b>	<b>Weighted Average Contract Prices</b>
<b>Forward Contracts</b>			
Sale	10,044,510	\$0.7725 — \$0.7750	\$0.7828
Purchase	9,975,000	\$0.7300 — \$0.7500	\$0.8007
<b>Futures Contracts</b>			
Sale	378,000	\$0.7450 — \$0.7500	\$0.7868
Purchase	420,000	\$0.7200 — \$0.7300	\$0.7500

*Estimated market prices and weighted average contract prices are in dollars per gallon.  
All contracts expired in 2005.*

The Company's natural gas distribution 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

## Management's Discussion and Analysis

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.

### Recent Pronouncements

In December 2004, the FASB released a revision ("Share-Based Payment") to SFAS No. 123 "Accounting for Stock-Based Compensation," referred to as SFAS No. 123R. In April 2005, the SEC approved a new rule that delayed the effective date for SFAS No. 123R until the first annual period beginning after June 15, 2005. This Statement establishes financial accounting and reporting standards for stock-based employee compensation plans. Those plans include all arrangements by which employees receive shares of stock or other equity instruments of the employer or the employer incurs liabilities to employees in amounts based on the price of the employer's stock. Examples are stock purchase plans, stock options, restricted stock and stock appreciation rights. The adoption of this pronouncement will not have a material impact on the Company's financial statements.

In March 2005, the FASB issued Interpretation No. 47 ("FIN No. 47"), "Accounting for Conditional Asset Retirement Obligations," an interpretation of SFAS No. 143. FIN No. 47 clarifies that the term conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The Company adopted FIN No. 47 during the fourth quarter of 2005 and it did not have a material impact on its financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections — a replacement of APB Opinion No. 20 and FASB Statement No. 3". SFAS No. 154 primarily requires retrospective application to prior periods' financial statements for the direct effects 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 applies to all voluntary changes in accounting principle and also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. The statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company is required to adopt the provision of SFAS No. 154, as applicable, beginning in fiscal year 2006.

### **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;
- 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 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 on the Company and its customers;
- the ability of the Company’s new and planned facilities and acquisitions to generate expected revenues; and
- the Company’s ability to obtain the rate relief and cost recovery requested from utility regulators and the timing of the requested regulatory actions.

#### **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 SUPPLEMENTAL 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, 2005.

Management's assessment of the effectiveness of Chesapeake's internal control over financial reporting as of December 31, 2005 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 2005 and 2004 consolidated financial statements and of its internal control over financial reporting as of December 31, 2005, and an audit of its 2003 financial statements 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, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, 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 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.


### 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, 2005, 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, 2005, 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 6, 2006

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## Consolidated Statements of Income

For the Years Ended December 31,	2005	2004	2003
<b>Operating Revenues</b>	\$229,629,736	\$177,955,441	\$163,567,592
<b>Operating Expenses</b>			
Cost of sales, excluding costs below	153,514,739	109,626,377	95,246,819
Operations	40,181,649	35,146,595	33,526,804
Maintenance	1,818,981	1,518,774	1,737,855
Depreciation and amortization	7,568,209	7,257,538	7,089,836
Other taxes	5,015,659	4,436,411	4,386,878
<b>Total operating expenses</b>	<b>208,099,237</b>	<b>157,985,695</b>	<b>141,988,192</b>
<b>Operating Income</b>	<b>21,530,499</b>	<b>19,969,746</b>	<b>21,579,400</b>
Other income net of other expenses	382,626	549,156	238,439
Interest charges	5,133,495	5,268,145	5,705,911
<b>Income Before Income Taxes</b>	<b>16,779,630</b>	<b>15,250,757</b>	<b>16,111,928</b>
Income taxes	6,312,016	5,701,090	6,032,445
<b>Net Income from Continuing Operations</b>	<b>10,467,614</b>	<b>9,549,667</b>	<b>10,079,483</b>
Loss from discontinued operations, net of tax benefit of \$0, \$59,751 and \$74,997	-	(120,900)	(787,607)
<b>Net Income</b>	<b>\$10,467,614</b>	<b>\$9,428,767</b>	<b>\$9,291,876</b>
<b>Earnings Per Share of Common Stock:</b>			
<u>Basic</u>			
From continuing operations	\$1.79	\$1.66	\$1.80
From discontinued operations	-	(0.02)	(0.14)
<b>Net Income</b>	<b>\$1.79</b>	<b>\$1.64</b>	<b>\$1.66</b>
<u>Diluted</u>			
From continuing operations	\$1.77	\$1.64	\$1.76
From discontinued operations	-	(0.02)	(0.13)
<b>Net Income</b>	<b>\$1.77</b>	<b>\$1.62</b>	<b>\$1.63</b>

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



## Consolidated Statements of Cash Flows

For the Years Ended December 31,	2005	2004	2003
<b>Operating Activities</b>			
Net Income	\$10,467,614	\$9,428,767	\$9,291,876
Adjustments to reconcile net income to net operating cash:			
Depreciation and amortization	7,568,209	7,257,538	8,030,399
Depreciation and accretion included in other costs	2,705,619	2,611,779	2,468,647
Deferred income taxes, net	1,510,776	4,559,207	2,397,594
Unrealized (loss) gain on commodity contracts	(227,193)	353,183	457,901
Employee benefits and compensation	1,621,607	1,536,586	2,042,093
Other, net	(62,692)	67,079	15,874
Changes in assets and liabilities:			
Sale (purchase) of investments	(1,242,563)	43,354	-
Accounts receivable and accrued revenue	(16,831,750)	(11,723,505)	(3,565,363)
Propane inventory, storage gas and other inventory	(5,704,040)	(1,741,941)	(466,412)
Regulatory assets	(1,719,184)	428,516	116,153
Prepaid expenses and other current assets	36,703	(221,137)	(316,425)
Other deferred charges	(102,562)	(168,898)	43,844
Long-term receivables	247,600	428,964	(101,373)
Accounts payable and other accrued liabilities	15,258,551	11,079,661	564,270
Income taxes receivable (payable)	(2,006,763)	(229,237)	25,090
Accrued interest	(42,374)	(51,272)	(47,464)
Customer deposits and refunds	462,781	665,549	128,704
Accrued compensation	875,342	(794,194)	910,587
Regulatory liabilities	144,499	(191,266)	466,923
Environmental and other liabilities	328,383	12,721	550,977
Net cash provided by operating activities	13,288,563	23,351,454	23,013,895
<b>Investing Activities</b>			
Property, plant and equipment expenditures	(33,008,235)	(17,784,240)	(11,790,364)
Sale of investments	-	135,170	-
Sale of discontinued operations	-	415,707	3,732,649
Environmental recoveries and other	240,336	369,719	2,127,248
Net cash used by investing activities	(32,767,899)	(16,863,644)	(5,930,467)
<b>Financing Activities</b>			
Common stock dividends	(5,789,179)	(5,560,535)	(5,403,536)
Issuance of stock for Dividend Reinvestment Plan	458,756	200,551	347,546
Change in cash overdrafts due to outstanding checks	874,083	(143,720)	(46,853)
Net borrowing (repayment) under line of credit agreements	29,606,400	1,184,743	(7,384,743)
Repayment of long-term debt	(4,794,827)	(3,665,589)	(3,945,617)
Net cash used by financing activities	20,355,233	(7,984,550)	(16,433,203)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>875,897</b>	<b>(1,496,740)</b>	<b>650,225</b>
<b>Cash and Cash Equivalents — Beginning of Period</b>	<b>1,611,761</b>	<b>3,108,501</b>	<b>2,458,276</b>
<b>Cash and Cash Equivalents — End of Period</b>	<b>\$2,487,658</b>	<b>\$1,611,761</b>	<b>\$3,108,501</b>
<b>Supplemental Disclosure of Cash Flow information</b>			
Cash paid for interest	\$5,052,013	\$5,280,299	\$5,648,332
Cash paid for income taxes	\$6,342,476	\$1,977,223	\$3,767,816

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

## Consolidated Balance Sheets

<b>Assets</b>		
<b>At December 31,</b>	<b>2005</b>	<b>2004</b>
<b>Property, Plant and Equipment</b>		
Natural gas distribution and transmission	\$220,685,461	\$198,306,668
Propane	41,563,810	38,344,983
Advanced information services	1,221,177	1,480,779
Other plant	9,275,729	9,368,153
<b>Total property, plant and equipment</b>	<b>272,746,177</b>	<b>247,500,583</b>
Less: Accumulated depreciation and amortization	(78,840,413)	(73,213,605)
Plus: Construction work in progress	7,598,531	2,766,209
<b>Net property, plant and equipment</b>	<b>201,504,295</b>	<b>177,053,187</b>
<b>Investments</b>	<b>1,685,635</b>	<b>386,422</b>
<b>Current Assets</b>		
Cash and cash equivalents	2,487,658	1,611,761
Accounts receivable (less allowance for uncollectible accounts of \$861,378 and \$610,819, respectively)	54,284,011	36,938,688
Accrued revenue	4,716,383	5,229,955
Propane inventory, at average cost	6,332,956	4,654,119
Other inventory, at average cost	1,538,936	1,056,530
Regulatory assets	4,434,828	2,435,284
Storage gas prepayments	8,628,179	5,085,382
Income taxes receivable	2,725,840	719,078
Prepaid expenses	2,021,164	1,759,643
Other current assets	1,596,797	459,908
<b>Total current assets</b>	<b>88,766,752</b>	<b>59,950,348</b>
<b>Deferred Charges and Other Assets</b>		
Goodwill	674,451	674,451
Other intangible assets, net	205,683	219,964
Long-term receivables	961,434	1,209,034
Other regulatory assets	1,178,232	1,542,741
Other deferred charges	1,003,393	902,281
<b>Total deferred charges and other assets</b>	<b>4,023,193</b>	<b>4,548,471</b>
<b>Total Assets</b>	<b>\$295,979,875</b>	<b>\$241,938,428</b>

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

## Capitalization and Liabilities

At December 31,	2005	2004
<b>Capitalization</b>		
Stockholders' equity		
Common Stock, par value \$.4867 per share; (authorized 12,000,000 shares) <sup>(1)</sup>	\$2,863,212	\$2,812,538
Additional paid-in capital	39,619,849	36,854,717
Retained earnings	42,854,894	39,015,087
Accumulated other comprehensive income	(578,151)	(527,246)
Deferred compensation obligation	794,535	816,044
Treasury stock	(797,156)	(1,008,696)
<b>Total stockholders' equity</b>	<b>84,757,183</b>	<b>77,962,444</b>
<b>Long-term debt, net of current maturities</b>	<b>58,990,363</b>	<b>66,189,454</b>
<b>Total capitalization</b>	<b>143,747,546</b>	<b>144,151,898</b>
<b>Current Liabilities</b>		
Current portion of long-term debt	4,929,091	2,909,091
Short-term borrowing	35,482,241	5,001,758
Accounts payable	45,645,228	30,938,272
Customer deposits and refunds	5,140,999	4,678,218
Accrued interest	558,719	601,095
Dividends payable	1,676,398	1,617,245
Deferred income taxes payable	1,150,828	571,876
Accrued compensation	3,793,244	2,680,370
Regulatory liabilities	550,546	571,111
Other accrued liabilities	3,560,055	1,800,540
<b>Total current liabilities</b>	<b>102,487,349</b>	<b>51,369,576</b>
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes payable	24,248,624	23,350,414
Deferred investment tax credits	367,085	437,909
Other regulatory liabilities	2,008,779	1,578,374
Environmental liabilities	352,504	461,656
Accrued pension costs	3,099,882	3,007,949
Accrued asset removal cost	16,727,268	15,024,849
Other liabilities	2,940,838	2,555,803
<b>Total deferred credits and other liabilities</b>	<b>49,744,980</b>	<b>46,416,954</b>
<b>Commitments and Contingencies (Note 4)</b>		
<b>Total Capitalization and Liabilities</b>	<b>\$295,979,875</b>	<b>\$241,938,428</b>

<sup>(1)</sup> Shares issued were 5,883,099 and 5,778,976 for 2005 and 2004, respectively.

Shares outstanding were 5,883,002 and 5,769,558 for 2005 and 2004, respectively.

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

## Consolidated Statements of Stockholders' Equity

For the Years Ended December 31,	2005	2004	2003
<b>Common Stock</b>			
Balance — beginning of year	\$2,812,538	\$2,754,748	\$2,694,935
Dividend Reinvestment Plan	20,038	20,125	24,888
Retirement Savings Plan	10,255	19,058	21,047
Conversion of debentures	11,004	9,060	9,144
Performance shares and options exercised <sup>(1)</sup>	9,377	9,547	4,734
Balance — end of year	2,863,212	2,812,538	2,754,748
<b>Additional Paid-in Capital</b>			
Balance — beginning of year	36,854,717	34,176,361	31,756,983
Dividend Reinvestment Plan	1,224,874	996,715	1,066,386
Retirement Savings Plan	682,829	946,319	899,475
Conversion of debentures	373,259	307,940	310,293
Performance shares and options exercised <sup>(1)</sup>	484,170	427,382	143,224
Balance — end of year	39,619,849	36,854,717	34,176,361
<b>Retained Earnings</b>			
Balance — beginning of year	39,015,087	36,008,246	32,898,283
Net income	10,467,614	9,428,767	9,291,876
Cash dividends <sup>(2)</sup>	(6,627,807)	(6,403,450)	(6,181,913)
Loss on issuance of treasury stock	-	(18,476)	-
Balance — end of year	42,854,894	39,015,087	36,008,246
<b>Accumulated Other Comprehensive Income</b>			
Balance — beginning of year	(527,246)	-	-
Minimum pension liability adjustment, net of tax	(50,905)	(527,246)	-
Balance — end of year	(578,151)	(527,246)	0
<b>Deferred Compensation Obligation</b>			
Balance — beginning of year	816,044	913,689	711,109
New deferrals	130,426	296,790	202,580
Payout of deferred compensation	(151,935)	(394,435)	-
Balance — end of year	794,535	816,044	913,689
<b>Treasury Stock</b>			
Balance — beginning of year	(1,008,696)	(913,689)	(711,109)
New deferrals related to compensation obligation	(130,426)	(296,790)	(202,580)
Purchase of treasury stock	(182,292)	(344,753)	-
Sale and distribution of treasury stock	524,258	546,536	-
Balance — end of year	(797,156)	(1,008,696)	(913,689)
<b>Total Stockholders' Equity</b>	<b>\$84,757,183</b>	<b>\$77,962,444</b>	<b>\$72,939,355</b>

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

<sup>(2)</sup> Cash dividends declared per share for 2005, 2004 and 2003 were \$1.14, \$1.12 and \$1.10, respectively.

### Statement of Comprehensive Income

Net income	\$10,467,614	\$9,428,767	\$9,291,876
Minimum pension liability adjustment, net of tax of \$33,615 and \$347,726, respectively	(50,905)	(527,246)	-
<b>Comprehensive Income</b>	<b>\$10,416,709</b>	<b>\$8,901,521</b>	<b>\$9,291,876</b>

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

## Consolidated Statements of Income Taxes

For the Years Ended December 31,	2005	2004	2003
<b>Current Income Tax Expense</b>			
Federal	\$3,687,800	\$1,221,155	\$4,168,433
State	789,233	618,916	948,023
Investment tax credit adjustments, net	(54,816)	(54,816)	(54,816)
<b>Total current income tax expense</b>	<b>4,422,217</b>	<b>1,785,255</b>	<b>5,061,640</b>
<b>Deferred Income Tax Expense <sup>(1)</sup></b>			
Property, plant and equipment	1,380,628	4,230,650	1,980,070
Deferred gas costs	1,064,310	283,547	105,846
Pensions and other employee benefits	(340,987)	(49,620)	(203,229)
Environmental expenditures	(98,229)	(150,864)	(866,206)
Other	(115,923)	(397,878)	(45,676)
<b>Total deferred income tax expense</b>	<b>1,889,799</b>	<b>3,915,835</b>	<b>970,805</b>
<b>Total Income Tax Expense</b>	<b>\$6,312,016</b>	<b>\$5,701,090</b>	<b>\$6,032,445</b>
<b>Reconciliation of Effective Income Tax Rates</b>			
Federal income tax expense <sup>(2)</sup>	\$5,872,871	\$5,185,257	\$5,478,056
State income taxes, net of federal benefit	708,192	736,176	737,370
Other	(269,047)	(220,343)	(182,981)
<b>Total Income Tax Expense</b>	<b>\$6,312,016</b>	<b>\$5,701,090</b>	<b>\$6,032,445</b>
<b>Effective income tax rate</b>	<b>37.6%</b>	<b>37.4%</b>	<b>37.4%</b>
<b>At December 31,</b>			
<b>Deferred Income Taxes</b>			
<b>Deferred income tax liabilities:</b>			
Property, plant and equipment	\$26,795,452	\$25,736,718	
Deferred gas costs	1,664,252	599,945	
Other	612,943	749,259	
<b>Total deferred income tax liabilities</b>	<b>29,072,647</b>	<b>27,085,922</b>	
<b>Deferred income tax assets:</b>			
Pension and other employee benefits	2,289,370	1,914,402	
Self insurance	575,303	535,755	
Environmental costs	181,734	83,510	
Other	626,788	629,965	
<b>Total deferred income tax assets</b>	<b>3,673,195</b>	<b>3,163,632</b>	
<b>Deferred Income Taxes Per Consolidated Balance Sheet</b>	<b>\$25,399,452</b>	<b>\$23,922,290</b>	

(1) Includes \$146,000, \$386,000 and \$113,000 of deferred state income taxes for the years 2005, 2004 and 2003, respectively.

(2) Federal income taxes were recorded at 35% for the year 2005. They were recorded at 34% in both 2004 and 2003.

*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 54,800 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 32,900 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 significant 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 property is stated at original cost while the assets of the non-utility segments are recorded at 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. 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,	2005	2004	Useful Life <sup>(1)</sup>
Plant in service			
Mains	\$113,111,408	\$99,154,938	24-37 years
Services — utility	29,010,008	25,733,797	14-28 years
Compressor station equipment	23,853,871	23,766,105	28 years
Liquefied petroleum gas equipment	22,162,867	21,483,969	30-39 years
Meters and meter installations	15,165,212	13,656,918	Propane 15-33 years, Natural gas 17-49 years
Measuring and regulating station equipment	12,219,964	10,142,531	17-37 years
Office furniture and equipment	9,572,926	10,171,180	Non-regulated 3-10 years, Regulated 3-20 years
Transportation equipment	9,822,272	9,425,605	2-11 years
Structures and improvements	9,161,696	9,177,011	5-44 years <sup>(2)</sup>
Land and land rights	5,646,852	4,703,683	Not depreciable, except certain regulated assets
Propane bulk plants and tanks	6,097,036	5,024,462	15 - 40 years
Various	16,922,065	15,060,384	Various
Total plant in service	272,746,177	247,500,583	
Plus construction work in progress	7,598,531	2,766,209	
Less accumulated depreciation	(78,840,413)	(73,213,605)	
Net property, plant and equipment	\$201,504,295	\$177,053,187	

<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 Federal Energy Regulatory Commission. 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. The appliance inventory is valued at first-in first-out ("FIFO"). 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, 2005 and 2004, 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,	2005	2004
<b>Regulatory Assets</b>		
<b>Current</b>		
Underrecovered purchased gas costs	\$4,016,522	\$1,479,358
Conservation cost recovery	303,930	186,234
Swing transportation imbalances	454	32,707
Flex rate asset	113,922	736,985
Total current	4,434,828	2,435,284
<b>Non-Current</b>		
Income tax related amounts due from customers	711,961	711,961
Deferred regulatory and other expenses	89,258	200,746
Deferred gas supply	15,201	15,201
Deferred gas required for operations	-	141,082
Deferred post retirement benefits	166,739	194,529
Environmental regulatory assets and expenditures	195,073	279,222
Total non-current	1,178,232	1,542,741
Total Regulatory Assets	\$5,613,060	\$3,978,025
<b>Regulatory Liabilities</b>		
<b>Current</b>		
Self insurance — current	\$44,221	\$127,000
Shared interruptible margins	3,039	135,098
Operational flow order penalties	7,831	130,338
Swing transportation imbalances	495,455	178,675
Total current	550,546	571,111
<b>Non-Current</b>		
Self insurance — long-term	1,383,247	1,221,101
Income tax related amounts due to customers	327,893	324,974
Environmental overcollections	297,639	32,299
Total non-current	2,008,779	1,578,374
Accrued asset removal cost	16,727,268	15,024,849
Total Regulatory Liabilities	\$19,286,593	\$17,174,334

Included in the regulatory assets listed above are \$1.8 million of which are accruing interest. Of the remaining regulatory assets, \$2.7 million will be collected in approximately one to two years, \$360,000 will be collected within approximately 3 to 10 years, and \$729,000 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**

Goodwill and other intangible assets are associated with the acquisition of non-utility companies. In accordance with SFAS No. 142, goodwill is not amortized, but is tested for impairment on an annual basis and when events change. Other intangible assets are amortized on a straight-line basis over their estimated economic useful lives.



**Other Deferred Charges**

Other deferred charges include discount, premium and issuance costs associated with long-term debt. Debt costs are deferred, then 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 \$46,000 and unrealized losses of \$182,000 at December 31, 2005 and 2004, 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 fair value hedges of its inventory, in order to mitigate the impact of wholesale price fluctuations. At December 31, 2005, propane distribution had entered into a put contract to protect 2.1 million gallons of propane inventory from a drop in value below the strike price of the put. The Company settled the put in January 2006, which resulted in a benefit of \$28,000.

## 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 Years Ended December 31,	2005	2004	2003
<b>Calculation of Basic Earnings Per Share from Continuing Operations:</b>			
Income from continuing operations	\$10,467,614	\$9,549,667	\$10,079,483
Weighted average shares outstanding	5,836,463	5,735,405	5,610,592
<b>Basic Earnings Per Share from Continuing Operations</b>	<b>\$1.79</b>	<b>\$1.66</b>	<b>\$1.80</b>
<b>Calculation of Diluted Earnings Per Share from Continuing Operations:</b>			
<b>Reconciliation of Numerator:</b>			
Income from continuing operations — Basic	\$10,467,614	\$9,549,667	\$10,079,483
Effect of 8.25% Convertible debentures	123,559	139,097	157,557
Adjusted numerator — Diluted	\$10,591,173	\$9,688,764	\$10,237,040
<b>Reconciliation of Denominator:</b>			
Weighted shares outstanding — Basic	5,836,463	5,735,405	5,610,592
Effect of dilutive securities			
Stock options	-	1,784	1,361
Warrants	11,711	7,900	5,481
8.25% Convertible debentures	144,378	162,466	184,532
Adjusted denominator — Diluted	5,992,552	5,907,555	5,801,966
<b>Diluted Earnings Per Share from Continuing Operations</b>	<b>\$1.77</b>	<b>\$1.64</b>	<b>\$1.76</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 FASB released a revision (“Share-Based Payment”) to SFAS No. 123 “Accounting for Stock-Based Compensation,” referred to as SFAS No. 123R. In April 2005, the SEC approved a new rule that delayed the effective date for SFAS No. 123R until the first annual period beginning after June 15, 2005. This Statement establishes financial accounting and reporting standards for stock-based employee compensation plans. Those plans include all arrangements by which employees receive shares of stock or other equity instruments of the employer or the employer incurs liabilities to employees in amounts based on the price of the employer’s stock. Examples are stock purchase plans, stock options, restricted stock and stock appreciation rights. The Company adoption of this pronouncement will not have a material impact on the financial statements.

In March 2005, the FASB issued Interpretation No. 47 (“FIN No. 47”), “Accounting for Conditional Asset Retirement Obligations” an interpretation of SFAS No. 143. FIN No. 47 clarifies that the term conditional asset retirement obligation refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. FIN No. 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The Company adopted FIN No. 47 in the fourth quarter of 2005. The adoption of this interpretation did not have a material impact on the company’s financial statements.

In May 2005, the FASB issued SFAS No. 154, “Accounting Changes and Error Corrections — a replacement of APB Opinion No. 20 and FASB Statement No. 3”. SFAS 154 primarily requires retrospective application to prior periods’ financial statements for the direct effects 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 applies to all voluntary changes in accounting principle and also applies to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. The statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company is required to adopt the provision of SFAS 154, as applicable, beginning in fiscal year 2006.

#### ***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 disposed of in October 2004. At December 31, 2005, Chesapeake owned one piece of property that was formerly used by a water subsidiary. That property was listed for sale at December 31, 2005 and subsequently sold in January 2006. The results of operations for all water service businesses have been reclassified to discontinued operations for all periods presented. A loss of \$52,000 and a gain of \$12,000, net of tax, were recorded for 2004 and 2003, respectively, on the sale of the water operations. The Company did not have any discontinued operations in 2005.

## Notes to the Consolidated Financial Statements

Operating revenues for discontinued operations were \$1.1 million and \$9.8 million for 2004 and 2003, respectively. Operating losses for discontinued operations were \$94,000 and \$917,000 for 2004 and 2003, respectively. The balance sheet included the following discontinued operations for December 31, 2004:

- Net property, plant, and equipment of \$184,000;
- Cash and other current assets were \$5,000 and \$63,000, respectively;
- Common stock, additional paid-in capital, and retained deficits were \$51,000, \$3.9 million, and \$6.5 million, respectively; and
- Due to affiliates and other current liabilities were \$2.7 million and \$45,000, respectively.

## 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,	2005	2004	2003
<b>Operating Revenues, Unaffiliated Customers</b>			
Natural gas distribution and transmission	\$166,388,562	\$124,073,939	\$110,071,054
Propane	48,975,349	41,499,687	41,029,121
Advanced information services	14,121,441	12,381,815	12,476,746
Other	144,384	-	(9,329)
<b>Total operating revenues, unaffiliated customers</b>	<b>\$229,629,736</b>	<b>\$177,955,441</b>	<b>\$163,567,592</b>
<b>Intersegment Revenues <sup>(1)</sup></b>			
Natural gas distribution and transmission	\$193,404	\$172,427	\$175,757
Propane	668	-	-
Advanced information services	18,123	45,266	100,804
Other	618,492	647,378	711,159
<b>Total intersegment revenues</b>	<b>\$830,687</b>	<b>\$865,071</b>	<b>\$987,720</b>
<b>Operating Income</b>			
Natural gas distribution and transmission	\$17,235,810	\$17,091,360	\$16,653,111
Propane	3,209,388	2,363,884	3,875,351
Advanced information services	1,196,544	387,193	691,909
Other and eliminations	(111,243)	127,309	359,029
<b>Total operating income</b>	<b>\$21,530,499</b>	<b>\$19,969,746</b>	<b>\$21,579,400</b>
<b>Depreciation and Amortization</b>			
Natural gas distribution and transmission	\$5,682,137	\$5,418,007	\$5,188,273
Propane	1,574,357	1,524,016	1,506,201
Advanced information services	122,569	138,007	190,548
Other and eliminations	189,146	177,508	204,814
<b>Total depreciation and amortization</b>	<b>\$7,568,209</b>	<b>\$7,257,538</b>	<b>\$7,089,836</b>
<b>Capital Expenditures</b>			
Natural gas distribution and transmission	\$28,433,671	\$13,945,214	\$9,078,043
Propane	3,955,799	3,395,190	2,244,583
Advanced information services	294,792	84,185	76,924
Other	739,079	404,941	422,789
<b>Total capital expenditures</b>	<b>\$33,423,341</b>	<b>\$17,829,530</b>	<b>\$11,822,339</b>

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

At December 31,	2005	2004	2003
<b>Identifiable Assets</b>			
Natural gas distribution and transmission	\$225,667,049	\$184,412,301	\$170,758,784
Propane	57,344,859	47,531,106	38,359,251
Advanced information services	2,062,902	2,387,440	2,912,733
Other	10,905,065	7,379,794	7,791,796
<b>Total identifiable assets</b>	<b>\$295,979,875</b>	<b>\$241,710,641</b>	<b>\$219,822,564</b>

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

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 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, 2005 had a gain in fair value of \$46,000 and at December 31, 2004 had a loss in fair value of \$182,000 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, 2005, including current maturities, had an estimated fair value of \$68.5 million as compared to a carrying value of \$63.9 million. At December 31, 2004, the estimated fair value was approximately \$74.8 million as compared to a carrying value of \$69.1 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, 2005 and 2004, 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.

### **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, 2005 and 2004. Testing for 2005 and 2004 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, 2005 are as follows:

	December 31, 2005		December 31, 2004	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Customer lists	\$115,333	\$67,845	\$115,333	\$60,155
Acquisition costs	263,659	105,465	263,659	98,873
<b>Total</b>	<b>\$378,992</b>	<b>\$173,310</b>	<b>\$378,992</b>	<b>\$159,028</b>

Amortization of intangible assets was \$14,000 and \$15,000 for the years ended December 31, 2005 and 2004, respectively. The estimated annual amortization of intangibles is \$14,000 per year for each of the years 2006 through 2010, respectively.

## G. STOCKHOLDERS' EQUITY

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

For the Years Ended December 31,	2005	2004	2003
<b>Common Stock shares issued and outstanding <sup>(1)</sup></b>			
Shares issued — beginning of period balance	5,778,976	5,660,594	5,537,710
Dividend Reinvestment Plan <sup>(2)</sup>	41,175	40,993	51,125
Retirement Savings Plan	21,071	39,157	43,245
Conversion of debentures	22,609	18,616	18,788
Performance shares and options exercised <sup>(3)</sup>	19,268	19,616	9,726
Shares issued — end of period balance <sup>(4)</sup>	5,883,099	5,778,976	5,660,594
Treasury shares — beginning of period balance	(9,418)	-	-
Purchases	(4,852)	(15,316)	-
Dividend Reinvestment Plan	2,142	-	-
Retirement Savings Plan	12,031	-	-
Other issuances	-	5,898	-
Treasury Shares — end of period balance	(97)	(9,418)	-
<b>Total Shares Outstanding</b>	<b>5,883,002</b>	<b>5,769,558</b>	<b>5,660,594</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 37,528, 48,175, and 47,659 shares at December 31, 2005, 2004 and 2003, respectively, held in a Rabbi Trust established by the Company relating to the Supplemental Executive Retirement Savings 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 share 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. The warrants are exercisable during a seven-year period after the grant date. At December 31, 2005, the Company had outstanding warrants of 30,000 at an average exercise price of \$18.125 per share — 15,000 warrants expire in 2007 and the remaining 15,000 expire in 2008.

## Notes to the Consolidated Financial Statements

### H. LONG-TERM DEBT

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

<b>At December 31,</b>	<b>2005</b>	<b>2004</b>
Uncollateralized senior notes:		
7.97% note, due February 1, 2008	\$2,000,000	\$3,000,000
6.91% note, due October 1, 2010	3,636,363	4,545,454
6.85% note, due January 1, 2012	5,000,000	6,000,000
7.83% note, due January 1, 2015	16,000,000	20,000,000
6.64% note, due October 31, 2017	30,000,000	30,000,000
Convertible debentures:		
8.25% due March 1, 2014	2,254,000	2,644,000
Promissory note	100,000	-
<b>Total Long-Term Debt</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: \$4,929,091 for 2006; \$7,656,364 for 2007; \$7,656,364 for 2008; \$6,656,364 for 2009 and \$6,656,364 for 2010.*

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 2005 and 2004, debentures totaling \$385,000 and \$317,000, 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. During 2005, debentures totaling \$5,000 were redeemed for cash. In 2004, no debentures were redeemed for cash. At the Company's option, the debentures may be redeemed at stated amounts.

On June 29, 2005, the Company entered into an agreement in principal with Prudential Investment Management Inc. Subsequently, the Company executed a Note Agreement, dated October 18, 2005, with three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company), pursuant to which the investors agreed, subject to certain conditions, to purchase from the Company \$20 million in principal of 5.5 percent Senior Notes (the "Notes") issued by the Company provided that the Company elects to effect the sale of the Notes at any time prior to January 15, 2007. The terms of the Notes will require annual principal repayments of \$2 million beginning on the fifth anniversary of the issuance of the Notes.

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, 2005, the Board of Directors ("Board") had authorized the Company to borrow up to \$50.0 million from various banks and trust companies under short-term lines of credit. As of December 31, 2005, the Company had three uncommitted and two committed, short-term bank lines of credit totaling \$65.0 million, none of which required compensating balances. Under these lines of credit, the Company had short-term debt outstanding of approximately \$35.5 million and \$5.0 million at December 31, 2005 and 2004, respectively. The annual weighted average interest rates were 4.6 percent for 2005 and 3.7 percent for 2004. The Company also had a letter of credit outstanding in the amount of \$694,000 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 \$837,000, \$934,000 and \$1.1 million for 2005, 2004 and



2003, respectively. Future minimum payments under the Company's current lease agreements are \$646,000, \$597,000, \$466,000, \$395,000 and \$298,000 for the years of 2006 through 2010, respectively; and \$2.4 million thereafter, totaling \$4.8 million.

## K. EMPLOYEE BENEFIT PLANS

### Retirement Plans

Before 1999, Company employees generally participated in both a defined benefit 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 benefit Pension Plan to new participants. Employees who participated in the defined benefit Pension Plan at that time were given the option of remaining in (and continuing to accrue benefits under) the Pension Plan or receiving an enhanced matching contribution in the Retirement Savings Plan.

Because the defined benefit 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 Pension Plan to maintain its tax-qualified status. To avoid jeopardizing the tax-qualified status of the Pension Plan, the Company's Board of Directors amended the defined benefit 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 benefit Pension Plan and the Retirement Savings Plan, effective January 1, 2005, so that Pension Plan participants who are actively employed by the Company on that date (1) receive two additional years of benefit service credit to be used in calculating their Pension Plan benefit (subject to the Pension Plan's limit of 35 years of benefit service credit), (2) have the option to receive their 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 benefit 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 Pension Plan, a gain of approximately \$172,000 (after tax) was recorded during 2004.

### Defined Benefit Pension Plan

As described above, effective January 1, 2005, the defined benefit 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 in 2006. The measurement dates for the Pension Plan were December 31, 2005 and 2004, respectively.

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

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

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

## Notes to the Consolidated Financial Statements

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 Pension Plan at December 31, 2005 and 2004:

<b>At December 31,</b>	<b>2005</b>	<b>2004</b>
<b>Change in benefit obligation:</b>		
Benefit obligation — beginning of year	\$12,053,063	\$11,948,755
Service cost	-	338,352
Interest cost	645,740	690,620
Change in assumptions	388,979	573,639
Actuarial loss	28,895	220,842
Amendments	-	883,753
Effect of curtailment/settlement	-	(2,171,289)
Benefits paid	(717,056)	(431,609)
<b>Benefit obligation — end of year</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	12,097,248	11,301,548
Actual return on plan assets	400,674	1,227,309
Benefits paid	(717,056)	(431,609)
<b>Fair value of plan assets — end of year</b>	<b>11,780,866</b>	<b>12,097,248</b>
Funded status	(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>(\$782,753)</b>	<b>(\$844,997)</b>
<b>Assumptions:</b>		
Discount rate	5.25%	5.50%
Rate of compensation increase	4.00%	4.00%
Expected return on plan assets	6.00%	7.88%

The assumptions used for the discount rate of the plan were reviewed by the Company and lowered from 5.5 percent to 5.25 percent, reflecting a reduction 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 was lowered from 7.88 percent to 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. There was no change in the assumed compensation rate increases. The accumulated benefit obligation was \$12.4 million and \$12.1 million at December 31, 2005 and 2004, respectively.

Net periodic pension costs for the defined benefit Pension Plan for 2005, 2004 and 2003 include the components as shown below:

<b>For the Years Ended December 31,</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Components of net periodic pension cost:</b>			
Service cost	\$0	\$338,352	\$325,366
Interest cost	645,740	690,620	684,239
Expected return on assets	(703,285)	(869,336)	(784,476)
Amortization of:			
Transition assets	-	(11,328)	(15,104)
Prior service cost	(4,699)	(4,699)	(4,699)
<b>Net periodic pension cost (benefit)</b>	<b>(\$62,244)</b>	<b>\$143,609</b>	<b>\$205,326</b>

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

<b>For the Years Ended December 31,</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Assumptions:</b>			
Discount rate	5.50%	5.88%	6.50%
Rate of compensation increase	4.00%	4.00%	4.50%
Expected return on plan assets	6.00%	7.88%	8.50%

#### **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 \$2.3 million and \$2.2 million at December 31, 2005 and 2004, respectively. Accrued pension costs at December 31, 2005 include \$959,000 related to a minimum pension liability. The minimum pension liability is a component of other comprehensive income.

Net periodic pension costs for the executive excess benefit pension plan for 2005, 2004 and 2003 include the components as shown below:

<b>For the Years Ended December 31,</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Components of net periodic pension cost:</b>			
Service cost	\$0	\$105,913	\$107,877
Interest cost	119,658	87,568	80,039
Amortization of:			
Prior service cost	-	2,090	2,787
Actuarial loss	49,319	21,699	18,677
<b>Net periodic pension cost</b>	<b>\$168,977</b>	<b>\$217,270</b>	<b>\$209,380</b>

## Notes to the Consolidated Financial Statements

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

<b>At December 31,</b>	<b>2005</b>	<b>2004</b>
<b>Change in benefit obligation:</b>		
Benefit obligation — beginning of year	\$2,162,952	\$1,406,190
Service cost	-	105,913
Interest cost	119,658	87,568
Actuarial loss	133,839	713,225
Amendments	-	60,000
Effect of curtailment/settlement	-	(184,844)
Benefits paid	(93,978)	(25,100)
<b>Benefit obligation — end of year</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	93,978	25,100
Benefits paid	(93,978)	(25,100)
<b>Fair value of plan assets — end of year</b>	<b>-</b>	<b>-</b>
Funded status	(2,322,471)	(2,162,952)
Unrecognized net actuarial loss	959,492	874,972
<b>Net amount accrued</b>	<b>(\$1,362,979)</b>	<b>(\$1,287,980)</b>
<b>Assumptions:</b>		
Discount rate	5.25%	5.50%
Rate of compensation increase	4.00%	4.00%

The assumptions used for the discount rate of the plan were reviewed by the Company and lowered from 5.5 percent to 5.25 percent, reflecting a reduction in the interest rates of high quality bonds and a reduction in the expected life of the plan. There was no change in the assumed pay rate increases. The measurement dates for the executive excess benefit plan were December 31, 2005 and 2004, respectively.

### Other Post-Retirement Benefits

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

Net periodic post-retirement costs for 2005, 2004 and 2003 include the following components:

<b>For the Years Ended December 31,</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
<b>Components of net periodic post-retirement cost:</b>			
Service cost	\$6,257	\$5,354	\$5,138
Interest cost	77,872	86,883	85,319
Amortization of:			
Transition obligation	27,859	27,859	27,859
Actuarial loss	88,291	78,900	66,271
<b>Net periodic post-retirement cost</b>	<b>\$200,279</b>	<b>\$198,996</b>	<b>\$184,587</b>

The following schedule sets forth the status of the post-retirement health care and life insurance plan:

<b>At December 31,</b>	<b>2005</b>	<b>2004</b>
<b>Change in benefit obligation:</b>		
Benefit obligation — beginning of year	\$1,599,280	\$1,471,664
Retirees	(59,152)	91,747
Fully-eligible active employees	(31,761)	22,071
Other active	26,317	13,798
<b>Benefit obligation — end of year</b>	<b>\$1,534,684</b>	<b>\$1,599,280</b>
Funded status	(\$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</b>	<b>(\$760,952)</b>	<b>(\$649,911)</b>
<b>Assumptions:</b>		
Discount rate	5.25%	5.50%

The health care inflation rate for 2005 is assumed to be 8 percent for medical and 10 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 post-retirement benefit obligation by approximately \$204,000 as of January 1, 2006, and would increase the aggregate of the service cost and interest cost components of the net periodic post-retirement benefit cost for 2006 by approximately \$13,000. A one percentage point decrease in the health care inflation rate from the assumed rate would decrease the accumulated post-retirement benefit obligation by approximately \$169,000 as of January 1, 2006, and would decrease the aggregate of the service cost and interest cost components of the net periodic post-retirement benefit cost for 2006 by approximately \$11,000. The measurement dates were December 31, 2005 and 2004, respectively.

#### Estimated Future Benefit Payments

The schedule below shows the estimated future benefit payments for each of the years 2006 through 2010 and the aggregate of the next five years for each of the plans previously described.

	<b>Defined Benefit Pension Plan <sup>(1)</sup></b>	<b>Executive Excess Defined Benefit Pension Plan <sup>(2)</sup></b>	<b>Other Post- Retirement Benefits <sup>(2)</sup></b>
2006	\$440,904	\$89,204	\$146,051
2007	713,051	88,490	152,321
2008	851,435	87,782	152,114
2009	1,431,421	87,080	155,098
2010	895,710	86,384	174,932
Years 2011 through 2015	4,089,216	692,464	987,030

<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.

## Notes to the Consolidated Financial Statements

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. 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.

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 earn interest income monthly.

The Company's contributions to the 401(k) plans totaled \$1,681,000, \$1,497,000 and \$1,444,000 for the years ended December 31, 2005, 2004 and 2003, respectively. As of December 31, 2005, there are 111,738 shares reserved to fund future contributions to the Retirement Savings Plan.

### L. EXECUTIVE INCENTIVE PLANS

A Performance Incentive Plan ("the Plan") adopted in 1992 and amended in April 1998 allows for the granting of performance shares, stock options and stock appreciation rights to certain officers of the Company. The Company now uses performance shares exclusively. All stock options granted in prior years were exercised as of December 31, 2005 and all stock appreciation rights ("SARs") were exercised prior to December 31, 2003.

The Plan enables participants the right to earn performance shares upon the Company's achievement of certain performance goals, as set forth in the specific agreements, and the individual's achievement of goals set annually for each executive. The Company recorded compensation expense of \$701,000, \$490,000 and \$726,000 associated with these performance shares in 2005, 2004 and 2003, respectively.

In 1997, the Company executed Stock Option Agreements for a three-year performance period ending December 31, 2000, with certain executive officers. One-half of these options became exercisable over time and the other half became exercisable if certain performance targets were achieved. SFAS No. 123 requires the disclosure of pro forma net income and earnings per share as if fair value based accounting had been used to account for the stock-based compensation costs. The assumptions used in calculating the pro forma information were: dividend yield, 4.73 percent; expected volatility, 15.53 percent; risk-free interest rate, 5.89 percent; and an expected life of four years. No options have been granted since 1997; therefore, there is no pro forma impact for 2005, 2004 or 2003. The weighted average exercise price of outstanding options was \$20.50 for all years presented. All outstanding options were exercised as of December 31, 2005.

Changes in outstanding options are shown on the chart below:

	2005		2004		2003	
	Number of shares	Option Price	Number of shares	Option Price	Number of shares	Option Price
Balance — beginning of year	17,537	\$20.50	29,490	\$20.50	41,948	\$20.50
Options exercised	(17,537)	\$20.50	(11,834)	\$20.50	(12,458)	\$20.50
Options forfeited	-		(119)	\$20.50	-	
Balance — end of year	-		17,537	\$20.50	29,490	\$20.50
Exercisable	-		17,537	\$20.50	29,490	\$20.50

In 2000, the Company replaced the third year of this Stock Option Agreement with Stock Appreciation Rights. The SARs were awarded based on performance with a minimum number of SARs established for each participant. During 2001 and 2000, the Company granted 10,650 and 13,150 SARs, respectively, in conjunction with the agreement. During 2003, all SARs were exercised.

As of December 31, 2005, there were 293,481 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 remedial work at one former gas manufacturing plant site and is currently participating in the investigation, assessment or remediation of two other former gas manufacturing plant sites. These sites are located in three different jurisdictions. The Company has accrued liabilities for three sites referred to respectively as the Dover Gas Light, Salisbury Town Gas Light and the Winter Haven Coal Gas sites. The Company is currently in discussions with the Maryland Department of the Environment ("MDE") regarding the possible responsibilities of the Company with respect to a former gas manufacturing plant site in Cambridge, Maryland.

### **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 expenditures for this site. Through December 31, 2005, the Company has incurred approximately \$9.7 million in costs related to environmental testing and remedial action studies at the site. Approximately \$9.9 million has been recovered through December 2005 from other parties or through rates. As of December 31, 2005, a regulatory liability of approximately \$298,000, 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 No Further Action ("NFA") determination. The Company has been in discussions with the MDE regarding such request and is waiting on a determination from the MDE.

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

The Company has adjusted the liability with respect to the Salisbury Town Gas Light site to \$2,300 at December 31, 2005. This amount is based on the estimated costs to perform limited product monitoring and recovery efforts and fulfill ongoing reporting requirements. A corresponding regulatory asset has been recorded, reflecting the Company's belief that costs incurred will be recoverable in base rates.

Through December 31, 2005, 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. The Company expects to recover the remaining costs through rates.

### **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 Air Sparging and Soil Vapor Extraction 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 AS/SVE Pilot Study 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 AS/SVE Pilot Study 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 is now fully operational.

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 require remediation. Early estimates by the Company's environmental consultant 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 vigorously 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.

The Company has accrued a liability of \$350,000 as of December 31, 2005 for the Winter Haven site. Through December 31, 2005, the Company has incurred approximately \$1.5 million of environmental costs associated with the Winter Haven site. At December 31, 2005 the Company had collected through rates \$158,000 in excess of costs incurred. A regulatory asset of approximately \$193,000, representing the uncollected portion of the estimated clean-up costs, has also been recorded. The Company expects to recover the remaining costs through rates.

### **Other**

The Company is in discussions with the MDE regarding the possible responsibilities of the Company for remediation of a gas manufacturing plant site located in Cambridge, Maryland. The outcome of this matter cannot be determined at this time.

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

### **Application of Florida Gross Receipts Tax**

The Company provides natural gas supply and management services through its affiliate, Peninsula Energy Services Company, Inc. ("PESCO"), to commercial and industrial customers located in Florida. Substantially all of the natural gas purchased by PESCO's customers is sold to the customers at delivery points located outside the State of Florida and because title to the gas typically passes outside Florida, PESCO does not collect gross receipts taxes from its customers.



The Company understands that the Florida Department of Revenue has alleged that other companies in the natural gas marketing industry should have collected the gross receipts tax from the purchasers of the gas under similar circumstances. On June 8, 2005, new legislation was enacted that establishes the responsibilities of regulated utilities, including Chesapeake (d/b/a/ Central Florida Gas), as well as unregulated natural gas marketers, such as PESCO, for the collection of the gross receipts tax. The law also contains amnesty provisions relating to the failure to collect gross receipts taxes on sales made prior to January 1, 2006. While the Company does not believe that it has any liability, it has prepared the required amnesty documents to be submitted to the Department of Revenue for both Chesapeake and PESCO during the fourth quarter of 2005. The Company received a conditional approval of its amnesty documents from the Florida Department of Revenue in a letter dated October 18, 2005. This conditional approval is stated in the Company's amnesty application and is expressly conditioned on those facts being accurate.

### **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 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, advanced information services subsidiary, and its Florida natural gas supply and management services subsidiary. The corporate guarantees provide for the payment of propane and natural gas purchases and office rent in the event of the subsidiary's default. The aggregate amount of the obligations guaranteed at December 31, 2005 totaled \$11.2 million, with the guarantees expiring on various dates in 2006. All payables of the subsidiaries are recorded in the Consolidated Financial Statements.

The Company has issued a letter of credit to its primary insurance company for \$694,000, which expires June 1, 2006. The letter of credit was provided as security for claims amounts below the deductibles on the Company's policies.

### **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.

## Notes to the Consolidated Financial Statements

### 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>2005</b>				
Operating Revenue	\$77,845,248	\$42,220,377	\$35,155,121	\$74,408,990
Operating Income	11,504,343	2,324,945	(99,149)	7,800,360
Net Income (Loss)				
From continuing operations	\$6,232,796	\$795,924	(\$693,774)	\$4,132,668
Net Income (Loss)	\$6,232,796	\$795,924	(\$693,774)	\$4,132,668
Earnings per share:				
Basic				
From continuing operations	\$1.08	\$0.14	(\$0.12)	\$0.70
Net Income (Loss)	\$1.08	\$0.14	(\$0.12)	\$0.70
Diluted				
From continuing operations	\$1.05	\$0.14	(\$0.12)	\$0.69
Net Income (Loss)	\$1.05	\$0.14	(\$0.12)	\$0.69
<b>2004</b>				
Operating Revenue	\$63,762,360	\$34,292,972	\$26,614,699	\$53,285,410
Operating Income	10,699,307	2,162,794	282,738	6,824,907
Net Income (Loss)				
From continuing operations	\$5,773,534	\$611,518	(\$584,171)	\$3,748,786
From discontinued operations	(34,335)	19,148	(72,041)	(33,672)
Net Income (Loss)	\$5,739,199	\$630,666	(\$656,212)	\$3,715,114
Earnings per share:				
Basic				
From continuing operations	\$1.01	\$0.11	(\$0.10)	\$0.65
From discontinued operations	-	-	(0.01)	(0.01)
Net Income (Loss)	\$1.01	\$0.11	(\$0.11)	\$0.64
Diluted				
From continuing operations	\$0.99	\$0.11	(\$0.10)	\$0.64
From discontinued operations	(0.01)	-	(0.01)	(0.01)
Net Income (Loss)	\$0.98	\$0.11	(\$0.11)	\$0.63

## **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, 2005. 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, 2005.

#### **Changes in Internal Controls**

During the fiscal quarter of the Company ended December 31, 2005, 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."

### **ITEM 9B. OTHER INFORMATION.**

The Company filed a Current Report on Form 8-K, dated December 5, 2005, discussing the Compensation Committee's (the "Committee") actions on November 30, 2005, including their approval of the compensation arrangements relating to the executive officers of the Company for 2006.

On November 30, 2005, the Committee approved awards under the Company's Performance Incentive Plan to John R. Schimkaitis, President and Chief Executive Officer; Paul M. Barbas, Executive Vice President and Chief Operating 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, 2006 (the "2006 Award Year"). In addition, any Contingent Performance Shares that are not earned by the applicable executive officer during the 2006 Award Year may be earned in 2007 or 2008, if in either of those two succeeding years cumulative pre-established Performance Goals are achieved over, respectively, the three-year period ending in that year.

On November 30, 2005, 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, 2006 and ending December 31, 2006, 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 AND EXECUTIVE OFFICERS OF THE REGISTRANT.**

The information required by this Item is incorporated herein by reference to the portions of the Proxy Statement, captioned "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, 2006 in connection with the Company's Annual Meeting to be held on May 2, 2006.

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" and "Management Compensation" in the Proxy Statement to be filed not later than March 31, 2006, in connection with the Company's Annual Meeting to be held on May 2, 2006.

### **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, 2006 in connection with the Company's Annual Meeting to be held on May 2, 2006.

The following table sets forth information as of December 31, 2005, 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	- (1)		293,481 (2)
Equity compensation plans not approved by security holders	30,000 (3)	\$18.125	
<b>Total</b>	<b>30,000</b>	<b>\$18.125</b>	<b>293,481</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 1992 Performance Incentive Plan.

(3) 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 2001 at a price of \$18.25 per share and 15,000 shares in 2000 at a price of \$18.00. The warrants are exercisable during a seven-year period after the date granted.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.**

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, 2006, in connection with the Company's Annual Meeting to be held on May 2, 2006.

## 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, 2005, 2004 and 2003
  - Consolidated Balance Sheets at December 31, 2005 and December 31, 2004
  - Consolidated Statements of Cash Flows for each of the three years ended December 31, 2005, 2004 and 2003
  - Consolidated Statements of Common Stockholders' Equity for each of the three years ended December 31, 2005, 2004 and 2003
  - Consolidated Statements of Income Taxes for each of the three years ended December 31, 2005, 2004 and 2003
  - Notes to Consolidated Financial Statements
2. Financial Statement Schedules — 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.

#### (b) Reports on Form 8-K:

- Sale of LAMPS (Item 8.01)
- Earnings press release dated November 4, 2004 (Items 2.02 and 9.01)
- Compensation Committee approval of Compensation Arrangements (Item 1.01)
- Approval of Paul M. Barbas to Chief Operating Officer (Item 5.02)

#### (c) Exhibits:

- Exhibit 3(a) 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(a) 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(b) 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(c) 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(d) 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(e) 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(f) 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(g) Agreement in principle between Prudential Investment Management, Inc. and Chesapeake Utilities Corporation related to the prospective purchase by Prudential of \$20 million of 5.5% Senior Notes dated June 29, 2005, is incorporated herein by reference to Exhibit 4.1 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 2005, File No. 001-11590.
- Exhibit 4(h) Note Agreement entered into by the Company on October 18, 2005, pursuant to which the Company, on or before December 28, 2006, will privately place \$20 million of its 5.5% Senior Notes due 2020, is filed herewith as Exhibit 4.1.
- \*Exhibit 10(a) Executive Employment Agreement dated January 1, 2006, by and between Sharp Energy, Inc. and S. Robert Zola, is filed herewith as Exhibit 10.1.
- \*Exhibit 10(b) Form of Performance Share Agreement dated November 9, 2004, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and each of John R. Schimkaitis, Michael P. McMasters and Paul Barbas, is incorporated herein by reference to Exhibit 10.1 of the Company's Annual Report on Form 10-K for the year ended December 31, 2004, File No. 001-11590.
- \*Exhibit 10(c) Performance Share Agreement dated December 30, 2005, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and each of John R. Schimkaitis, Paul M. Barbas and Michael P. McMasters, is filed herewith as Exhibit 10.2.
- \*Exhibit 10(d) Performance Share Agreement dated December 23, 2005, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and Stephen C. Thompson, is filed herewith as Exhibit 10.3.
- \*Exhibit 10(e) Performance Share Agreement dated December 26, 2005, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and S. Robert Zola, is filed herewith as Exhibit 10.4.
- \*Exhibit 10(f) 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(g) Executive Officer Compensation Arrangements, filed herewith as Exhibit 10.5.
- \*Exhibit 10(h) 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(i) 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(j) 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(k) 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 12 Computation of Ratio of Earning to Fixed Charges, filed herewith.
- Exhibit 21 Subsidiaries of the Registrant, filed herewith.

- Exhibit 23 Consent of Independent Registered Public Accounting Firm, filed herewith.
- Exhibit 31.1 Certificate of Chief Executive Office of Chesapeake Utilities Corporation pursuant to Exchange Act Rule 13a-14(a), dated March 6, 2006, filed herewith.
- Exhibit 31.2 Certificate of Chief Financial Officer of Chesapeake Utilities Corporation pursuant to Exchange Act Rule 13a-14(a), dated March 6, 2006, filed herewith.
- Exhibit 32.1 Certificate of Chief Executive Office of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated March 6, 2006, filed herewith.
- Exhibit 32.2 Certificate of Chief Financial Officer of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated March 6, 2006, 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 6, 2006

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 23, 2006

/s/ JOHN R. SCHIMKAITIS  
John R. Schimkaitis, President,  
Chief Executive Officer and Director  
Date: March 6, 2006

/s/ MICHAEL P. MCMASTERS  
Michael P. McMasters, Senior Vice President  
and Chief Financial Officer  
(Principal Financial and Accounting Officer)  
Date: March 6, 2006

/s/ RICHARD BERNSTEIN  
Richard Bernstein, Director  
Date: February 23, 2006

/s/ THOMAS J. BRESNAN  
Thomas J. Bresnan, Director  
Date: March 6, 2006

/s/ WALTER J. COLEMAN  
Walter J. Coleman, Director  
Date: February 23, 2006

/s/ J. PETER MARTIN  
J. Peter Martin, Director  
Date: February 23, 2006

/s/ JOSEPH E. MOORE, ESQ.  
Joseph E. Moore, Esq., Director  
Date: February 23, 2006

/s/ CALVERT A. MORGAN, JR.  
Calvert A. Morgan, Jr., Director  
Date: February 23, 2006

/s/ RUDOLPH M. PEINS, JR.  
Rudolph M. Peins, Jr., Director  
Date: February 23, 2006

/s/ ROBERT F. RIDER  
Robert F. Rider, Director  
Date: February 23, 2006

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

<b>For the Year Ended December 31,</b>	<b>Balance at Beginning of Year</b>	<b>Additions</b>			<b>Balance at End of Year</b>
		<b>Charged to Income</b>	<b>Other Accounts <sup>(1)</sup></b>	<b>Deductions <sup>(2)</sup></b>	
<b>Reserve Deducted From Related Assets</b>					
<b>Reserve for Uncollectible Accounts</b>					
2005	\$ 610,819	\$ 632,645	\$ 158,408	\$ (540,494)	\$ 861,378
2004	\$ 682,002	\$ 505,595	\$ 103,020	\$ (679,798)	\$ 610,819
2003	\$ 659,628	\$ 660,390	\$ 10,093	\$ (648,109)	\$ 682,002

<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,	2005	2004	2003
<b>Income from continuing operations</b>	<b>\$10,467,614</b>	<b>\$9,549,667</b>	<b>\$10,079,483</b>
Add:			
Income taxes	6,312,016	5,701,090	6,032,445
Portion of rents representative of interest factor	278,846	309,446	351,445
Interest on indebtedness	5,077,693	5,206,723	5,616,756
Amortization of debt discount and expense	55,802	61,422	89,155
<b>Earnings as adjusted</b>	<b>\$22,191,971</b>	<b>\$20,828,348</b>	<b>\$22,169,284</b>
<b>Fixed Charges</b>			
Portion of rents representative of interest factor	\$278,846	\$309,446	\$351,445
Interest on indebtedness	5,077,693	5,206,723	5,616,756
Amortization of debt discount and expense	55,802	61,422	89,155
<b>Fixed Charges</b>	<b>\$5,412,341</b>	<b>\$5,577,591</b>	<b>\$6,057,356</b>
<b>Ratio of Earnings to Fixed Charges</b>	<b>4.10</b>	<b>3.73</b>	<b>3.66</b>

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

<u>Subsidiaries</u>	<u>State Incorporated</u>
aQuality Company, Inc	Delaware
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

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We hereby consent to the incorporation by reference in the Registration Statement on Form S-3 (Nos. 333-63381 and 333-121524) 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 6, 2006 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 6, 2006

**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 6, 2006

/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 6, 2006

/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, 2005, 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 6, 2006

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, 2005, 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 6, 2006

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 2005 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, 2006

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)

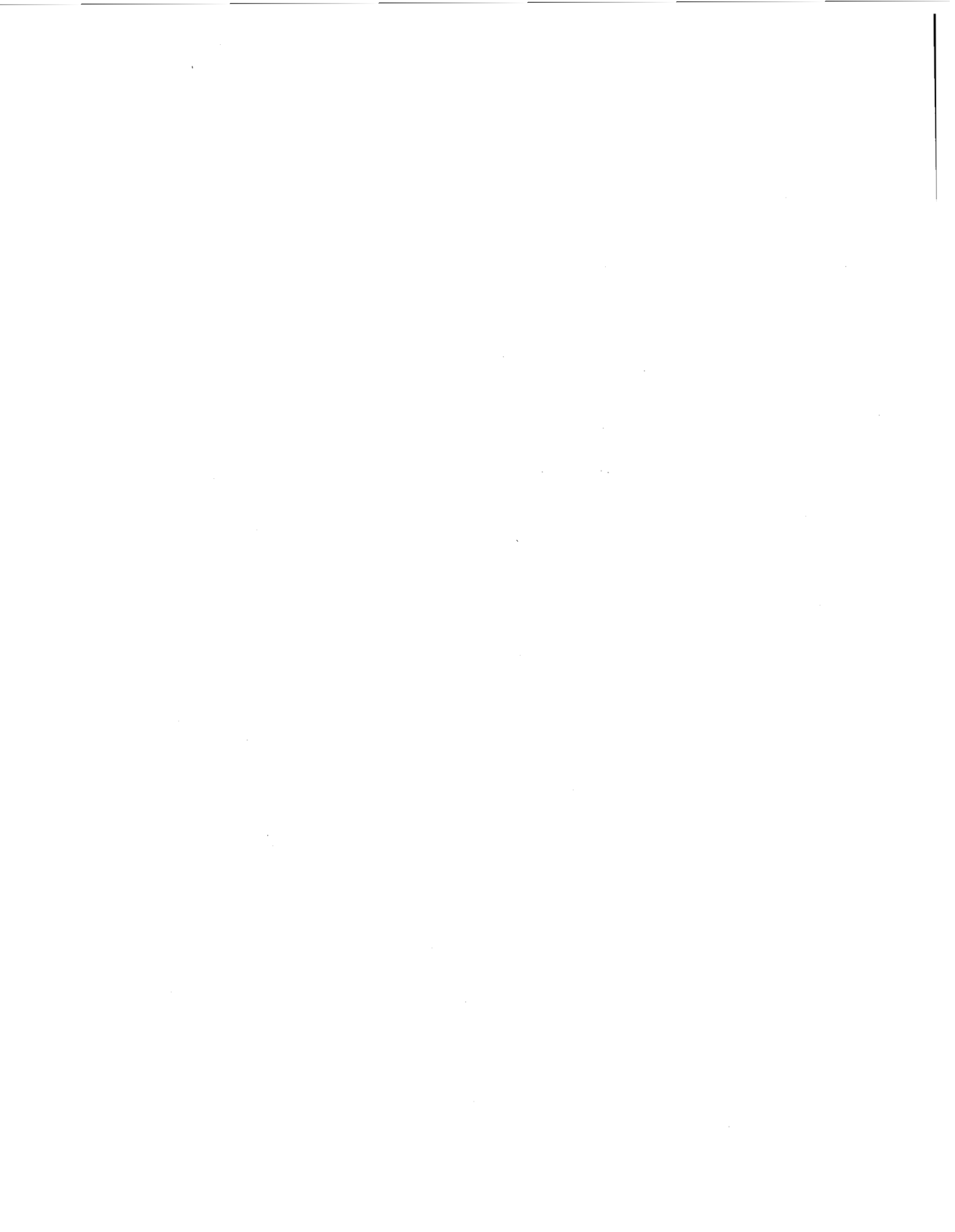
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such 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 — 5,971,275 shares outstanding as of July 31, 2006.



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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,	2006	2005
<b>Operating Revenues</b>	<b>\$44,303,752</b>	<b>\$42,220,377</b>
<b>Operating Expenses</b>		
Cost of sales, excluding costs below	28,505,528	26,922,487
Operations	8,851,831	9,422,034
Maintenance	583,638	488,659
Depreciation and amortization	2,037,003	1,911,120
Other taxes	1,120,384	1,151,132
Total operating expenses	41,098,384	39,895,432
<b>Operating Income</b>	<b>3,205,368</b>	<b>2,324,945</b>
Other income net of other expenses	63,715	228,481
Interest charges	1,501,352	1,273,166
<b>Income Before Income Taxes</b>	<b>1,767,731</b>	<b>1,280,260</b>
Income taxes	635,222	484,336
<b>Net Income</b>	<b>\$1,132,509</b>	<b>\$795,924</b>
<b>Earnings Per Share of Common Stock:</b>		
Basic	\$0.19	\$0.14
Diluted	\$0.19	\$0.14
Basic weighted average shares outstanding	5,952,074	5,823,043
Diluted weighted average shares outstanding	5,963,596	5,834,548
<b>Cash Dividends Declared Per Share of Common Stock:</b>	<b>\$0.290</b>	<b>\$0.285</b>

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

## Chesapeake Utilities Corporation and Subsidiaries

### Condensed Consolidated Statements of Income (Unaudited)

<b>For the Six Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>
<b>Operating Revenues</b>	<b>\$135,254,425</b>	<b>\$120,065,625</b>
<b>Operating Expenses</b>		
Cost of sales, excluding costs below	94,430,289	79,495,162
Operations	18,453,112	19,509,803
Maintenance	1,027,607	818,234
Depreciation and amortization	4,014,350	3,812,091
Other taxes	2,686,471	2,601,047
<b>Total operating expenses</b>	<b>120,611,829</b>	<b>106,236,337</b>
<b>Operating Income</b>	<b>14,642,596</b>	<b>13,829,288</b>
Other income net of other expenses	142,299	310,861
Interest charges	2,994,689	2,550,944
<b>Income Before Income Taxes</b>	<b>11,790,206</b>	<b>11,589,205</b>
Income taxes	4,561,281	4,560,485
<b>Net Income</b>	<b>\$7,228,925</b>	<b>\$7,028,720</b>
<b>Earnings Per Share of Common Stock:</b>		
Basic	\$1.22	\$1.21
Diluted	\$1.20	\$1.19
Basic weighted average shares outstanding	5,930,872	5,808,515
Diluted weighted average shares outstanding	6,070,191	5,970,223
<b>Cash Dividends Declared Per Share of Common Stock:</b>	<b>\$0.575</b>	<b>\$0.565</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,	2006	2005
<b>Operating Activities</b>		
Net Income	\$7,228,925	\$7,028,720
Adjustments to reconcile net income to net operating cash:		
Depreciation and amortization	4,014,350	3,812,091
Depreciation and accretion included in other costs	1,503,982	1,327,778
Deferred income taxes, net	(2,594,607)	(1,468,724)
Unrealized loss on commodity contracts	(99,715)	(205,891)
Unrealized gain (loss) on investments	(56,628)	4,964
Employee benefits and compensation	865,693	871,595
Other, net	(1,806)	841
Changes in assets and liabilities:		
Sale (purchase) of investments	(66,146)	(1,200,019)
Accounts receivable and accrued revenue	20,855,446	14,640,804
Propane inventory, storage gas and other inventory	2,947,555	1,341,440
Regulatory assets	3,826,484	1,403,048
Prepaid expenses and other current assets	(145,409)	(440,294)
Other deferred charges	28,383	(45,602)
Long-term receivables	87,643	111,683
Accounts payable and other accrued liabilities	(21,453,582)	(10,904,950)
Income taxes receivable	5,346,331	2,999,588
Accrued interest	54,092	1,111,847
Customer deposits and refunds	(468,019)	(1,161,802)
Accrued compensation	(1,521,300)	51,480
Regulatory liabilities	2,110,253	2,217,930
Environmental and other liabilities	(68,757)	177,151
Net cash provided by operating activities	22,393,168	21,673,678
<b>Investing Activities</b>		
Property, plant and equipment expenditures	(16,247,088)	(10,778,644)
Environmental recoveries	1,620	168,983
Net cash used by investing activities	(16,245,468)	(10,609,661)
<b>Financing Activities</b>		
Common stock dividends	(2,945,899)	(2,887,983)
Issuance of stock for Dividend Reinvestment Plan	176,104	138,592
Change in cash overdrafts due to outstanding checks	1,268,914	(301,758)
Net repayment under line of credit agreements	(3,747,750)	(4,700,000)
Repayment of long-term debt	(1,020,454)	(1,005,197)
Net cash used by financing activities	(6,269,085)	(8,756,346)
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<b>(121,385)</b>	<b>2,307,671</b>
<b>Cash and Cash Equivalents — Beginning of Period</b>	<b>2,487,658</b>	<b>1,611,761</b>
<b>Cash and Cash Equivalents — End of Period</b>	<b>\$2,366,273</b>	<b>\$3,919,432</b>

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 Months Ended June 30, 2006	For the Twelve Months Ended December 31, 2005
<b>Common Stock</b>		
Balance — beginning of period	\$2,863,212	\$2,812,538
Dividend Reinvestment Plan	9,475	20,038
Retirement Savings Plan	7,679	10,255
Conversion of debentures	4,628	11,004
Performance shares and options exercised	14,536	9,377
Balance — end of period	\$2,899,530	\$2,863,212
<b>Additional Paid-in Capital</b>		
Balance — beginning of period	\$39,619,849	\$36,854,717
Dividend Reinvestment Plan	587,184	1,224,874
Retirement Savings Plan	478,462	682,829
Conversion of debentures	156,919	373,259
Performance shares and options exercised	886,548	484,170
Balance — end of period	\$41,728,962	\$39,619,849
<b>Retained Earnings</b>		
Balance — beginning of period	\$42,854,894	\$39,015,087
Net income	7,228,925	10,467,614
Cash dividends declared	(3,417,795)	(6,627,807)
Balance — end of period	\$46,666,024	\$42,854,894
<b>Accumulated Other Comprehensive Income</b>		
Balance — beginning of period	(\$578,151)	(527,246)
Minimum pension liability adjustment, net of tax	-	(50,905)
Balance — end of period	(\$578,151)	(\$578,151)
<b>Deferred Compensation Obligation</b>		
Balance — beginning of period	\$794,535	\$816,044
New deferrals	296,427	130,426
Payout of deferred compensation	-	(151,935)
Balance — end of period	\$1,090,962	\$794,535
<b>Treasury Stock</b>		
Balance — beginning of period	(\$797,156)	(\$1,008,696)
New deferrals related to compensation obligation	(296,427)	(130,426)
Purchase of treasury stock <sup>(1)</sup>	(24,018)	(182,292)
Sale and distribution of treasury stock <sup>(2)</sup>	24,178	524,258
Balance — end of period	(\$1,093,423)	(\$797,156)
<b>Total Stockholders' Equity</b>	<b>\$90,713,904</b>	<b>\$84,757,183</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 Supplemental Executive Retirement Savings Plan ("SERP plan").

<sup>(2)</sup> Amount includes shares issued to the Company's Rabbi Trust as obligation under the SERP plan.

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

## Chesapeake Utilities Corporation and Subsidiaries

### Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	For the Six Months Ended June 30, 2006	For the Twelve Months Ended December 31, 2005
Net income	\$7,228,925	\$10,467,614
Minimum pension liability adjustment, net of tax benefit of \$33,615	-	(50,905)
<b>Comprehensive Income</b>	<b>\$7,228,925</b>	<b>\$10,416,709</b>

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

## Chesapeake Utilities Corporation and Subsidiaries

### Condensed Consolidated Balance Sheets (Unaudited)

Assets	June 30, 2006	December 31, 2005
<b>Property, Plant and Equipment</b>		
Natural gas distribution and transmission	\$234,440,734	\$220,685,461
Propane	42,865,530	41,563,810
Advanced information services	945,125	1,221,177
Other plant	9,088,643	9,275,729
Total property, plant and equipment	287,340,032	272,746,177
Less: Accumulated depreciation and amortization	(82,171,712)	(78,840,413)
Plus: Construction work in progress	8,000,861	7,598,531
Net property, plant and equipment	213,169,181	201,504,295
<b>Investments</b>	<b>1,808,409</b>	<b>1,685,635</b>
<b>Current Assets</b>		
Cash and cash equivalents	2,366,273	2,487,658
Accounts receivable (less allowance for uncollectible accounts of \$815,988 and \$861,378, respectively)	36,477,308	54,284,011
Accrued revenue	1,667,640	4,716,383
Propane inventory, at average cost	5,442,377	6,332,956
Other inventory, at average cost	1,534,245	1,538,936
Regulatory assets	591,131	4,434,828
Storage gas prepayments	6,575,894	8,628,179
Income taxes receivable	-	2,725,840
Deferred income taxes	1,287,128	-
Prepaid expenses	2,161,298	2,021,164
Other current assets	1,522,296	1,596,797
Total current assets	59,625,590	88,766,752
<b>Deferred Charges and Other Assets</b>		
Goodwill	674,451	674,451
Other intangible assets, net	198,781	205,683
Long-term receivables	873,791	961,434
Other regulatory assets	1,157,637	1,178,232
Other deferred charges	949,408	1,003,393
Total deferred charges and other assets	3,854,068	4,023,193
<b>Total Assets</b>	<b>\$278,457,248</b>	<b>\$295,979,875</b>

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

<b>Capitalization and Liabilities</b>	<b>June 30, 2006</b>	<b>December 31, 2005</b>
<b>Capitalization</b>		
Stockholders' equity		
Common Stock, par value \$0.4867 per share (authorized 12,000,000 shares) <sup>(1)</sup>	<b>\$2,899,530</b>	\$2,863,212
Additional paid-in capital	<b>41,728,962</b>	39,619,849
Retained earnings	<b>46,666,024</b>	42,854,894
Accumulated other comprehensive income	<b>(578,151)</b>	(578,151)
Deferred compensation obligation	<b>1,090,962</b>	794,535
Treasury stock	<b>(1,093,423)</b>	(797,156)
<b>Total stockholders' equity</b>	<b>90,713,904</b>	84,757,183
<b>Long-term debt, net of current maturities</b>	<b>57,808,363</b>	58,990,363
<b>Total capitalization</b>	<b>148,522,267</b>	143,747,546
<b>Current Liabilities</b>		
Current portion of long-term debt	<b>4,929,091</b>	4,929,091
Short-term borrowing	<b>33,003,405</b>	35,482,241
Accounts payable	<b>23,787,216</b>	45,645,228
Customer deposits and refunds	<b>4,672,980</b>	5,140,999
Accrued interest	<b>612,813</b>	558,719
Dividends payable	<b>1,727,738</b>	1,676,398
Income taxes payable	<b>2,620,491</b>	-
Deferred income taxes	-	1,150,828
Accrued compensation	<b>1,732,247</b>	3,793,244
Regulatory liabilities	<b>2,992,458</b>	550,546
Other accrued liabilities	<b>3,784,994</b>	3,560,055
<b>Total current liabilities</b>	<b>79,863,433</b>	102,487,349
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	<b>24,091,974</b>	24,248,624
Deferred investment tax credits	<b>339,677</b>	367,085
Other regulatory liabilities	<b>1,714,891</b>	2,008,779
Environmental liabilities	<b>278,543</b>	352,504
Accrued pension costs	<b>3,117,887</b>	3,099,882
Accrued asset removal cost	<b>17,656,495</b>	16,727,268
Other liabilities	<b>2,872,081</b>	2,940,838
<b>Total deferred credits and other liabilities</b>	<b>50,071,548</b>	49,744,980
<b>Commitments and Contingencies (Note 4)</b>		
<b>Total Capitalization and Liabilities</b>	<b>\$278,457,248</b>	\$295,979,875

<sup>(1)</sup> Shares issued were 5,957,719 and 5,883,099 for 2006 and 2005, respectively.  
Shares outstanding were 5,957,627 and 5,883,002 for 2006 and 2005, respectively.

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

## NOTES TO THE 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 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 has 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 for the year ended December 31, 2005 filed on March 7, 2006. 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 (Loss)

Comprehensive income contains items that are excluded from “net income (loss)” 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 second quarters of 2006 and 2005. Accumulated other comprehensive income was (\$578,151) at June 30, 2006 and December 31, 2005 and (\$527,246) at June 30, 2005 and December 31, 2004.

### 3. Calculation of Earnings Per Share (“EPS”)

For the Periods Ended June 30,	Three Months Ended		Six Months Ended	
	2006	2005	2006	2005
<b>Calculation of Basic Earnings Per Share:</b>				
Net income	\$1,132,509	\$795,924	\$7,228,925	\$7,028,720
Weighted average shares outstanding	5,952,074	5,823,043	5,930,872	5,808,515
<b>Basic Earnings Per Share</b>	<b>\$0.19</b>	<b>\$0.14</b>	<b>\$1.22</b>	<b>\$1.21</b>
<b>Calculation of Diluted Earnings Per Share:</b>				
<b>Reconciliation of Numerator:</b>				
Net Income before cumulative effect of change — Basic	\$1,132,509	\$795,924	\$7,228,925	\$7,028,720
Effect of 8.25% Convertible debentures (1)	-	-	54,048	64,043
<b>Adjusted numerator — Diluted</b>	<b>\$1,132,509</b>	<b>\$795,924</b>	<b>\$7,282,973</b>	<b>\$7,092,763</b>
<b>Reconciliation of Denominator:</b>				
Weighted shares outstanding — Basic	5,952,074	5,823,043	5,930,872	5,808,515
Effect of dilutive securities (1)				
Stock options	-	581	-	533
Warrants	11,522	10,924	12,016	10,306
8.25% Convertible debentures	-	-	127,303	150,869
<b>Adjusted denominator — Diluted</b>	<b>5,963,596</b>	<b>5,834,548</b>	<b>6,070,191</b>	<b>5,970,223</b>
<b>Diluted Earnings per Share</b>	<b>\$0.19</b>	<b>\$0.14</b>	<b>\$1.20</b>	<b>\$1.19</b>

(1) The amount of interest accumulated, per common share, for the three-month periods ended June 30, 2006 and 2005, obtainable from the 8.25% Convertible Debentures exceeds Basic EPS. The inclusion of these securities would therefore have an anti-dilutive effect on EPS for the three-month periods presented and, accordingly, have been omitted from this calculation for the quarter. The Company did not have any outstanding stock options at June 30, 2006.

#### **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 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 expenditures for this site. Through June 30, 2006, the Company has incurred approximately \$9.7 million in costs related to environmental testing and remedial action studies at the site. Approximately \$9.9 million has been recovered through June 2006 from other parties or through rates. As of June 30, 2006, a regulatory liability of approximately \$274,000, 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 June 30, 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. The Company expects to recover the remaining costs through rates.

### **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 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 is fully operational.

The Company has accrued a liability of \$279,000 as of June 30, 2006 for the Winter Haven site. Through June 30, 2006, the Company has incurred approximately \$1.5 million of environmental costs associated with this site. At June 30, 2006, the Company had collected \$121,000 through rates in excess of costs incurred. A regulatory asset of approximately \$157,000, 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. Early estimates by the Company's environmental consultant 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.

## **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 November 2004, 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. The contract expires March 31, 2007.

### **Corporate Guarantees**

The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary and its Florida natural gas marketing 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, 2006, totaled \$14.9 million, with the guarantees expiring on various dates in 2006 and 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.

#### **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, 2006 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 that 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. 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 December 2004, the FASB released a revision ("Share-Based Payment") to SFAS No. 123 "Accounting for Stock-Based Compensation," referred to as SFAS No. 123R. In April 2005, the SEC approved a new rule that delayed the effective date for SFAS No. 123R until the first annual period beginning after June 15, 2005. SFAS 123R establishes financial accounting and reporting standards for stock-based employee compensation plans. Those plans include all arrangements by which employees receive shares of stock or other equity instruments of the employer or the employer incurs liabilities to employees in amounts based on the price of the employer's stock. Examples are stock purchase plans, stock options, restricted stock and stock appreciation rights. The impact of the Company's adoption of this pronouncement is disclosed in Note 9 to the financial statements entitled "Share Based Compensation."

In July 2006, the FASB issued FASB Interpretation 48, "Accounting for Income Tax Uncertainties" ("FIN 48"). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is continuing to evaluate the impact of this new standard and its impact, if any, on the Company's financial statements.

## 6. Segment Information

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 chief operating decision maker in order to make decisions about 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	
	2006	2005	2006	2005
<b>Operating Revenues, Unaffiliated Customers</b>				
Natural gas	\$33,327,846	\$31,795,714	\$100,906,504	\$86,250,524
Propane	7,937,378	7,294,710	28,488,315	27,485,820
Advanced information services	3,038,015	3,028,527	5,858,581	6,189,885
Other	513	101,426	1,025	139,396
<b>Total operating revenues, unaffiliated customers</b>	<b>\$44,303,752</b>	<b>\$42,220,377</b>	<b>\$135,254,425</b>	<b>\$120,065,625</b>
<b>Intersegment Revenues <sup>(1)</sup></b>				
Natural gas	\$58,769	\$39,140	\$117,717	\$84,017
Propane	-	33	-	668
Advanced information services	16,875	1,881	21,513	10,809
Other	154,623	154,623	309,246	309,246
<b>Total intersegment revenues</b>	<b>\$230,267</b>	<b>\$195,677</b>	<b>\$448,476</b>	<b>\$404,740</b>
<b>Operating Income</b>				
Natural gas	\$3,500,628	\$3,193,851	\$11,495,833	\$10,986,237
Propane	(441,632)	(762,685)	2,992,101	3,239,163
Advanced information services	172,061	(30,729)	188,371	(263,590)
Other and eliminations	(25,689)	(75,492)	(33,709)	(132,522)
<b>Total operating income</b>	<b>\$3,205,368</b>	<b>\$2,324,945</b>	<b>\$14,642,596</b>	<b>\$13,829,288</b>

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

	June 30, 2006	December 31, 2005
<b>Identifiable Assets</b>		
Natural gas	\$211,401,275	\$225,667,049
Propane	54,703,261	57,344,859
Advanced information services	2,529,864	2,062,902
Other	9,822,848	10,905,065
<b>Total identifiable assets</b>	<b>\$278,457,248</b>	<b>\$295,979,875</b>

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.

## 7. Employee Benefit Plans

Net periodic benefit costs for the defined benefit pension plan, the executive excess retirement 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	
	2006	2005	2006	2005	2006	2005
Service cost	\$0	\$0	\$0	\$0	\$1,565	\$1,565
Interest cost	156,726	161,435	29,897	29,914	19,468	19,468
Expected return on plan assets	(171,075)	(175,822)	-	-	-	-
Amortization of transition amount	-	-	-	-	6,965	6,965
Amortization of prior service cost	(1,175)	(1,175)	-	-	-	-
Amortization of net loss (gain)	-	-	14,260	12,330	22,073	22,073
Net periodic (benefit) cost	(\$15,524)	(\$15,562)	\$44,157	\$42,244	\$50,071	\$50,071

For the Six Months Ended June 30,	Defined Benefit Pension Plan		Executive Excess Retirement Benefit Plan		Other Post-Retirement Benefits	
	2006	2005	2006	2005	2006	2005
Service cost	\$0	\$0	\$0	\$0	\$3,129	\$3,129
Interest cost	313,452	322,870	59,794	59,829	38,936	38,936
Expected return on plan assets	(342,151)	(351,643)	-	-	-	-
Amortization of transition amount	-	-	-	-	13,930	13,930
Amortization of prior service cost	(2,350)	(2,350)	-	-	-	-
Amortization of net loss (gain)	-	-	28,520	24,660	44,146	44,146
Net periodic (benefit) cost	(\$31,049)	(\$31,123)	\$68,314	\$84,489	\$100,141	\$100,141

As disclosed in the December 31, 2005 financial statements, no contributions are expected to be required in 2006 for the defined benefit pension plan. The Company maintains a Rabbi Trust to cover the costs of the executive excess retirement benefit plan; however, the other post-retirement benefit plans are unfunded. Cash benefits paid under the executive excess retirement benefit plan for the first six months of 2006 were \$51,000, and for the year 2006, benefits paid are expected to be \$100,000. Net benefits paid for other post-retirement benefits are primarily for medical claims and were \$96,000 for the first six months of 2006. For the year 2006, the Company's actuary has estimated that the benefits to be paid are \$215,000.

## 8. Investments

The Company maintains investments in Rabbi Trusts to cover the cost of the Company's Supplemental Executive Retirement Savings Plan. In accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and based on the Company's intentions regarding these instruments, the Company classifies all investments in equity securities 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 earnings. At the end of June 2006, total investments had a fair value of \$1.8 million.

## 9. Share-Based Compensation

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 in this Form 10-Q have not been restated to reflect the fair value of expensing stock-based compensation. For the three months ended June 30, 2006 and 2005, included in net income are expense amounts of \$160,000 and \$137,000, after-tax, respectively, related to stock-based compensation expense from restricted stock awards issued under the Company's Director's Stock Compensation and Performance Incentive Plans. For the first six months of 2006 and 2005, included in

net income are expense amounts of \$264,000 and \$259,000, after-tax, respectively, related to stock-based compensation expense from restricted stock awards issued under the Company's Director's Stock Compensation and Performance Incentive Plans.

Stock Options

The Company did not have any stock options outstanding at June 30, 2006 or December 31, 2005, nor were any stock options issued during the six months ended June 30, 2006.

Director's Stock Compensation Plan

Under the Company's Director's Stock Compensation Plan ("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 \$41,000 and \$35,000 for the three-month periods ended June 30, 2006 and 2005, respectively, and \$77,000 and \$68,000 for the first six months of 2006 and 2005, respectively.

A summary of restricted stock activity for the DSCP as of June 30, 2006, and changes during the six months then ended, is presented below:

	Number of Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding - December 31, 2005	-	
Issued - May 2, 2006	5,850	\$30.02
Vested	5,850	
Outstanding - June 30, 2006	-	

Performance Incentive Plans

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 awards are made pursuant to the Company's Performance Incentive Plan ("PIP"), subject to certain post-vesting transfer restrictions, and are granted in the first quarter of each year based upon the performance achieved in the previous fiscal year. In the first quarters of 2006 and 2005, the Company granted 23,666 and 10,130 shares, respectively, to key employees as PIP stock awards for each of the preceding fiscal years.

The Company accrues an expense each month of the fiscal year, preceding the date of grant, representing an estimate of the value of the stock awards to be 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 grant date, which occurs in the first quarter of the subsequent year. 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 stock on the date of grant. Compensation expense recorded by the Company relating to the Performance Incentive Plan was \$221,000 and \$190,000 for the three-month periods ended June 30, 2006 and 2005, respectively, and \$356,000 and \$357,000 for the first six months of 2006 and 2005, respectively.

A summary of restricted stock activity for the PIP as of June 30, 2006, and changes during the six months then ended, is presented below:

	Number of Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding - December 31, 2005	-	
Issued - February 23, 2006	23,666	\$30.3999
Vested	23,666	
Outstanding - June 30, 2006	-	

## 10. Stockholders' Equity

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

	For the Six Months Ended June 30, 2006	For the Twelve Months Ended December 31, 2005
<b>Common Stock shares issued and outstanding <sup>(1)</sup></b>		
Shares issued — beginning of period balance	5,883,099	5,778,976
Dividend Reinvestment Plan <sup>(2)</sup>	19,468	41,175
Retirement Savings Plan	15,777	21,071
Conversion of debentures	9,509	22,609
Employee award plan	350	-
Performance shares and options exercised <sup>(3)</sup>	29,516	19,268
Shares issued — end of period balance <sup>(4)</sup>	5,957,719	5,883,099
Treasury shares — beginning of period balance	(97)	(9,418)
Purchases	-	(4,852)
Dividend Reinvestment Plan	-	2,142
Retirement Savings Plan	-	12,031
Other issuances	5	-
Treasury Shares — end of period balance	(92)	(97)
<b>Total Shares Outstanding</b>	<b>5,957,627</b>	<b>5,883,002</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 47,270 and 37,528 shares at June 30, 2006 and December 31, 2005, respectively, held in a Rabbi Trust established by the Company relating to the Supplemental Executive Retirement Savings Plan.

## 11. Other Event

The Company's propane distribution subsidiary, Sharp Energy, Inc. ("Sharp"), identified that approximately 75,000 gallons of propane that it purchased in the first half of March 2006 contained above-normal levels of petroleum byproducts. The supplier's testing identified above-normal concentration levels of the petroleum byproduct benzene. Benzene, which may be found in trace amounts in propane, is used to make plastics, resins, nylon, synthetic fibers, detergents, lubricants, drugs, dyes and pesticides. It is also routinely found in crude oil and gasoline. The supplier has conducted modeling and testing of the propane in combustion situations and has stated that they have found no health or safety concerns.

Sharp replaced the propane for each of the approximately 600 customers impacted by this event at no cost to the customers. Sharp also replaced any remaining propane contained at its storage facilities. The propane that the Company retrieved from customers and Sharp's storage facilities was returned to the supplier.

The supplier indicated that it would reimburse Sharp for all damages, costs and expenses incurred by Sharp or the Company in connection with this matter. As a result of the supplier's commitment, Sharp invoiced the supplier \$734,000 for costs relating to this incident through June 2006. The supplier paid \$223,000 of this amount, with the remaining \$511,000 listed on the Company's Balance Sheet as an accounts receivable. The Company does not believe that the event will ultimately have a material adverse effect on the Company or its business, results of operations or long-term financial condition.

## **12. Subsequent Event**

On June 27, 2006, the Company's natural gas transmission operation, Eastern Shore Natural Gas ("Eastern Shore"), submitted a petition to the Federal Energy Regulatory Commission ("FERC") requesting approval of an uncontested Settlement Agreement, to implement the rate-related Settlement Agreement to address the development costs of the proposed project to construct facilities to connect the Company's pipeline facilities with Dominion Resources' Cove Point facilities in Calvert County, Maryland.

As of June 30, 2006, the Company has incurred approximately \$310,000 of pre-service costs related to this project. These costs are typically deferred pending approval from the FERC that amounts may be recovered via rates. On August 1, 2006, Eastern Shore received an order from the FERC approving the Company's petition, and, accordingly, costs associated with the project have been deferred as a regulatory asset at June 30, 2006. Prior to the FERC's approval, the Company had recognized the related costs in the income statement in accordance with generally accepted accounting principles ("GAAP"). Please refer to the section labeled "Regulatory Matters" within Item 2 for a further discussion of the project.

## **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. The Company's MD&A is presented in nine sections: Overview, Results of Operations, Liquidity and Capital Resources, Off-Balance Sheet Arrangements, Contractual Obligations, Environmental Matters, Other Matters, Competition, and Recent Accounting Pronouncements. This discussion and analysis should be read in conjunction with the attached unaudited consolidated financial statements and notes thereto and Chesapeake's 2005 Annual Report on Form 10-K, including the audited consolidated financial statements and notes contained in the 2005 Annual Report on Form 10-K.

### **Overview**

Chesapeake Utilities Corporation (the "Company" or "Chesapeake") is a diversified utility company engaged 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 to grow earnings from a stable utility foundation by investing in related businesses and services that provide opportunities for higher, unregulated returns. This growth strategy includes acquisitions and investments in unregulated businesses, as well as the continued investment and expansion of the Company's utility operations that provide the stable base of earnings. The Company continually reevaluates its investments to ensure that they are consistent with its strategy and the goal of enhancing shareholder value. The Company's unregulated businesses and services currently include natural gas marketing, propane distribution and wholesale marketing, advanced information services and other related businesses.

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.

The principal business, economic and other factors that affect the operations and/or financial performance of the Company include:

- weather conditions and weather patterns;
- regulatory environment and regulatory decisions;
- availability of natural gas and propane supplies;
- natural gas and propane production levels;
- interstate pipeline transportation and storage capacity;
- natural gas and propane prices and the prices of competing fuels, such as oil and electricity;
- changes in natural gas and propane usage resulting from customer conservation, including improved appliance efficiencies;
- the level of capital expenditures for adding new customers and replacing facilities worn beyond economic repair;
- use of derivative instruments;
- changes in credit risk;
- competitive environment;
- environmental matters;
- economic conditions and interest rates;
- inflation / deflation;
- changes in technology; and
- changes in accounting principles.

## Results of Operations for the Three Months Ended June 30, 2006

### Consolidated Overview

The Company's net income for the second quarter ended June 30, 2006 increased \$337,000, or 42 percent, compared to the same period in 2005. Net income for the second quarter of 2006 was \$1.1 million, or \$0.19 per share (diluted), an increase of \$0.05 per share when compared to 2005. The Company's net income increased during the second quarter, despite temperatures on the Delmarva Peninsula being 32 percent warmer in the second quarter of 2006 compared to the same period of 2005 and 24 percent warmer than normal. The warmer temperatures on the Delmarva Peninsula resulted in reduced volumes sold to our natural gas and propane distribution heating customers to heat their homes. The Company estimates that the warmer weather reduced net income by \$422,000, or \$0.07 per share, and reduced gross margin by \$698,000 in the second quarter of 2006. The negative impact of the warmer weather was more than offset by the Company's continued strong customer growth, improved results by the advanced information services segment and our continued cost containment measures.

For the Three Months Ended June 30,	2006	2005	Change
Operating Income			
Natural Gas	\$3,500,628	\$3,193,851	\$306,777
Propane	(441,632)	(762,685)	321,053
Advanced Information Services	172,061	(30,729)	202,790
Other & eliminations	(25,689)	(75,492)	49,803
Operating Income	3,205,368	2,324,945	880,423
Other Income	63,715	228,481	(164,766)
Interest Charges	1,501,352	1,273,166	228,186
Income Taxes	635,222	484,336	150,886
Net Income	\$1,132,509	\$795,924	\$336,585
Diluted Earnings Per Share	\$0.19	\$0.14	\$0.05

The following discussions for the three months ended June 30, 2006 of segment results include use of the terms "gross margin". Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for the 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 unregulated 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.



## Natural Gas

Operating income for the natural gas segment increased \$307,000, or 10 percent, in the second quarter of 2006 when compared to the same period in 2005. The increase in operating income was primarily due to an increase in gross margin from strong customer growth and lower other operating expenses. Gross margin increased by \$147,000, or 1 percent, while other operating expenses decreased \$160,000, or 2 percent.

For the Three Months Ended June 30,	2006	2005	Change
Revenue	\$33,386,615	\$31,834,854	\$1,551,761
Cost of gas	21,941,405	20,536,212	1,405,193
Gross margin	11,445,210	11,298,642	146,568
Operations & maintenance	5,563,477	5,830,545	(267,068)
Depreciation & amortization	1,565,995	1,431,179	134,816
Other taxes	815,110	843,067	(27,957)
Other operating expenses	7,944,582	8,104,791	(160,209)
Total Operating Income	\$3,500,628	\$3,193,851	\$306,777

### Statistical Data — Delmarva Peninsula

Heating degree-days ("HDD")			
Actual	388	572	(184)
10-year average (normal)	512	506	6
Estimated gross margin per HDD	\$2,234	\$1,800	\$434
Per residential customer added:			
Estimated gross margin	\$372	\$372	\$0
Estimated other operating expenses	\$106	\$104	\$2

### Residential Customer Information

Average number of customers			
Delmarva	40,037	37,130	2,907
Florida	12,511	11,661	850
Total	52,548	48,791	3,757

Gross margin for the Company's natural gas segment increased \$147,000 in the second quarter of 2006 compared to the same period in 2005. The gross margin for the Delmarva natural gas distribution operations was lower by \$288,000 when compared to the same period in 2005, primarily due to warmer weather; however, this decline was more than offset by increased gross margin of \$326,000 in the natural gas transmission operation.

- The Delmarva distribution operations experienced a decrease of \$288,000 in gross margin. Temperatures on the Delmarva Peninsula were 32 percent warmer during the three months ended June 30, 2006 compared to same period in 2005 and 24 percent warmer than normal. The Company estimates that the warmer temperatures resulted in a decrease in gross margin of approximately \$377,000 and lower consumption by our customers decreased gross margin by \$217,000, compared to 2005. These decreases were partially offset by residential customer growth in the Delmarva Peninsula area, which contributed approximately \$257,000 to gross margin as the average number of customers residential increased by 8 percent.
- The natural gas transmission operation achieved gross margin growth of \$326,000, or 9 percent. The increase was attributed to additional transportation services initiated in November 2005. These additional contracts are expected to continue to contribute approximately \$110,000 to gross margin for each month in 2006, or \$1.3 million annually.
- Gross margin for the Florida natural gas distribution and the unregulated natural gas marketing operations increased \$50,000 and \$58,000, respectively. The increases were attained primarily from continued growth, including a 7 percent increase in the average number of residential customers.

Other operating expenses for the natural gas operations decreased \$160,000, or 2 percent, in the second quarter of 2006 compared to the same period in 2005. Items contributing to the increase include:

- On August 1, 2006, the Company's interstate pipeline subsidiary (Eastern Shore Natural Gas Company or "Eastern Shore") received approval from the Federal Energy Regulatory Commission ("FERC") to recover the pre-service costs associated with a future pipeline project through its rates with two of its customers. Please refer to Note 12 to the financial statements entitled "Subsequent Event" for additional details. As a result of the FERC's recent approval, the Company deferred these costs by recording a regulatory asset. Of the \$310,000 deferred as a regulatory asset, \$226,000 was recorded as other operating expense in previous quarters.
- Payroll costs decreased \$70,000 primarily due to a decrease of \$170,000 in accruals for incentive compensation to reflect the lower than expected earnings from the weather being warmer than normal. This decrease was partially offset by an increase in other payroll costs as the Company increased its staff to support continued customer growth.
- Health care costs decreased by \$118,000 for the natural gas segment during the second quarter of 2006. The Company changed health care service providers in November 2005 and has subsequently experienced lower cost of claims.
- Due to the additional capital investments by the Company, depreciation and amortization expense, asset removal cost, and property taxes increased \$135,000, \$59,000, and \$47,000, respectively.

### Propane

The propane segment narrowed its operating loss by \$321,000, or 42 percent in the second quarter of 2006 compared to the same period in 2005, despite temperatures being 32 percent warmer on the Delmarva Peninsula in the second quarter of 2006 compared to the same period of 2005 and 24 percent warmer than normal. The operating loss for the second quarter of 2006 was \$442,000 compared to an operating loss of \$763,000 for the same period in 2005.

<b>For the Three Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>	<b>Change</b>
Revenue	\$7,937,378	\$7,294,743	\$642,635
Cost of sales	4,781,819	4,454,279	327,540
Gross margin	3,155,559	2,840,464	315,095
Operations & maintenance	3,024,725	3,054,185	(29,460)
Depreciation & amortization	402,675	388,768	13,907
Other taxes	169,791	160,196	9,595
Other operating expenses	3,597,191	3,603,149	(5,958)
<b>Total Operating Loss</b>	<b>(\$441,632)</b>	<b>(\$762,685)</b>	<b>\$321,053</b>
<b>Statistical Data — Delmarva Peninsula</b>			
Heating degree-days ("HDD")			
Actual	388	572	(184)
10-year average (normal)	512	506	6
Estimated gross margin per HDD	\$1,743	\$1,691	\$52

The Company's propane segment experienced an increase of \$315,000 in gross margin in the second quarter of 2006 compared to the same period in 2005, primarily from an increase of \$132,000 for the Delmarva propane distribution operation and an increase of \$221,000 for the propane wholesale and marketing operation.

- During the second quarter of 2006, the Delmarva propane distribution operation experienced an increase in gross margin of \$132,000. Volumes sold during the second quarter of 2006 decreased by 235,000 gallons, or 7 percent, compared to 2005. Temperatures on the Delmarva Peninsula were 32 percent warmer during the second quarter of 2006 compared to 2005 and 24 percent warmer than normal. The Company estimates that the warmer temperatures resulted in a decrease in gross margin of approximately \$321,000 when compared to 2005. The weather impact was offset by a \$368,000 increase in gross margin from an increase in the average gross margin per retail gallon of \$0.12 in 2006 compared to 2005. The remaining \$85,000 of gross margin growth is attributed to a combination of fuel surcharges and various fees.
- Gross margin for the Company's propane wholesale marketing operation increased by \$221,000 in the second quarter of 2006 compared to the same period in 2005. The increase is primarily due to the increase in volatility of wholesale propane prices that occurred during the quarter.
- A decrease in gross margin of \$38,000 for the Florida propane distribution operation was offset by a decrease of \$43,000 in other operating expenses. The lower gross margin reflects a decrease of in-house piping sales as the operation is exiting the house piping service. The increase in other operating expenses is attributed to lower payroll and health care costs.

Other operating expenses of the propane segment decreased for the three months ended June 30, 2006 by \$6,000, compared to the same period in 2005. Other operating expenses for the Delmarva propane distribution operation decreased \$11,000 for the quarter ended June 30, 2006 compared to the same period in 2005.

During the second quarter of 2006, the Company charged approximately \$87,000 of fixed costs to accounts receivable in anticipation of recovery of these costs from one of our propane suppliers. The \$87,000 represents costs we incurred in response to the supplier delivery of approximately 75,000 gallons of propane that contained above normal levels of petroleum by products. Please refer to Note 11, "Other Event," for more information.

If these fixed costs were listed as expenses on the income statement, other operating expense for the Delmarva propane distribution operation would have increased by \$76,000 in the second quarter, when compared to the second quarter of the prior year. These higher operating costs are primarily attributable to the operating costs for the Pennsylvania start-up located in Allentown, Pennsylvania, increased vehicle fuel costs in response to the rising price per gallon of gasoline, offset by a decrease in health care claims. The decrease in health care claims is attributed to the Company changing health insurance providers in November 2005.

### Advanced Information Services

Operating income for the Company's advanced information services business increased \$203,000 for the three months ended June 30, 2006 compared to the same period in 2005. Operating income for the second quarter was \$172,000 compared to an operating loss of \$31,000 for the same period in 2005. Contributing to the operating loss in the second quarter of 2005 was an operating loss of \$93,000 for the Lightweight Association Management Processing Systems ("LAMPS™") product. LAMPS™ is an internet-based membership management software tool specifically developed for REALTOR® Associations, which provides real time integration with the National Association of REALTOR® Database System. The LAMPS™ product was sold to Fidelity National Information Solutions, Inc., a subsidiary of Fidelity National Financial, Inc. during the third quarter of 2005.

For the Three Months Ended June 30,	2006	2005	Change
Revenue	\$3,054,890	\$3,030,408	\$24,482
Cost of sales	1,781,866	1,849,279	(67,413)
Gross margin	1,273,024	1,181,129	91,895
Operations & maintenance	958,234	1,059,584	(101,350)
Depreciation & amortization	28,276	28,834	(558)
Other taxes	114,453	123,440	(8,987)
Other operating expenses	1,100,963	1,211,858	(110,895)
Total Operating Income (Loss)	\$172,061	(\$30,729)	\$202,790

The Company's advanced information services segment increased gross margin by approximately \$92,000 to \$1.3 million, compared to the same period in 2005. Revenues for the period increased \$24,000 compared to 2005, due primarily to increases in consulting revenues for the Progress® group of \$432,000. This increase was partially offset by decreases in consulting revenues from the eBusiness group of \$361,000 and a decrease of \$104,000 relating to the LAMPS™ product. The eBusiness group offers consulting, web-based services, and other products and services for companies. The Progress® group offers consulting and provides other products and services to companies that utilize Progress' software application infrastructure.

Cost of sales for the three months ended June 30, 2006 decreased \$67,000 compared to the same period in 2005, of which \$106,000 was related to LAMPS™. Cost of sales for the Progress® software group increased \$130,000 in 2006 to reflect increased revenues, while the cost of sales for the eBusiness group decreased \$85,000 in 2006 as a result of lower revenue.

Other operating expenses decreased \$111,000 for the three months ended June 30, 2006 to \$1.1 million, when compared to same period in 2005. The reduction in expenses primarily reflects expenses of \$91,000 in the second quarter of 2005 associated with LAMPS™.

Effective July 1, 2006, the Company changed the retirement savings plan ("401k") for the employees of its advanced information services segment and implemented a profit sharing plan. The net effect of the change is to reduce the Company's costs during those years when the segment is not meeting its earnings targets in exchange for higher compensation to the employees when the segment exceeds its targets.

### 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"). Eliminations are entries required to eliminate activities between business segments from the consolidated results. Other operations and eliminating entries resulted in an operating loss of \$26,000 for the second quarter of 2006 compared to an operating loss of \$75,000 for the same period in 2005. The losses in 2006 and 2005 are primarily attributed to the OnSight operation.

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 second quarter of 2006, OnSight had an operating loss of \$98,000 compared to an operating loss of \$122,000 for the same period in 2005.

<b>For the Three Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>	<b>Change</b>
Revenue	\$155,136	\$256,049	(\$100,913)
Cost of sales	438	82,716	(82,278)
Gross margin	154,698	173,333	(18,635)
Operations & maintenance	119,301	162,058	(42,757)
Depreciation & amortization	40,827	70,378	(29,551)
Other taxes	21,029	24,429	(3,400)
Other operating expenses	181,157	256,865	(75,708)
Operating Loss - Other	(26,459)	(83,532)	57,073
Operating Income - Eliminations	770	8,040	(7,270)
Total Operating Loss	(\$25,689)	(\$75,492)	\$49,803

### Interest Expense

Interest expense for the second quarter of 2006 increased approximately \$228,000, or 18 percent, versus the same period in 2005. The higher interest expense is attributed to the following:

- The Company's outstanding short-term borrowing balance was \$33.0 million at June 30, 2006 compared to no outstanding balance at June 30, 2005. The increased borrowing, resulting in higher interest expense, is related to the Company's capital investments made in 2005 and higher working capital due to the rising costs of natural gas and propane.
- The average interest rate on short-term borrowing increased from 3.78% in the second quarter of 2005, to 5.46% for the same period in 2006.
- The increase in interest expense on short-term borrowing was partially offset by a decrease in interest expense on long-term debt. The Company's average long-term debt balance declined from \$68.1 million in the second quarter of 2005 to \$62.8 million for the second quarter of 2006, which lowered interest expense for the period by \$99,000.

### Income Taxes

Income tax expense for the three months ended June 30, 2006 and June 30, 2005 was \$635,000 and \$484,000, respectively. The effective tax rate for the second quarter of 2006 is 35.9 percent compared to an effective tax rate of 37.8 percent for the same period in 2005. The seasonality of the Company's business segments will have an impact on the effective tax rate on interim reporting periods.

## Results of Operations for the Six Months Ended June 30, 2006

### Consolidated Overview

Net income for the Company increased \$200,000, or 3 percent, for the first six months ended June 30, 2006 when compared to the same period in 2005, despite temperatures on the Delmarva Peninsula being 21 percent warmer in 2006. The company estimates that the warmer weather reduced net income by \$1.6 million, or \$0.26 per share, and reduced gross margin by \$2.6 million in the first six months of 2006. The warmer weather was more than offset by the increase from the growth experienced by the natural gas operations and the improved results from the advanced information services and cost containment measures. Net income was \$7.2 million, or \$1.20 per share, for the six months ended June 30, 2006 compared to \$7.0 million, or \$1.19 per share, for the same period in 2005.

For the Six Months Ended June 30,	2006	2005	Change
Operating Income			
Natural Gas	\$11,495,833	\$10,986,237	\$509,596
Propane	2,992,101	3,239,163	(247,062)
Advanced Information Services	188,371	(263,590)	451,961
Other & eliminations	(33,709)	(132,522)	98,813
Operating Income	14,642,596	13,829,288	813,308
Other Income	142,299	310,861	(168,562)
Interest Charges	2,994,689	2,550,944	443,745
Income Taxes	4,561,281	4,560,485	796
Net Income	\$7,228,925	\$7,028,720	\$200,205
Diluted Earnings Per Share	\$1.20	\$1.19	\$0.01

The following discussions for the six months ended June 30, 2006 of segment results include use of the terms "gross margin". Gross margin is determined by deducting the cost of sales from operating revenue. Cost of sales includes the purchased gas cost for the 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 unregulated 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.

## Natural Gas

The natural gas segment earned an operating income of \$11.5 million for the first six months of 2006 compared to \$11.0 million for the corresponding period in 2005, an increase of \$510,000, or 5 percent.

<b>For the Six Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>	<b>Change</b>
Revenue	\$101,024,221	\$86,334,541	\$14,689,680
Cost of gas	73,166,577	59,014,226	14,152,351
Gross margin	27,857,644	27,320,315	537,329
Operations & maintenance	11,367,924	11,665,984	(298,060)
Depreciation & amortization	3,053,083	2,846,073	207,010
Other taxes	1,940,804	1,822,021	118,783
Other operating expenses	16,361,811	16,334,078	27,733
<b>Total Operating Income</b>	<b>\$11,495,833</b>	<b>\$10,986,237</b>	<b>\$509,596</b>
<b>Statistical Data — Delmarva Peninsula</b>			
Heating degree-days ("HDD")			
Actual	2,457	3,107	(650)
10-year average (normal)	2,793	2,765	28
Estimated gross margin per HDD	\$2,234	\$1,800	\$434
Per residential customer added:			
Estimated gross margin	\$372	\$372	\$0
Estimated other operating expenses	\$106	\$104	\$2
<b>Residential Customer Information</b>			
Average number of customers			
Delmarva	40,126	37,133	2,993
Florida	12,470	11,665	805
<b>Total</b>	<b>52,596</b>	<b>48,798</b>	<b>3,798</b>

Gross margin for the Company's natural gas segment increased \$537,000 in the first six months of 2006 compared to the same period in 2005. The gross margin for the Delmarva natural gas distribution operations was lower when compared to the same period in 2005 by \$637,000, due to warmer weather; however, this decline was offset by increased gross margin in the natural gas transmission operation of \$660,000, increased gross margin in the natural gas marketing operation of \$403,000 and increased gross margin for the Florida natural gas distribution operation of \$112,000.

- The Delmarva distribution operations experienced a decrease of \$637,000 in gross margin. Temperatures on the Delmarva Peninsula were 21 percent warmer during the first six months of 2006 compared to same period in 2005. The Company estimates that the warmer temperatures led to a decrease in gross margin of approximately \$1.4 million when compared to 2005. This decrease is partially offset by residential customer growth in the Delmarva Peninsula area, which contributed approximately \$719,000 to gross margin as the number of customers increased by 8 percent.
- The natural gas transmission operation achieved gross margin growth of \$660,000, or 8 percent. The increase was attributed to the additional transportation services executed in November 2005. These additional services are expected to continue to contribute approximately \$110,000 to gross margin for each month in 2006, or \$1.3 million annually.
- Gross margin for the natural gas marketing operation increased \$403,000, or 45 percent. The increase was attained primarily from an increase in the number of customers to which the operation provides supply management services and the operation's ability to sell excess capacity.

- Gross margin for the Florida distribution operation increased by \$112,000. The impact of the 7 percent growth in residential customers more than offset the decrease in gross margins from lower volumes sold to commercial and industrial customers.

Other operating expenses for the natural gas operations remained relatively unchanged for the six months ended June 20, 2006 as it increased \$28,000 compared to the same period in 2005. Items contributing to the increase include:

- Depreciation and amortization expense, asset removal cost, and property taxes increased \$207,000, \$113,000, and \$90,000, respectively, in response to the Company's continued capital investments.
- Payroll costs increased \$200,000 as the Company increased its staff to support strong customer growth. This increase was offset by a decrease of \$211,000 in incentive compensation to reflect lower than expected earnings from the Delmarva distribution operations, as weather was warmer than normal.
- Health care costs decreased by \$118,000 for the natural gas segment during the first six months of 2006. The Company changed health care service providers in November 2005 and has subsequently experienced lower claims.
- On August 1, 2006, the Company's interstate pipeline subsidiary (Eastern Shore Natural Gas Company or "Eastern Shore") received approval from the FERC to recover the pre-service costs associated with a future pipeline project through its rates with two of its customers. Please refer to Note 12 to the financial statements entitled "Subsequent Event" for additional details. As a result of the FERC's recent approval, the Company deferred these costs by recording a regulatory asset. Of the \$310,000 deferred as a regulatory asset, \$188,000 was recorded as other operating expense in previous quarters.

### Propane

Operating income for the propane segment decreased \$247,000, or 8 percent, to \$3.0 million for the first six months of 2006 compared to the same period in 2005. This decrease was due primarily to warmer weather in the first six months of 2006, resulting in reduced customer consumption.

<b>For the Six Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>	<b>Change</b>
Revenue	\$28,488,315	\$27,486,488	\$1,001,827
Cost of sales	17,877,811	16,540,553	1,337,258
Gross margin	10,610,504	10,945,935	(335,431)
Operations & maintenance	6,365,200	6,480,877	(115,677)
Depreciation & amortization	819,384	800,327	19,057
Other taxes	433,819	425,568	8,251
Other operating expenses	7,618,403	7,706,772	(88,369)
<b>Total Operating Income</b>	<b>\$2,992,101</b>	<b>\$3,239,163</b>	<b>(\$247,062)</b>

### Statistical Data — Delmarva Peninsula

Heating degree-days ("HDD")			
Actual	2,457	3,107	(650)
10-year average (normal)	2,793	2,765	28
Estimated gross margin per HDD	\$1,743	\$1,691	\$52

The Company's propane segment experienced a decrease of approximately \$335,000 in gross margin in the first six months of 2006 compared to the same period in 2005. Gross margin in the Delmarva propane distribution operation was lower when compared to the same period in 2005 by \$515,000, primarily due to warmer weather. Gross margin also decreased in the Florida propane operations by \$112,000. The negative weather impact experienced by the Delmarva propane distribution operation was partially offset by increased



gross margin from Community Gas Systems ("CGS") of \$42,000 and increased gross margin from the Company's wholesale propane marketing operation of \$292,000.

- The Delmarva propane distribution operation experienced a decrease in gross margin of \$515,000. Volumes sold in 2006 decreased 2.0 million gallons or 15 percent. Temperatures on the Delmarva Peninsula were 21 percent warmer during the first six months of 2006 compared to 2005 and 12 percent warmer than normal. The Company estimates that the warmer temperatures resulted in a decrease in gross margin of approximately \$1.1 million when compared to 2005. Partially offsetting the weather impact is an increase of \$674,000 in the gross margin from an increase in the average gross margin per retail gallon of \$0.042 in 2006 compared to 2005. The remaining gross margin decrease of \$89,000 can be attributed to such items as customer conservation and changes in the timing of deliveries to customers.
- Gross margin for the CGS increased \$42,000 when compared to the prior period, primarily from an increase in the number of customers. The average number of customers increased 1,021, or 36 percent, to 3,840 in the first six months of 2006, compared to the same period in 2005. The Company expects the growth of its CGS operation to continue in the future as the number of systems currently under construction is anticipated to provide for an additional 7,739 customers.
- The Florida propane distribution operation experienced a decrease in gross margin and operating income of \$112,000 and \$48,000, respectively, when compared to the same period in 2005. The lower gross margin reflects a decrease of \$185,000 for in-house piping sales as the operation exits the house piping service. The decrease in gross margin was partially offset by lower other operating expenses of \$64,000, primarily payroll related costs.
- Gross margin for the Company's propane wholesale marketing operation increased by \$292,000 in the first six months of 2006 compared to the same period in 2005. The increase is primarily due to the increase in volatility of wholesale propane prices that occurred during the six months.

Other operating expenses of the Propane segment decreased for the first six months of 2006 by \$88,000, compared to the same period in 2005. Other operating expenses for the Delmarva propane distribution operation decreased \$107,000 for the six months ended June 30, 2006 compared to the same period in 2005.

During the first six months of 2006, the Company charged approximately \$387,000 of fixed costs to accounts receivable in anticipation of recovery of the costs from one of our propane suppliers. The \$387,000 represents costs we incurred in response to the supplier delivery of approximately 75,000 gallons of propane that contained above normal levels of petroleum by products. Please refer to Note 11, "Other Event", for more information.

If these fixed costs were listed as expenses on the income statement, other operating expense for the Delmarva propane distribution operation would have increased by \$280,000 in the first six months of 2006, when compared to the same period of the prior year. These increased costs are attributable to one of the Pennsylvania start-ups with higher costs of \$176,000, increased payroll costs of \$83,000 and higher costs of \$101,000 associated with vehicle fuel and maintenance. The higher operating costs were partially offset by a decrease of \$124,000 for health insurance costs.

### Advanced Information Services

Operating income for advanced information services business increased \$452,000 for the six months ended June 30, 2006 compared to the same period in 2005. Operating income for the first six months was \$188,000 compared to an operating loss of \$264,000 for the same period in 2005. Contributing to the operating loss in the first six months of 2005 was an operating loss of \$350,000 for LAMPS™. The LAMPS™ product was sold to Fidelity National Information Solutions, Inc., a subsidiary of Fidelity National Financial, Inc. in the third quarter of 2005.

<b>For the Six Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>	<b>Change</b>
Revenue	\$5,880,094	\$6,200,694	(\$320,600)
Cost of sales	3,385,026	3,827,754	(442,728)
Gross margin	2,495,068	2,372,940	122,128
Operations & maintenance	1,972,680	2,277,882	(305,202)
Depreciation & amortization	61,940	60,129	1,811
Other taxes	272,077	298,519	(26,442)
Other operating expenses	2,306,697	2,636,530	(329,833)
Total Operating Income (Loss)	\$188,371	(\$263,590)	\$451,961

The Company's advanced information services segment increased gross margin by approximately \$122,000 to \$2.5 million for the first six months of 2006, compared to the same period in 2005. Revenues for the period decreased \$321,000 compared to 2005, due primarily to decreases of \$594,000 and \$176,000 in consulting revenues for the eBusiness and MfgPro groups, respectively, and a decrease of \$216,000 relating to the LAMPS™ product, which were partially offset by an increase of \$556,000 in consulting revenue for the Progress® software group. The eBusiness and MfgPro groups offer consulting, web-based services, and other products and services for companies. The Progress® software group offers consulting and provides other products and services to companies that utilize the Progress application infrastructure software.

Cost of sales for the six months ended June 30, 2006 decreased \$443,000 compared to the same period in 2005, of which \$256,000 related to the LAMPS™ product. Lower revenues by the eBusiness group contributed \$188,000 to the remaining decrease in the cost of sales in 2006.

Other operating expenses decreased \$330,000 in the six months ended June 30, 2006 to \$2.3 million, compared to \$2.6 million for the same period of 2005. The reduction in expenses primarily reflects the expenses of \$309,000 in the first six months of 2005 associated with the LAMPS™ product.

### 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. Eliminations are entries required to eliminate activities between business segments from the consolidated results. Other operations and eliminating entries resulted in an operating loss of \$34,000 for the first six months of 2006 compared to an operating loss of \$133,000 for the same period in 2005. The losses in 2006 and 2005 are primarily attributed to the OnSight operation. For the first six months of 2006, OnSight had an operating loss of \$196,000 compared to an operating loss of \$254,000 for the same period in 2005.

<b>For the Six Months Ended June 30,</b>	<b>2006</b>	<b>2005</b>	<b>Change</b>
Revenue	\$310,271	\$448,642	(\$138,371)
Cost of sales	875	112,629	(111,754)
Gross margin	309,396	336,013	(26,617)
Operations & maintenance	223,390	308,034	(84,644)
Depreciation & amortization	81,484	121,640	(40,156)
Other taxes	39,771	54,939	(15,168)
Other operating expenses	344,645	484,613	(139,968)
Operating Loss - Other	(35,249)	(148,600)	113,351
Operating Income - Eliminations	1,540	16,078	(14,538)
Total Operating Loss	(\$33,709)	(\$132,522)	\$98,813

### Interest Expense

Interest expense for the first six months of 2006 increased approximately \$444,000, or 17 percent, versus the same period in 2005. The higher interest expense is attributed to the following:

- Interest on short-term debt increased \$670,000 during the first six months of 2006, compared to the same period during 2005 as a result of an increase in the average balance of short-term debt outstanding.
- The average interest rate on short-term borrowing increased from 3.18% for the first six months of 2005, to 5.20% for the same period in 2006.
- Interest on long-term debt decreased \$197,000 as a result of the average long-term debt balance declined from \$68.0 million in the first half of 2005 to \$62.8 million for the first half of 2006 due to scheduled principal repayments.

### Income Taxes

Income tax expense for the six months ended June 30, 2006 is \$4.6 million compared to an income tax expense of \$4.6 million for the six months ended June 30, 2005. The effective tax rate for the first six months of 2006 is 38.7 percent compared to an effective tax rate of 39.4 percent for the same period in 2005.

### 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 and short-term borrowing to meet normal working capital requirements and to temporarily finance capital expenditures. During the first six months of 2006, net cash provided by operating activities was \$22.4 million, cash used by investing activities was \$16.2 million and cash used by financing activities was \$6.3 million.

During the first six months of 2005, net cash provided by operating activities was \$21.7 million, cash used by investing activities was \$10.6 million and cash used by financing activities was \$8.8 million.

At the Company's Board of Director's meeting on August 8, 2006, the Board of Directors increased the Company's authority to borrow short-term debt from \$60.0 million to \$75.0 million. Chesapeake currently has four unsecured bank lines of credit with two financial institutions, totaling \$75.0 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 banks' availability of funds. The outstanding balance of short-term borrowing at June 30, 2006 was \$33.0 million. The Company did not have any short-term borrowing outstanding at June 30, 2005.

On October 18, 2005, the Company executed a note agreement with three institutional investors (The Prudential Insurance Company of America, Prudential Retirement Insurance and Annuity Company and United Omaha Life Insurance Company), pursuant to which the investors agreed, subject to certain conditions, to purchase from the Company \$20 million in principal of 5.5 percent Senior Notes (the "Notes") issued by the Company; provided, that the Company elects to effect the sale of the Notes at any time prior to January 15, 2007. The terms of the Notes will require annual principal repayments of \$2 million beginning on the fifth anniversary of the issuance of the Notes.

Chesapeake has budgeted \$54.4 million for capital expenditures during 2006. This amount includes \$20.8 million for natural gas distribution, \$26.7 million for natural gas transmission, \$5.7 million for propane distribution and wholesale marketing, \$178,000 for advanced information services and \$1.0 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 operations category includes general plant, computer software and hardware. Financing for the 2006 capital expenditure program is expected to be provided from short-term borrowing, cash provided by operating activities and other sources to be determined from the Shelf Registration. 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 \$300,000 in 2006 and \$25,000 in 2007 for environmental-related expenditures. Additional expenditures may be required in future years. 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**

As of June 30, 2006, common equity represented 61.0 percent of total capitalization, compared to 56.9 percent in 2005. 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 48.6 percent and 55.1 percent at June 30, 2006 and June 30, 2005, respectively. The decrease in the capitalization percent is from the increase of \$33.0 million in net short-term borrowing in 2006. 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.

### **Cash Flows from Operating Activities**

The primary drivers for the Company's operating cash flows are cash payments received from gas customers, offset by payments made by the Company for gas costs, operation and maintenance expenses, taxes and interest costs.

Net cash provided by operating activities totaled \$22.4 million and \$21.7 million for the six months ended June 30, 2006 and 2005, respectively. Certain material changes in working capital are listed below for the first six months of 2006:

- Accounts receivable and accrued revenue decreased \$20.9 million, which generated an increase of cash. The decrease in accounts receivable primarily resulted from lower revenues from the warmer weather and the seasonality of the Company as it enters the warmer summer months. In addition, the lower cost of natural gas during the first six months of 2006 compared with December 2005 contributed to the decline.
- Propane inventory, storage gas and other inventory decreased \$2.9 million, which generated an increase of cash. Decreased propane inventory and storage gas resulted from a seasonal reduction of inventory levels in the first six months of 2006 compared with December 31, 2005 due to withdrawals.
- Accounts payable and other accrued liabilities decreased \$21.5 million, which resulted in a decrease of cash. The decreases in accounts payable and accrued liabilities primarily resulted from the lower cost of natural gas in first six months of 2006 compared to December 2005. In addition, the payment of invoices for capital expenditures in the first six months of 2006 and those outstanding at December 31, 2005 contributed to the decrease.

Certain material changes in working capital are listed below for the first six months of 2005:

- Accounts receivable and accrued revenue decreased \$14.6 million due to seasonality of the Company as it collects balances outstanding at December 31, 2004 and enters the summer months.
- Propane inventory, storage gas and other inventory decreased \$1.3 million.
- Accounts payable and other accrued liabilities decreased \$10.9 million. The decreases in accounts payable and accrued liabilities primarily resulted from fewer purchases of natural gas as the Company enters the summer months. In addition, the payment of invoices for capital expenditures in the first six months of 2005 and those invoices outstanding at December 31, 2004 contributed to the decrease.

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

Net cash flows used in investing activities totaled \$16.2 million and \$10.6 million during the six months ended June 30, 2006 and 2005, respectively. Cash utilized for capital expenditures was \$15.9 million and \$10.8 million for the first six months of 2006 and 2005, respectively. Additions to property, plant and equipment in the first six months of 2006 and 2005 were primarily for natural gas transmission, natural gas distribution and propane distribution. In both periods in 2006 and 2005, 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. Additionally, net cash of \$2,000 and \$169,000 was received during the first six months ended June 30, 2006 and 2005, respectively, for recovery of environmental costs through rates charged to customers.

### **Cash Flows Used in Financing Activities**

Cash flows used in financing activities totaled \$6.3 million and \$8.8 million for the six months ended June 30, 2006 and 2005, respectively. During the first six months of 2006, the Company repaid \$3.7 million of cash borrowed under its short-term line of credit agreements. Additionally, the Company paid common stock dividends totaling \$2.9 million and reduced its outstanding long-term notes payable balance by \$1.0 million.

During the first six months of 2005, the Company repaid \$4.7 million of cash borrowed under its short-term line of credit agreements. Additionally, the Company paid common stock dividends totaling \$2.9 million and reduced its outstanding long-term notes payable balance by \$1.0 million.

#### **Shelf Registration**

On July 5, 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. Under this registration statement, Chesapeake may sell common stock and/or debt securities in one or more separate offerings with the size, price and terms to be determined at the time of sale. The net proceeds from the sale of common stock and/or debt securities will be added to the Company's 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.

At the time of this report, the Company has not issued any common stock and/or debt securities covered under this registration.

#### **Off-Balance Sheet Arrangements**

As noted in the Company's 2005 Annual Report on Form 10-K, the Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its advanced information services subsidiary, and its Florida natural gas marketing subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases and office rent in the event of the subsidiaries' default. The liabilities for these purchases are recorded in the Consolidated Financial Statements in this Quarterly Report on Form 10-Q. The aggregate amount guaranteed at June 30, 2006, totaled \$14.9 million, with the guarantees expiring on various dates in 2006 and 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 Company's insurance policies were renewed.

### Contractual Obligations

There have been no material changes in the contractual obligations presented in the Company's 2005 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, 2006:

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>	\$9,768,777	\$3,294,063	-	-	\$13,062,840
Propane <sup>(2)</sup>	14,467,415	-	-	-	14,467,415
Total Purchase Obligations	\$24,236,192	\$3,294,063	\$0	\$0	\$27,530,255

<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 that allow 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 \$16.3 million. See Part I, Item 3, "Quantitative and Qualitative Disclosures about Market Risk," below for further information.

### Environmental Matters

As more fully described in Note 4 to the Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q, Chesapeake has incurred costs relating to the completed or ongoing environmental remediation at three former gas manufacturing plant sites. In addition, Chesapeake is currently participating in discussions regarding the possible responsibilities of the Company for remediation of a fourth former gas manufacturing 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 are subject to regulation by the Delaware, Maryland and Florida Public Service Commissions. Eastern Shore Natural Gas Company ("Eastern Shore"), the Company's natural gas transmission operation, is subject to regulation by the FERC.

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. Chesapeake understands that the other matter has now been resolved. Eastern Shore updated its gas supply realignment filing and entered into pre-filing discussions with customers potentially impacted by the filing before re-filing its application with the FERC. Discussions with customers were completed during the first quarter of 2006. Eastern Shore resubmitted its filing to the FERC on June 22, 2006, requesting authorization to recover a total of \$ 222,848 (including interest) of gas supply realignment costs.

On December 9, 2005, Eastern Shore filed revised tariff sheets to replace its existing fixed price penalties with penalties that are the higher of a fixed price or a multiple of a daily index price. The revised penalties are applicable to customers who violate Operational Flow Orders and customers who take unauthorized overrun quantities that could threaten the operational integrity of the pipeline, or to Eastern Shore's ability to render

reliable service. By letter order dated January 6, 2006, the FERC accepted Eastern Shore's proposed changes, effective December 21, 2005.

On January 20, 2006, Eastern Shore filed an application for a Certificate of Public Convenience and Necessity for its 2006-2008 system expansion project with the FERC. The proposed expansion application requests 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:

	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	\$ 3,670,256	\$ 1,484,146	\$ 1,594,785

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 an Order Issuing Certificate to Eastern Shore authorizing it to construct and operate the 2006-2008 system expansion project. Eastern Shore has commenced construction of certain Phase I facilities. Phase II and Phase III facilities are expected to be constructed in 2007 and 2008, respectively.

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

Eastern Shore has proposed to develop, construct and operate new pipeline facilities that would transport natural gas from Calvert County, Maryland, through Dorchester and Caroline Counties, Maryland, to points on the Delmarva Peninsula where such facilities would interconnect with its existing facilities in Sussex County, Delaware. The total cost of the Proposed Project is estimated at \$93 million, depending upon the final size and route of the pipeline, as well as construction materials and labor costs.

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 Proposed Project. Pursuant to these agreements ("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 Proposed Project.

During the negotiations of the Precedent Agreements, Eastern Shore and each of the customers entered into Letter Agreements, which provide that, in the event that the Proposed Project is not certified and placed in service, the customers will 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 Proposed Project, Eastern Shore, on June 27, 2006, submitted to FERC a petition for approval of an uncontested Settlement Agreement, to implement the rate-related Settlement Agreement to address the development costs of the Proposed Project. The filed Settlement Agreement was entered into by Eastern Shore and its firm customers. 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.

Delaware. On October 3, 2005, the Delaware division filed its annual Gas Sales Service Rates ("GSR") application that was effective for service rendered on and after November 1, 2005 with the Delaware Public Service Commission ("Delaware PSC"). On October 11, 2005, the Delaware PSC approved the GSR charges, subject to full evidentiary hearings and a final decision. On February 23, 2006, the Delaware division filed a supplemental GSR application with the Delaware PSC that was consolidated with the previously filed application. In its supplemental application, the Delaware division proposed reduced GSR charges to be effective March 15, 2006. On February 28, 2006, the Delaware PSC approved the reduced GSR charges subject to full evidentiary hearings and a final decision. The Delaware division expects a final decision on both of these applications during the third quarter of 2006.

On November 1, 2005, 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, 2005. The Delaware PSC granted approval of the ER rate at its regularly scheduled meeting on November 8, 2005, subject to full evidentiary hearings and a final decision. An evidentiary hearing was held on April 5, 2006, which was uncontested. The Delaware PSC granted final approval of the ER rate at its regularly scheduled meeting on May 9, 2006.

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 and traditional ratemaking processes, natural gas has not been extended to 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 during the second half of 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. The proposed increase, if approved, would represent an increase in total annual revenues of the Maryland division of approximately 6 percent. The Company cannot predict the outcome of this application; however, a final decision by the Maryland PSC is expected during the third or fourth quarter of 2006.

On December 8, 2005, 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, 2005. On January 12, 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 February 14, 2006.

Florida. On March 22, 2006, the Florida division filed a petition with the Florida Public Service Commission (the "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 deliver natural gas transmission service to industrial customers in Florida by an intra-state pipeline.

### **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 sides of its business to maximize sales volumes. As a result of the transmission business' conversion to open access, this business has 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 industrial customers. The Florida operation extended transportation service to commercial customers in 2001 and to residential customers in 2002. With transportation service available on the Company's distribution systems, the Company is competing with third-party suppliers to sell gas to certain customers. As it relates to transportation services, the Company's competitors include interstate transmission companies that are in close proximity to the Company's pipeline. 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 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 operates a natural gas marketing operation in Florida to compete for customers eligible for transportation services.

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 primarily with electricity and heating oil as energy sources. 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.

### **Recent Pronouncements**

In December 2004, the FASB released a revision ("Share-Based Payment") to SFAS No. 123 "Accounting for Stock-Based Compensation," referred to as SFAS No. 123R. In April 2005, the SEC approved a new rule that delayed the effective date for SFAS No. 123R until the first annual period beginning after June 15, 2005. SFAS 123R establishes financial accounting and reporting standards for stock-based employee compensation plans. Those plans include all arrangements by which employees receive shares of stock or other equity instruments of the employer or the employer incurs liabilities to employees in amounts based on the price of the employer's stock. Examples are stock purchase plans, stock options, restricted stock and stock appreciation rights. The impact of the Company's adoption of this pronouncement is disclosed in Note 9 to the financial statements entitled "Share-Based Compensation."

In July 2006, the FASB issued FASB Interpretation 48, "Accounting for Income Tax Uncertainties" ("FIN 48"). FIN 48 defines the threshold for recognizing the benefits of tax return positions in the financial statements as "more-likely-than-not" to be sustained by the taxing authority. The recently issued literature also provides guidance on the derecognition, measurement and classification of income tax uncertainties, along with any related interest and penalties. FIN 48 also includes guidance concerning accounting for income tax uncertainties in interim periods and increases the level of disclosures associated with any recorded income tax uncertainties. FIN 48 is effective for fiscal years beginning after December 15, 2006. The differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is continuing to evaluate the impact of this new standard and its impact, if any, on the Company's financial statements.

### **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 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.

### 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 margins, 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;
- 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 accounting changes;
- the effect of compliance with environmental regulations or the remediation of environmental damage;
- the effects of general economic conditions on the Company and its customers;
- the ability of the Company’s new and planned facilities and acquisitions to generate expected revenues; and
- the Company’s ability to obtain the rate relief and cost recovery requested from utility regulators and the timing of the requested regulatory actions.

### 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 the change 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 \$62.7 million at June 30, 2006, as compared to a fair value of \$65.0 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 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 entering into 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. At of June 30, 2006 management reviewed the Company’s storage position and several hedging strategies 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 oversight officials on a daily basis. Additionally, 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, 2006 is presented in the following table.

<b>At June 30, 2006</b>	<b>Quantity in gallons</b>	<b>Estimated Market Prices</b>	<b>Weighted Average Contract Prices</b>
<b>Forward Contracts</b>			
Sale	15,113,700	\$1.16625 — \$1.22375	\$1.0808
Purchase	13,545,000	\$1.16875 — \$1.20875	\$1.0681

*Estimated market prices and weighted average contract prices are in dollars per gallon.  
All contracts expire in 2006 or the first quarter of 2007.*

#### **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, 2006. Based upon their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective.

##### **Changes in Internal Control Over Financial Reporting**

During the quarter ended June 30, 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.

## PART II — OTHER INFORMATION

**Item 1. Legal Proceedings**

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**

None.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

<u>Period</u>	<u>Total Number of Shares Purchased</u>	<u>Average Price Paid per Share</u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or</u>	<u>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs</u>
April 1, 2006 through April 30, 2006 (1)	433	\$30.80	0	0
May 1, 2006 through May 31, 2006	0	\$0.00	0	0
June 1, 2006 through June 30, 2006	0	\$0.00	0	0
<b>Total</b>	<b>433</b>	<b>\$30.80</b>	<b>0</b>	<b>0</b>

(1) Chesapeake maintains a Rabbi Trust to secure its obligations under the Company's Supplemental Executive Retirement Savings Plan ("SERP plan"). The shares of Chesapeake common stock reported as purchased during each of the periods consist of shares purchased for the Rabbi Trust in the open market to match the shares held with Chesapeake's contractual obligations under the SERP plan.

(2) 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, 2006 for the purpose of electing directors. Proxies for the meeting were solicited in accordance with Regulation 14A under the Securities Exchange Act of 1934, as amended.

The stockholders elected the following nominees to the Company's Board of Directors to serve as Class I Directors for three-year terms ending in 2009, and until their successors are elected and qualify. Broker non-votes had no effect on the outcome of the vote. The following shows the separate tabulation of votes for each nominee:

<u>Name</u>	<u>Votes For</u>	<u>Votes Withheld</u>
Eugene H. Bayard	5,279,279	121,479
Thomas P. Hill, Jr.	5,284,809	115,949
Calvert A. Morgan, Jr.	5,276,625	124,133

The terms of the following directors continued after the meeting:

<u>Class II Directors (Terms Expire in 2007)</u>		<u>Class III Directors (Terms Expire in 2008)</u>	
Ralph J. Adkins		Thomas J. Bresnan	
Richard Bernstein		Walter J. Coleman	
J. Peter Martin		Joseph E. Moore	
		John R. Schimkaitis	

As of the Record Date, March 15, 2006, 5,929,928 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 and Reports on Form 8-K**

(a) Exhibits:

- Exhibit 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, 2006.
- Exhibit 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, 2006.
- Exhibit 32.1 — Certificate of Chief Executive Officer of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated August 9, 2006
- Exhibit 32.2 — Certificate of Chief Financial Officer of Chesapeake Utilities Corporation pursuant to 18 U.S.C. Section 1350, dated August 9, 2006.

(b) Reports on Form 8-K:

- May 1, 2006 (Item 8.01, Other Events.)
- May 5, 2006 (Item 2.02, Results of Operations and Financial Condition and Item 9.01, Financial Statements and Exhibits.)
- May 6, 2006 (Item 1.01, Entry into a Material Definitive Agreement and Item 5.02, Departure of Directors or Principal Officers; Election of Directors; Appointment of Principal Officers.)
- May 31, 2006 (Item 1.01, Entry into a Material Definitive Agreement.)
- June 13, 2006 (Item 8.01, Other Events and 9.01, Financial Statements and Exhibits.)



## 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, 2006

**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, 2006 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, 2006

/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, 2006 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, 2006

/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, 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  
August 9, 2006

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, 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  
August 9, 2006

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  
 2006 SUMMARY OF ESTIMATED CAPITAL EXPENDITURES  
 DISTRIBUTION UTILITY PLANT  
 UNAUDITED

EXHIBIT B

<u>PLANT ACCOUNT NUMBER</u>	<u>DESCRIPTION</u>	<u>TOTAL 2006 CAPITAL 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	\$500,000
376	MAINS	\$2,544,000
378	M & R STATIONS - GENERAL	\$104,545
379	M & R STATIONS - CITY GATE	\$50,000
380	SERVICES	\$730,507
381	METERS	\$282,440
382	METER INSTALLATIONS	\$227,585
383	HOUSE REGULATORS	\$100,425
384	REGULATOR INSTALLATIONS	\$0
385	INDUSTRIAL M & R STATION	\$66,000
387	OTHER EQUIPMENT	\$28,426
389	LAND AND LAND RIGHTS	\$0
390	STRUCTURES AND IMPROVEMENTS	\$0
391	OFFICE AND EQUIPMENT	\$75,506
392	TRANSPORTATION	\$179,000
393	STORES EQUIPMENT	\$0
394	TOOLS, SHOP, AND GARAGE EQUIP	\$10,000
395	LABORATORY EQUIPMENT	\$0
396	POWER OPERATED EQUIPMENT	\$8,000
397	COMMUNICATION EQUIPMENT	\$60,000
398	MISCELLANEOUS EQUIPMENT	\$7,500
399	OTHER TANGIBLE PROPERTY	\$0
	TOTAL CAPITAL EXPENDITURES	----- \$4,973,934 =====

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, Convertible Debentures, and to satisfy 30,000 outstanding stock warrants, 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.

EXECUTION COPY

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**CHESAPEAKE UTILITIES CORPORATION**

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**NOTE AGREEMENT**

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**Dated October 18, 2005**

**\$20,000,000**

**5.50% Senior Notes**

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**(Not Part of Agreement)**

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**CHESAPEAKE UTILITIES CORPORATION**

909 Silver Lake Boulevard  
Dover, Delaware 19904

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**NOTE AGREEMENT**

\$20,000,000

5.50% Senior Notes

---

As of October 18, 2005

To the Purchasers listed in the  
attached Purchaser Schedule

Ladies and Gentlemen:

Chesapeake Utilities Corporation, a Delaware corporation (the "Company"), hereby agrees with the purchasers listed in the attached Purchaser Schedule (collectively, the "Purchasers" and, individually, a "Purchaser") as follows:

**SECTION 1. PURCHASE AND SALE OF NOTES**

*Section 1.1 Issue of Notes.*

The Company will authorize the issue of \$20,000,000 principal amount of its 5.50% Senior Notes due on the Maturity Date (the "Notes"). Each Note will bear interest on the unpaid principal balance thereof, from the date of the Note or the most recent date to which interest thereon has been paid, until the same is due and payable, at an annual rate of 5.50% (computed on the basis of a 360-day year of twelve 30-day months), payable quarterly on each Quarterly Interest Payment Date, beginning with the first Quarterly Interest Payment Date to occur after the Closing Date. The Notes will be subject to certain mandatory principal repayments prior to maturity, as provided in Section 2.1 and will mature on the Maturity Date. Payments of principal, Make Whole Amount, if any, and, to the extent permitted by law, interest not paid when due will bear interest from the date such payment was due until paid at a rate per annum from time to time equal to the greater of (i) 7.50% or (ii) the rate of interest publicly announced by JPMorgan Chase Bank from time to time in New York City as its Prime Rate. The Notes will be registered notes in the form set out in Exhibit A.

*Section 1.2 The Closing.*

The Company agrees to sell to each Purchaser and each Purchaser agrees to purchase from the Company, in accordance with the provisions of this Agreement, the principal amount of the Notes indicated for such Purchaser on the Purchaser Schedule attached hereto at par. The closing of the sale and purchase of the Notes will be held at 10:00 a.m. on the Closing Date, at the offices of Schiff Hardin LLP, 6600 Sears Tower, Chicago, Illinois. On the Closing Date, the Company will deliver to each Purchaser one or more Notes, as specified in the Purchaser Schedule attached hereto in the aggregate amount of each Purchaser's purchase, dated the Closing Date and payable to such Purchaser or such Purchaser's nominee(s), if any, listed in the Purchaser Schedule, against payment in immediately available funds. Each Purchaser's obligations hereunder are several and not joint and no Purchaser shall have any obligation or liability to any Person for the performance or nonperformance by any other Purchaser hereunder.

*Section 1.3 Expenses.*

Whether or not the Notes are sold, the Company will, upon presentation to the Company of documentation in reasonable detail, pay the following expenses relating to this Agreement, including:

- (a) the cost of reproducing this Agreement and the Notes;
- (b) the reasonable fees and disbursements (including the cost of obtaining the private placement number) of the Purchasers' special counsel;
- (c) the cost of any fees of agents, brokers or dealers or otherwise incurred in connection with the sale of the Notes pursuant to this Agreement but not with respect to any subsequent resale;
- (d) each Purchaser's reasonable out-of-pocket expenses incurred in negotiating this Agreement;
- (e) the cost of delivering to or from any Purchaser's home office, insured to any Purchaser's satisfaction, the Notes purchased by any Purchaser, any Note surrendered by any Purchaser to the Company pursuant to this Agreement and any Note issued to any Purchaser in substitution or replacement for a surrendered Note; and
- (f) all costs (including reasonable fees and expenses of counsel) related to proposed or actual modifications of, or proposed or actual consents under, this Agreement.

The obligations of the Company under this Section 1.3 shall survive the payment of the Notes and the termination of this Agreement, and shall continue regardless of whether or not the Closing Date occurs and whether or not any Purchaser has purchased Notes hereunder.

*Section 1.4 Closing Conditions.*

Each Purchaser's obligation to purchase and pay for the Notes to be purchased by such Purchaser hereunder is subject to the satisfaction, on or before the Closing Date, of the following conditions:

(a) Certain Documents. Such Purchaser shall have received the following dated the Closing Date:

(i) The Notes to be purchased by such Purchaser.

(ii) Certified copies of the resolutions of the Board of Directors of the Company approving this Agreement and the Notes, and of all documents evidencing other necessary corporate action and governmental approvals, if any, with respect to this Agreement and the Notes.

(iii) A certificate of the Secretary or an Assistant Secretary of the Company certifying the names and true signatures of the officers of the Company authorized to sign this Agreement and the Notes and the other documents to be delivered hereunder.

(iv) Certified copies of the Certificate of Incorporation and By-laws of the Company.

(v) Good standing certificates for the Company from each of the Secretary of State of Delaware, the Secretary of State of Maryland, and the Secretary of State of Florida, dated of a recent date.

(b) Opinion of Purchasers' Special Counsel. Such Purchaser shall have received from Schiff Hardin LLP, who are acting as special counsel for the Purchasers in connection with this transaction, a favorable opinion satisfactory to the Purchasers as to such matters as the Purchasers may request.

(c) Opinion of Company's Special and Local Counsel. Such Purchaser shall have received from Covington & Burling, who are acting as special counsel for the Company in connection with this transaction, a favorable opinion satisfactory to the Purchasers substantially in the form of Exhibit B-1 hereto, from Parkowski, Guerke and Swayze, who are acting as Delaware counsel for the Company in connection with this transaction, a favorable opinion satisfactory to the Purchasers substantially in the form of Exhibit B-2 hereto, from DLA Piper Rudnick Gray US LLP, who are acting as Maryland counsel for the Company in connection with this transaction, a favorable opinion satisfactory to the Purchasers substantially in the form of Exhibit B-3 hereto, and from Rose, Sundstrom & Bentley, LLP, who are acting as Florida counsel for the Company in connection with this transaction, a favorable opinion satisfactory to the Purchasers substantially in the form of Exhibit B-4 hereto. The Company hereby directs each such counsel to deliver such opinions, agrees that the issuance and sale of any Notes will constitute a reconfirmation of such direction, and understands and agrees that each Purchaser will rely on such opinions.

(d) Representations and Warranties; No Default. The representations and warranties contained in Section 6 shall be true on and as of the Closing Date, except to the extent of changes caused by the transactions herein contemplated; there shall exist on the Closing Date no Event of Default or Default; and the Company shall have delivered to such Purchaser an Officer's Certificate, dated the Closing Date, to both such effects. The delivery of such Officer's Certificate will constitute the repeating of such representations and warranties by the Company as of the Closing Date.

(e) Purchase Permitted By Applicable Laws. The purchase of and payment for the Notes to be purchased by such Purchaser on the Closing Date on the terms and conditions herein provided (including the use of the proceeds of such Notes by the Company) shall not violate any applicable law or governmental regulation (including, without limitation, Section 5 of the Securities Act or Regulation T, U or X of the Board of Governors of the Federal Reserve System) and shall not subject such Purchaser to any tax, penalty, liability or other onerous condition under or pursuant to any applicable law or governmental regulation, and such Purchaser shall have received such certificates or other evidence as it may reasonably request to establish compliance with this condition. The order of the Florida Public Service Commission referred to in Section 6.10 shall have been obtained. The orders of the Delaware and Florida State Commissions referred to in Section 6.10 shall be satisfactory to such Purchaser and shall be final and in full force and effect on the Closing Date. No appeal, review or contest of either thereof shall be pending on the Closing Date, and, as of the Closing Date, the time for appeal or to seek review or reconsideration of such orders shall have expired. Any conditions contained in either order shall have been satisfied to such Purchaser's reasonable satisfaction. Such Purchaser and its special counsel shall have received copies of such documents and papers (including, without limitation, a certified or attested copy of such orders) as such Purchaser may reasonably request in connection therewith or as a basis for the Purchasers' special counsel's closing opinion, all in form and substance satisfactory to such Purchaser and the Purchasers' special counsel.

(f) Structuring Fee. The Company shall have paid to each Purchaser, by wire transfer of immediately available funds, such Purchaser's ratable portion (in proportion to the aggregate principal amount of the Notes to be purchased by such Purchaser) of a structuring fee in the aggregate amount, for all Purchasers, equal to (i) \$15,000, minus (ii) 50% of the amount, if any, by which the fees and disbursements of Purchasers' special counsel related to the preparation of this Agreement payable by the Company under Section 1.3(b) exceeds \$25,000 (provided that such structuring fee shall not be less than zero).

(g) Delayed Delivery Fee. The Company shall have paid to each Purchaser, by wire transfer of immediately available funds, any Delayed Delivery Fee due to such Purchaser under Section 2.5.

(h) Diversification Event. No Diversification Event shall have occurred.

(i) Proceedings. All corporate and other proceedings taken or to be taken in connection with the transactions contemplated hereby and all documents incident thereto shall be satisfactory in substance and form to such Purchaser, and such Purchaser shall have received all

such counterpart originals or certified or other copies of such documents as it may reasonably request.

## SECTION 2. PAYMENTS

### *Section 2.1 Required Payments.*

(a) Until the Notes are paid in full, the Company will pay \$2,000,000 in aggregate principal amount of the Notes on each Annual Principal Amortization Date. The entire outstanding principal amount and unpaid interest thereon shall be due and payable on the Maturity Date. Prepayments on each holder's Notes under Section 2.2 shall be applied to mandatory payments on such Notes in inverse order of maturity and the Company's obligation to make the payments required by this Section 2.1 shall not be reduced by any payment pursuant to Section 2.2. Notwithstanding the foregoing, upon any payment of less than all of the outstanding Notes pursuant to Section 2.1(b) hereof or any acquisition of any Notes by the Company or any Subsidiary or Affiliate permitted by Section 9.6(b) hereof, the principal amount of such required prepayment of the Notes becoming due under this Section 2.1 on or after the day of such payment or acquisition shall be reduced in the same proportion as the aggregate unpaid principal amount of the Notes is reduced as a result of such prepayment or purchase.

(b) If, at any time, the aggregate net book value of all assets that are used in the regulated utilities business segments of the Company and its Subsidiaries is less than 50% of Consolidated Total Assets (a "Diversification Event"), any holder of any of the Notes then outstanding may elect, at its option, by notice to the Company, to declare the outstanding Notes held by such holder to be due and payable on the next business day after the 30th day following such notice (the "Required Payment Date"). Upon such election by any holder of the Notes, the Company will pay the aggregate principal amount of such holder's Notes on the Required Payment Date, together with interest accrued to the Required Payment Date on such principal amount, and a premium equal to the Make Whole Amount, if any, applicable to such payment. Upon the occurrence of a Diversification Event, the Company shall deliver to each holder of the outstanding Notes a notice that such event has occurred and the reason or reasons for such occurrence.

### *Section 2.2 Optional Prepayments.*

(a) At a Premium. The Company may prepay the Notes in whole or part, at any time and from time to time, in multiples of \$100,000, by payment of 100% of the principal amount then being prepaid, together with interest accrued to the date of prepayment on the principal amount being prepaid and a premium equal to the Make Whole Amount, if any, applicable to such prepayment; provided that no partial prepayment shall be in an amount less than (i) \$1,000,000 or (ii) the aggregate principal amount remaining outstanding, whichever is less.

(b) Notice of Optional Prepayment. The Company will give written notice of any optional prepayment of the Notes to each holder of Notes at least 15 but not more than 45 days before the date fixed for prepayment, specifying (1) such date (the "Prepayment Date"), and (2) the amount of principal and interest with respect to the Notes and such holder's Notes to be prepaid on such date. Any such notice of prepayment will be irrevocable. Upon the giving of

such notice by the Company, the principal amount of the Notes specified in the notice, together with interest accrued to the Prepayment Date on such principal amount, and a premium equal to the Make Whole Amount, if any, applicable to such payment, shall be due and payable on the Prepayment Date, and the Company shall pay such amount on the Prepayment Date. The Company shall, on or before the day on which it gives written notice of any prepayment pursuant to Section 2.2(a), give telephonic notice of the principal amounts of the Note to be prepaid and the prepayment date to each Purchaser which shall have designated a recipient of such notices in the Purchaser Schedule attached hereto or by notice in writing to the Company.

*Section 2.3 Partial Payment Pro Rata.*

If there is more than one Note outstanding, the principal amount of each required or optional partial payment of the Notes, other than a prepayment pursuant to Section 2.1(b), will be allocated among the Notes at the time outstanding in proportion, as nearly as practicable, to the respective outstanding principal amounts of the Notes.

*Section 2.4 Request for Delay of Closing Beyond December 28, 2006.*

If the Closing Date is December 28, 2006 and the Company fails to tender to any Purchaser the Notes to be purchased by such Purchaser on December 28, 2006, or any of the conditions specified in Section 1.4 shall not have been fulfilled on December 28, 2006, the Company shall, prior to 1:00 P.M., New York City local time, on December 28, 2006, notify Prudential (which notification shall be deemed received by each Purchaser) in writing whether (i) such closing of the purchase or sale of the Notes is to be rescheduled (such rescheduled date to be a Business Day not before December 29, 2006 and not later than January 15, 2007 (the “**Rescheduled Closing Date**”)) and certify to Prudential (which certification shall be for the benefit of each Purchaser) that the Company reasonably believes that it will be able to comply with the conditions set forth in Section 1.4 on such Rescheduled Closing Date and that the Company will pay the Delayed Delivery Fee in accordance with Section 2.5 or (ii) such closing is to be canceled. In the event that the Company shall fail to give the notice referred to in the preceding sentence, the Company shall be deemed to have elected that such closing is to be cancelled as of December 28, 2006. Notwithstanding anything to the contrary appearing in this Agreement, the Company may not elect to reschedule the closing on more than one occasion, unless the Purchasers shall have otherwise consented in writing.

*Section 2.5 Delayed Delivery Fee.*

If the closing of the purchase and sale of the Note(s) to be sold to any Purchaser is delayed for any reason beyond December 28, 2006, then, except as otherwise provided in Section 2.7, the Company will pay to such Purchaser on the Cancellation Date or actual closing date of such purchase and sale, a fee (herein called the “**Delayed Delivery Fee**”) calculated as follows:

$$(BEY - MMY) \times DTS/360 \times PA$$

where “**BEY**” means Bond Equivalent Yield, i.e., the bond equivalent yield per annum of the Notes; “**MMY**” means Money Market Yield, i.e., the yield per annum on a commercial paper investment of the highest quality selected by Prudential and having a maturity date or dates the



same as, or closest to, the Rescheduled Closing Date or Rescheduled Closing Dates for such the Notes (a new alternative investment being selected by Prudential each time such closing is delayed); “DTS” means Days to Settlement, i.e., the number of actual days elapsed from and including December 28, 2006 to but excluding the date of such payment; and “PA” means Principal Amount, i.e., the principal amount of the Note for which such calculation is being made. In no case shall the Delayed Delivery Fee be less than zero. Nothing contained herein shall obligate any Purchaser to purchase any Note on any day other than the Closing Date, as the same may be rescheduled from time to time by mutual agreement of the Company and the Purchasers.

*Section 2.6 Cancellation Fee.*

If the Company at any time notifies Prudential in writing that the Company is canceling the closing of the purchase and sale of the Notes, if the Company is deemed to have elected pursuant to the penultimate sentence of Section 2.4 that the closing of the purchase and sale of the Notes is to be canceled, or if the Closing Date is rescheduled to a Rescheduled Closing Date pursuant to Section 2.4 but the Company fails to tender to any Purchaser the Notes to be purchased by such Purchaser on such Rescheduled Closing Date or any of the conditions specified in Section 1.4 shall not have been either fulfilled or expressly waived in writing by the Purchasers on such Rescheduled Closing Date and such closing does not occur on such Rescheduled Closing Date (the date of any such notification or deemed election or such Rescheduled Closing Date, as the case may be, being herein called the “Cancellation Date”), then, except as otherwise provided in Section 2.7, the Company will pay to each Purchaser on the Cancellation Date in immediately available funds an amount (the “Cancellation Fee”) calculated as follows:

$$\text{PI X PA}$$

where “PI” means Price Increase, i.e., the quotient (expressed in decimals) obtained by dividing (a) the excess of the ask price (as determined by Prudential) of the Hedge Treasury Note(s) on the Cancellation Date over the bid price (as determined by Prudential) of the Hedge Treasury Notes(s) on June 29, 2005 by (b) such bid price; and “PA” has the meaning ascribed to it in Section 2.5; provided, however, the Cancellation Fee shall be no less than \$50,000. The foregoing bid and ask prices shall be as reported by TradeWeb LLC (or, if such data for any reason ceases to be available through TradeWeb LLC, any publicly available source of similar market data). Each price shall be rounded to the second decimal place. In no case shall the Cancellation Fee be less than \$50,000.

*Section 2.7 No Delayed Delivery or Cancellation Fees Payable Under Certain Circumstances.*

Notwithstanding the provisions of Section 2.5 or 2.6, in the event that either (i) all conditions set forth in Section 1.4 have been satisfied on the Closing Date but any Purchaser refuses to purchase the Notes to be purchased by such Purchaser hereunder, or (ii) any Purchaser refuses to purchase the Notes to be purchased by such Purchaser hereunder on the grounds that such purchase would violate any applicable law or government regulation binding on such Purchaser or subject such Purchaser to any tax, penalty, liability or other onerous condition under

or pursuant to any such applicable law or governmental regulation, no Cancellation Fee or Delayed Delivery Fee will be payable to such Purchaser.

### SECTION 3. INFORMATION AS TO COMPANY

#### *Section 3.1 Financial and Business Information.*

The Company will deliver in duplicate to each Purchaser, if at the time such Purchaser or such Purchaser's nominee holds any Notes (or if such Purchaser is obligated to purchase any Notes), and to each other Institutional Holder of outstanding Notes:

(a) Quarterly Statements--as soon as practicable and in any event within sixty (60) days after the end of each of the first three quarterly fiscal periods in each fiscal year of the Company:

(i) a consolidated balance sheet of the Company and its Subsidiaries as at the end of such quarter and as at the end of the corresponding quarter in the most recently completed fiscal year and a consolidating balance sheet of the Company and its Subsidiaries as of the end of such quarter, and

(ii) consolidated statements of income, retained earnings and cash flows of the Company and its Subsidiaries for that quarter and for the portion of the fiscal year ending with such quarter, and for the corresponding periods in the prior fiscal year and consolidating statements of income, retained earnings and cash flows of the Company and its Subsidiaries for such quarter and for the portion of the fiscal year ending with such quarter,

setting forth in the statements of income for each fiscal period, the specific dollar amounts of depreciation charged, lease rental expense and interest expense on Indebtedness, accompanied by a certificate signed by a principal financial officer of the Company stating that such financial statements present fairly the financial condition of the companies being reported upon and have been prepared in accordance with generally accepted accounting principles consistently applied, with such adjustments as may be required to present fairly the financial statements therein contained; provided that if the Company is subject to the reporting requirements of the Exchange Act, the delivery to such recipients of the Company's Quarterly Report on Form 10-Q containing such information within the specified time period shall satisfy this requirement;

(b) Annual Statements--as soon as practicable and in any event within one hundred twenty (120) days after the end of each fiscal year of the Company:

(i) a consolidated and consolidating balance sheet of the Company and its Subsidiaries, as at the end of that fiscal year, and

(ii) consolidated and consolidating statements of income, retained earnings and cash flows of the Company and its Subsidiaries, for that year,

setting forth in the case of such consolidated financial statements, the figures for the previous fiscal year in comparative form, and setting forth in such statements of income, the specific

dollar amounts of depreciation charged, lease rental expense, and interest expense on Indebtedness, and accompanied in the case of such consolidated financial statements by an opinion of a firm of independent public accountants of recognized national standing stating that such financial statements present fairly the results of the operations and financial condition of the companies being reported upon and have been prepared in accordance with generally accepted accounting principles consistently applied (except for changes in application in which such accountants concur); provided that if the Company is subject to the reporting requirements of the Exchange Act, the delivery to such recipients of the Company's Quarterly Report on Form 10-K containing such information within the specified time period shall satisfy this requirement;

(c) Audit Reports--promptly upon receipt thereof, one copy of each other report submitted to the Company or any Subsidiary by independent accountants in connection with any annual, interim or special audit made by them of the books of the Company or any Subsidiary;

(d) SEC and Other Reports--promptly upon their becoming available, copies of each periodic report (including Forms 8-K, 10-K, and 10-Q, proxy statement and registration statement or prospectus (other than registration statements on Form S-8 and any corresponding prospectus) relating to Securities of the Company filed with or delivered to any securities exchange, the Securities and Exchange Commission or any successor agency, and promptly upon transmission thereof, copies of such other financial statements, notices and reports, if any, as the Company or any Subsidiary shall send to its public stockholders;

(e) Annual Regulatory Reports--promptly upon their becoming available, copies of each annual report required to be filed by the Company or any Subsidiary with any of the State Commissions or with the FERC;

(f) Notice of Default or Event of Default-- immediately upon becoming aware of the existence of any Default or Event of Default, a notice describing in reasonable detail its nature and what action the affected Company or Subsidiary is taking or proposes to take with respect thereto;

(g) Notice of Claimed Default--immediately upon becoming aware that the holder of any Note or of any other evidence of Indebtedness or other Security of the Company or any Subsidiary has given notice (or taken any other action) with respect to a claimed default, breach, Default or Event of Default, a notice describing in reasonable detail the notice given (or action taken) and in reasonable detail the nature of the claimed default, breach, Default or Event of Default and what action the affected Company or Subsidiary is taking or proposes to take with respect thereto;

(h) Report on Proceedings--promptly upon the Company's making public information with respect to (1) any proposed or pending investigation of it or any Subsidiary by any governmental authority or agency, or (2) any court or administrative proceeding, which in either case involves the possibility of materially and adversely affecting the Properties, business, prospects, profits or financial condition of the Company and its Subsidiaries taken as a whole, a notice specifying its nature and the action the Company is taking with respect thereto; and

(i) Requested Information--with reasonable promptness, any other data and information which may be reasonably requested from time to time, including without limitation any information required to be made available at any time to any prospective transferee of any Notes in order to satisfy the requirements of Rule 144A under the Securities Act of 1933, as amended.

*Section 3.2 Officer's Certificates.*

With each set of financial statements delivered pursuant to Section 3.1(a) or 3.1(b), the Company will deliver to each Purchaser a certificate signed by its Chief Financial Officer and setting forth:

(a) Covenant Compliance--the information required in order to establish compliance with Section 4 during the period covered by the financial statements then being furnished; and

(b) Default or Event of Default--that the signer has reviewed the relevant terms of this Agreement and has made, or caused to be made, under the signer's supervision, a review of the transactions and condition of the Company and its Subsidiaries from the beginning of the period covered by the financial statements then being furnished and that the review has not disclosed the existence of any Default or Event of Default or, if a Default or Event of Default exists, describing its nature.

*Section 3.3 Accountants' Certificates.*

Each set of annual financial statements delivered pursuant to Section 3.1(b) will be accompanied by a certificate of the accountants who certify such financial statements, stating that, in making the audit necessary to the certification of such financial statements, they have reviewed this Agreement and obtained no knowledge of any Event of Default or Default, or, if they have obtained knowledge of any Event of Default or Default, specifying the nature and period of existence thereof.

*Section 3.4 Inspection.*

The Company will permit each Purchaser's representatives, while such Purchaser or such Purchaser's nominee holds any Note, and the representatives of any other Institutional Holder of the Notes to visit and inspect any of the Properties of the Company or any Subsidiary, to examine and make copies and extracts of all their books of account, records, reports and other papers, and to discuss their respective affairs, finances and accounts with their respective officers, employees with management duties and independent public accountants (and by this provision the Company authorizes said accountants to so discuss the finances and affairs of the Company and its Subsidiaries), all upon reasonable notice, at reasonable times and as often as may be reasonably requested. Any holder making any visit or inspection pursuant to this Section 3.4 shall pay its own costs and expenses thereof unless, at the time of such visit or inspection, there shall exist a Default or Event of Default, in which event the Company shall bear the costs and expenses thereof.

## SECTION 4. COMPANY BUSINESS COVENANTS

The Company covenants that on and after the date of this Agreement until the Notes are paid in full:

### *Section 4.1 Payment of Taxes and Claims.*

The Company shall, and shall cause each Subsidiary to, pay, before they become delinquent,

(a) all taxes, assessments and governmental charges or levies imposed upon it or its Property, and

(b) all claims or demands of materialmen, mechanics, carriers, warehousemen, landlords and other like Persons which, if unpaid, might result in the creation of a Lien upon its Property,

provided that items of the foregoing description need not be paid while being contested in good faith and by appropriate proceedings and provided further that adequate book reserves have been established with respect thereto and provided further that the owning company's title to, and its right to use, its Property is not materially adversely affected thereby.

### *Section 4.2 Maintenance of Properties and Corporate Existence.*

The Company shall, and shall cause each Subsidiary to:

(a) Property--maintain its Property in good condition and make all necessary renewals, replacements, additions, betterments and improvements thereto;

(b) Insurance--maintain, with financially sound and reputable insurers, insurance with respect to its Properties and business against such casualties and contingencies, of such types (including public liability, larceny, embezzlement or other criminal misappropriation insurance) and in such amounts as is customary in the case of corporations of established reputations engaged in the same or a similar business and similarly situated;

(c) Financial Records--keep true books of records and accounts in which full and correct entries will be made of all its business transactions, and will reflect in its financial statements adequate accruals and appropriations to reserves, all in accordance with generally accepted accounting principles;

(d) Corporate Existence and Rights--do or cause to be done all things necessary (a) to preserve and keep in full force and effect its existence, rights and franchises and (b) except as provided in Section 4.10 or 4.11, to maintain each Subsidiary as a Subsidiary; and

(e) Compliance with Law--comply with all laws (including but not limited to environmental laws), ordinances, or governmental rules and regulations (including, without limitation, federal, state and local environmental laws, rules and regulations) to which it is subject and maintain any licenses, permits, franchises or other governmental authorizations

necessary to the ownership of its Properties or to the conduct of its business, if the failure to so comply or the failure to so maintain might materially adversely affect the Properties, business, prospects, profits or condition (financial or otherwise) of the Company and its Subsidiaries or the ability of the Company to perform its obligations set forth in this Agreement and in the Notes.

*Section 4.3 Payment of Notes and Maintenance of Office.*

The Company will punctually pay or cause to be paid the principal and interest (and premium, if any) to become due in respect of the Notes according to the terms thereof and will maintain an office at the address of the Company set forth in Section 9.1 where notices, presentations and demands in respect of this Agreement or the Notes may be made upon it. Such office shall be maintained at such address until such time as the Company shall notify the holders of the Notes of a change of location of such office within such State.

*Section 4.4 Fixed Charge Coverage Ratio.*

The Company will, for each fiscal year of the Company, maintain Consolidated Net Earnings Available for Fixed Charges at not less than 120% of Consolidated Fixed Charges.

*Section 4.5 Minimum Consolidated Net Worth.*

The Company will at all times maintain Consolidated Net Worth at not less than \$50,000,000.

*Section 4.6 Incurrence of Indebtedness.*

The Company will not, nor will it permit any of its Subsidiaries to, create, incur, assume, become liable for, or guaranty, or permit any of its Property to become subject to, any Funded Indebtedness (and in the case of a Subsidiary, Current Indebtedness) other than:

(i) Funded Indebtedness represented by the Notes and the outstanding Indebtedness set forth in Schedule 4.6;

(ii) Unsecured Funded Indebtedness of the Company, if after giving effect thereto and to any concurrent transactions, the aggregate principal amount of outstanding secured and unsecured Funded Indebtedness of the Company and secured and unsecured Current and Funded Indebtedness of the Subsidiaries (excluding Indebtedness owed by a Subsidiary to the Company or a Wholly-Owned Subsidiary) does not exceed 65% of Total Capitalization; and

(iii) Purchase Money Indebtedness of the Company or a Subsidiary and unsecured Current or Funded Indebtedness of a Subsidiary, if after giving effect thereto and to any concurrent transactions, (a) the conditions set forth in Section 4.6(ii) are satisfied, and (b) the aggregate principal amount of outstanding Purchase Money Indebtedness of the Company and its Subsidiaries and the unsecured Current and Funded Indebtedness of the Subsidiaries, excluding Current or Funded Indebtedness owed by a Subsidiary to the Company or a

Wholly-Owned Subsidiary, does not exceed 20% of Consolidated Tangible Net Worth.

*Section 4.7 Guaranties.*

The Company will not, and will not permit any Subsidiary to, become liable for or permit any of its Property to become subject to any Guaranty except Guaranties under which the maximum aggregate amount of Indebtedness, dividend or other obligation being guaranteed can be mathematically determined at the time of issuance. Each Guaranty permitted by this Section 4.7 must comply with the applicable requirements of Section 4.6 above.

*Section 4.8 Liens and Encumbrances.*

The Company will not, and will not permit any Subsidiary to, cause or permit or agree or consent to cause or permit in the future (upon the happening of a contingency or otherwise), any of its Property, whether now owned or subsequently acquired, to be subject to a Lien except:

(a) Liens securing the payment of taxes, assessments or governmental charges or levies or the demands of suppliers, mechanics, carriers, warehousemen, landlords and other like Persons, provided that payment thereof is not at the time required by Section 4.1;

(b) Liens incurred or deposits made in the ordinary course of business (i) in connection with worker's compensation, unemployment insurance, social security and other like laws, or (ii) to secure the performance of letters of credit, bids, tenders, sales contracts, leases, statutory obligations, surety, appeal and performance bonds and other similar obligations, in each case not incurred in connection with the borrowing of money, the obtaining of advances or the payment of the deferred purchase price of Property;

(c) attachment, judgment and other similar Liens arising in connection with court proceedings, provided that (i) execution and other enforcement are effectively stayed, (ii) all claims which the Liens secure are being actively contested in good faith and by appropriate proceedings, (iii) adequate book reserves have been established with respect thereto, and (iv) the owning company's right to use, its Property is not materially adversely affected thereby;

(d) Liens on Property of a Subsidiary, provided that they secure only obligations owing to the Company or a Wholly-Owned Subsidiary;

(e) the Liens existing at the date of this Agreement which are set forth in Schedule 4.8(e);

(f) Liens securing Purchase Money Indebtedness of the Company or a Subsidiary, provided (i) the incurrence of such Purchase Money Indebtedness is then permitted by Section 4.6, and (ii) after giving effect to the incurrence of such Purchase Money Indebtedness and to any concurrent transactions, the aggregate amount of outstanding Purchase Money Indebtedness of the Company and its

Subsidiaries and the unsecured Current and Funded Indebtedness of the Subsidiaries (excluding Indebtedness owed by a Subsidiary to the Company or a Wholly-Owned Subsidiary) does not exceed 20% of Consolidated Tangible Net Worth; and provided further that no such Lien shall extend to or cover any Property not originally subject thereto, other than improvements to the Property originally subject thereto; and

(g) other Liens securing obligations that in the aggregate do not exceed \$100,000.

*Section 4.9 Restricted Payments.*

Except as provided in this Section 4.9, the Company will not, and the Company will not permit any Subsidiary to,

(a) declare or pay any dividends, either in cash or property, on any shares of capital stock of the Company (except dividends payable solely in shares of capital stock of the Company);

(b) directly or indirectly, purchase, redeem or retire any share of capital stock of the Company or any warrants, rights or options to purchase or acquire any shares of capital stock of the Company (other than shares of capital stock or warrants, rights or options to purchase or acquire shares of capital stock issued to employees, directors or agents of the Company pursuant to a benefit or compensation plan or agreement of the Company); or

(c) make any other payment or distribution, either directly or indirectly, in respect of capital stock of the Company (such declarations, payments, redemptions or retirements being called "Restricted Payments"),

if at the time of any such Restricted Payment and after giving effect thereto, the aggregate amount of all Restricted Payments made, paid or declared since the Closing Date would exceed the sum of (x) \$10,000,000 plus (y) 100% of Consolidated Net Income for the period beginning on January 1, 2003 and ending on the date of the proposed Restricted Payment, computed on a cumulative basis (or if Consolidated Net Income is a deficit figure for the period, then minus 100% of such deficit).

*Section 4.10 Sale of Property and Subsidiary Stock.*

(a) The Company will not, and will not permit any Subsidiary to, except in the ordinary course of business, sell, lease, transfer or otherwise dispose of any of its assets (not including Excluded Assets); provided that the foregoing restriction does not apply to the sale of assets for a cash consideration to a Person other than an Affiliate, if all of the following conditions are met:

(i) the amount of such assets (valued at net book value), together with all other assets of the Company and Subsidiaries previously disposed of (other than in the ordinary course of business) as permitted by this Section 4.10(a) and the assets of any Subsidiary disposed of as permitted by Section 4.10(b)(ii) during



the fiscal year in which the disposition occurs does not exceed 10% of Consolidated Total Assets as of the end of the fiscal year then most recently ended; provided that assets, as so valued, may be sold in excess of 10% of Consolidated Total Assets in any fiscal year if either (1) within one year of such sale, the proceeds from the sale of such assets are used, or committed by the Company's Board of Directors to be used, to acquire other assets of at least equivalent value and earning power, or (2) with the written consent of the holders of the Notes, the proceeds from sale of such assets are used immediately upon receipt to prepay pro rata the Notes under Section 2.2(a) hereof and other senior Funded Indebtedness of the Company; and

(ii) in the opinion of the Company's Board of Directors, the sale is for fair value and is in the best interest of the Company; and

(iii) immediately after the consummation of the sale, and after giving effect thereto, no Default or Event of Default would exist.

(b) The Company will not, and will not permit any Subsidiary to, dispose of its investment in any Subsidiary, and the Company will not, and will not permit any Subsidiary to, issue or transfer any shares of a Subsidiary's capital stock or any other Securities exchangeable or convertible into such Subsidiary's stock (such stock and other Securities being called "Subsidiary Stock"), if the effect would be to reduce the direct or indirect proportionate interest of the Company in the outstanding Subsidiary Stock of the Subsidiary whose shares are the subject of the transaction, provided that these restrictions do not apply to (x) the issue of directors' qualifying shares or (y) the sale for a cash consideration to a Person other than an Affiliate of the entire investment of the Company and its other Subsidiaries (i) in any Excluded Assets or (ii) in any other Subsidiary provided the Company would be permitted to dispose of all of the assets of such other Subsidiary at the time in compliance with the conditions specified in paragraphs (i), (ii) and (iii) of Section 4.10(a).

#### *Section 4.11 Merger and Consolidation.*

The Company will not, and will not permit any Subsidiary to, be a party to any merger or consolidation or sell, lease or otherwise transfer all or substantially all of its Property, provided that the Company may merge or consolidate with, or sell substantially all of its assets to, another corporation if all of the following conditions are met:

(i) the surviving or acquiring corporation is organized under the laws of the United States or a jurisdiction thereof,

(ii) the surviving or acquiring corporation, if not the Company, expressly and unconditionally assumes in writing the covenants and obligations to be performed by the Company under the Notes and this Agreement, such assumption to be in a form acceptable to the holder or holders of not less than 66-2/3% in principal amount of all Notes at the time outstanding, and

(iii) the surviving or acquiring corporation could, immediately after giving effect to the transaction, incur at least \$1.00 of additional Funded

Indebtedness pursuant to Section 4.6(ii), and at the time of such transaction and immediately after giving effect thereto, no Default or Event of Default shall have occurred and be continuing; and

provided, further, that any Subsidiary may merge or consolidate with or into the Company or any other Subsidiary so long as (x) immediately after giving effect to the transaction, the Company can incur at least \$1.00 of additional Funded Indebtedness consistent with Section 4.6(ii), (y) at the time of such transaction and immediately after giving effect thereto, no Default or Event of Default shall have occurred and be continuing, and (z) in any merger or consolidation involving the Company, the Company shall be the surviving or continuing corporation.

*Section 4.12 Transactions with Affiliates.*

The Company will not, and will not permit any Subsidiary to, enter into any transaction (including the purchase, sale or exchange of Property or the rendering of any service) with any Affiliate except in the ordinary course of and pursuant to the reasonable requirements of such Company's or Subsidiary's business and upon fair and reasonable terms which are at least as favorable to the Company or the Subsidiary as would be obtained in a comparable arm's-length transaction with a non-Affiliate.

*Section 4.13 Loans, Advances and Investments.*

The Company will not, and will not permit any Subsidiary to, make or permit to remain outstanding any investment in any Property or own, purchase or acquire any stock, obligations or securities of, or any other interest in, or make any capital contribution to, or make or permit to remain outstanding any loan or advance to, any Person, (herein collectively referred to as "Investments") except that the Company or a Subsidiary may make or permit to remain outstanding Permitted Investments.

*Section 4.14 Sale-Leaseback.*

Without the written consent of the holder or holders of not less than 66-2/3% in principal amount of all Notes at the time outstanding, neither the Company nor any Subsidiary will sell and lease back (whether or not under a Financing Lease) any Property.

*Section 4.15 ERISA Compliance.*

(a) The Company will not permit the present value of all employee benefits vested under all Defined Benefit Plans maintained by the Company and its Subsidiaries, determined as of the end of any Defined Benefit Plan year, to exceed the present value of the assets allocable to such vested benefits as of such date of determination;

(b) All assumptions and methods used to determine the actuarial valuation of vested employee benefits under Defined Benefit Plans and the present value of assets of Defined Benefit Plans shall be reasonable in the good faith judgment of the Company and shall comply with all requirements of law, provided, however, that for purposes of the foregoing the Company shall be entitled to rely upon the independent actuaries for its Defined Benefit Plans; and

(c) The Company will not permit at any time, and will not permit any Subsidiary at any time to permit, any Pension Plan maintained by it to:

(i) engage in any “prohibited transaction” as such term is defined in section 4975 of the Code or described in section 406 of ERISA;

(ii) incur any “accumulated funding deficiency” as such term is defined in section 302 of ERISA, whether or not waived; or

(iii) terminate under circumstances which could result in the imposition of a Lien on the Property of the Company or any Subsidiary pursuant to section 4068 of ERISA.

*Section 4.16 Use of Proceeds.*

Neither the Company nor any Subsidiary owns or has any present intention of acquiring any “margin stock” as defined in Regulation U (12 CFR Part 221) of the Board of Governors of the Federal Reserve System (herein called “margin stock”). The proceeds of sale of the Notes will be used to refinance outstanding short-term debt previously used to fund capital expenditures and for general corporate purposes, including to fund capital expenditures. None of such proceeds will be used, directly or indirectly, for the purpose, whether immediate, incidental or ultimate, of purchasing or carrying any margin stock or for the purpose of maintaining, reducing or retiring any Indebtedness which was originally incurred to purchase or carry any stock that is currently a margin stock or for any other purpose which might constitute this transaction a “purpose credit” within the meaning of such Regulation U. Neither the Company nor any agent acting on its behalf has taken or will take any action which might cause this Agreement or the Notes to violate Regulation T, Regulation U or any other regulation of the Board of Governors of the Federal Reserve System or to violate the Exchange Act, in each case as in effect now or as the same may hereafter be in effect.

*Section 4.17 Terrorism Sanctions Regulations.*

The Company will not and will not permit any Subsidiary to (a) become a Person described or designated in the Specially Designated Nationals and Blocked Persons List of the Office of Foreign Assets Control or in Section 1 of the Anti-Terrorism Order or (b) knowingly engage in any dealings or transactions with any such Person.

SECTION 5. DEFAULT

*Section 5.1 Nature of Default.*

An “Event of Default” shall exist if any of the following occurs and is continuing:

(a) Principal, Premium or Interest Payments--failure to pay principal or Make Whole Amount on any Note on or before the date the payment is due, or failure to pay interest on any Note on or before the fifth day after the payment is due;

(b) Breach of Particular Covenants--failure to comply with any covenant contained in Sections 4.4 through 4.11 or Section 4.14, 4.15 or 4.17;

(c) Other Breaches--failure to comply with any other provision of this Agreement, which continues for more than 30 days after it first becomes known to the chief executive officer, president, chief financial officer or treasurer of the Company;

(d) Default on Indebtedness or Other Security-- failure by the Company or any Subsidiary to make one or more payments due on aggregate indebtedness exceeding \$1,000,000; or any event, other than the giving of a notice of voluntary prepayment, shall occur or any condition shall exist, the effect of which event or condition is to cause (or permit one or more Persons to cause) more than \$1,000,000 of aggregate indebtedness or other Securities of the Company or any Subsidiary to become due before its (or their) stated maturity or before its (or their) regularly scheduled dates of payment;

(e) Involuntary Bankruptcy Proceedings, Etc.--a custodian, receiver, liquidator or trustee of the Company or any Subsidiary, or of any of the Property of either, is appointed or takes possession and such appointment or possession remains in effect for more than 60 days; or the Company or any Subsidiary generally fails to pay its debts as they become due; or the Company or any Subsidiary is adjudicated bankrupt or insolvent; or an order for relief is entered under the Federal Bankruptcy Code against the Company or any Subsidiary; or any of the Property of either is sequestered by court order and the order remains in effect for more than 60 days; or a petition is filed against the Company or any Subsidiary under any bankruptcy, reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law of any jurisdiction, whether now or subsequently in effect, and is not dismissed within 60 days after filing;

(f) Voluntary Bankruptcy Proceedings, Etc.--the Company or any Subsidiary files a voluntary petition in bankruptcy or seeking relief under any provision of any bankruptcy, reorganization, arrangement, insolvency, readjustment of debt, dissolution or liquidation law of any jurisdiction, whether now or subsequently in effect; or consents to the filing of any petition against it under any such law; or consents to the appointment of or taking possession by a custodian, receiver, trustee or liquidator of the Company, or a Subsidiary, or of all or any part of the Property of either; or makes an assignment for the benefit of its creditors;

(g) Warranties or Representations--any warranty, representation or other statement by or on behalf of the Company contained in this Agreement or in any document, certificate or instrument furnished in compliance with or in reference to this Agreement shall prove to have been false or misleading in any material respect on the date as of which it was made; or

(h) Undischarged Final Judgments--a final judgment for the payment of money is outstanding against one or more of the Company and its Subsidiaries and has been outstanding for more than 60 days from the date of its entry and has not been discharged in full or effectively stayed.

*Section 5.2 Default Remedies.*

(a) Acceleration--If an Event of Default of the type described in Sections 5.1(e) or 5.1(f) shall occur, the entire outstanding principal amount of the Notes shall automatically become due and payable, without the taking of any action on the part of any holder of the Notes or any other Person and without the giving of any notice with respect thereto. If an Event of Default of the type described in Section 5.1(a) exists, any holder of Notes may, at its option, exercise any right, power or remedy permitted by law, including the right, by notice to the Company, to declare the Notes held by such holder to be immediately due and payable. If any other Event of Default exists, the holder or holders of at least 66-2/3% in outstanding principal amount of the Notes (exclusive of Notes owned by the Company, Subsidiaries and Affiliates) may, at its or their option, exercise any right, power or remedy permitted by law, including the right, by notice to the Company, to declare all the outstanding Notes to be immediately due and payable. Upon each such acceleration, the principal of the Notes declared due or automatically becoming due shall be immediately payable, together with all accrued interest and the Make Whole Amount, if any, applicable thereto, and the Company will immediately make payment, without any presentment, demand, protest or other notice of any kind, all of which are hereby expressly waived.

No course of dealing or delay or failure to exercise any right on the part of any holder of the Notes shall operate as a waiver of such right or otherwise prejudice such holder's rights, powers or remedies. The Company will pay or reimburse the holders of the Notes for all costs and expenses (including reasonable attorneys' fees) incurred by them in collecting any sums due on the Notes or in otherwise enforcing any of their rights.

(b) Annulment of Acceleration--In the event of each declaration or automatic acceleration pursuant to Section 5.2(a), the holder or holders of at least 75% of the outstanding principal amount of the Notes (exclusive of Notes owned by the Company, Subsidiaries and Affiliates) may annul such declaration or automatic acceleration and its consequences if no judgment or decree has been entered for the payment of any amount due pursuant to such declaration or automatic acceleration and if all sums payable under the Notes and under this Agreement (except any principal or interest on the Notes which has become payable solely by reason of such declaration or automatic acceleration) shall have been duly paid.

*Section 5.3 Other Remedies.*

If any Event of Default or Default shall occur and be continuing, the holder of any Note may proceed to protect and enforce its rights under this Agreement and such Note by exercising such remedies as are available to such holder in respect thereof under applicable law, either by suit in equity or by action at law, or both, whether for specific performance of any covenant or other agreement contained in this Agreement or in aid of the exercise of any power granted in this Agreement. No remedy conferred in this Agreement upon any Purchaser or any other holder of any Note is intended to be exclusive of any other remedy, and each and every such remedy shall be cumulative and shall be in addition to every other remedy conferred herein or now or hereafter existing at law or in equity or by statute or otherwise.

## SECTION 6. REPRESENTATIONS, COVENANTS AND WARRANTIES

The Company represents, covenants and warrants as follows:

### *Section 6.1 Organization, Etc.*

(a) Due Organization, Foreign Qualifications, Stock Ownership. The Company is a corporation duly organized and existing in good standing under the laws of the State of Delaware, and is qualified to do business and is in good standing in the States of Florida and Maryland, which are the only jurisdictions where the ownership by it of property or the nature of the business conducted by it makes such qualification necessary. Each Subsidiary of the Company is duly organized and existing in good standing under the laws of the jurisdictions in which it is incorporated. Neither the ownership by any Subsidiary of property or the nature of the business conducted by any Subsidiary requires any Subsidiary to be qualified to do business in any jurisdiction in which it is not already qualified to do business. The names of the Subsidiaries of the Company and the jurisdiction of incorporation of such (i) as of the date of this Agreement are listed on Schedule 6.1(a) hereto, and (ii) as of the date upon when this representation is repeated as provided in Section 1.4(d), as such Schedule may have been updated by the delivery by the Company to the Purchasers of an updated version thereof on or before such date.

(b) Power and Authority. The Company and each of its Subsidiaries has all requisite corporate power to conduct their respective businesses as currently conducted and as currently proposed to be conducted. The Company has all requisite corporate power to execute, deliver and perform its obligations under this Agreement and the Notes. The execution, delivery and performance of the obligations of the Company under this Agreement and the Notes have been duly authorized by all requisite corporate action on the part of the Company. The Company has duly executed and delivered this Agreement, and this Agreement constitutes the legal, valid and binding obligation of the Company, enforceable against the Company in accordance with its terms subject, as to enforceability, to applicable laws relating to bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditor's rights generally and subject to general principles of equity. As of the Closing Date, the Company shall have duly executed and delivered the Notes being issued on such Closing Date, and such Notes shall be the legal, valid and binding obligations of the Company enforceable against the Company in accordance with their terms subject, as to enforceability, to applicable laws relating to bankruptcy, insolvency, reorganization, moratorium, or other similar laws affecting creditor's rights generally and subject to general principles of equity.

### *Section 6.2 Financial Statements.*

The Company has furnished each Purchaser with the following financial statements, identified by a principal financial officer of the Company: (i) a consolidated balance sheet of the Company and its Subsidiaries as at December 31 in each of the five fiscal years of the Company most recently completed prior to the date as of which this representation is made or repeated as provided in Section 1.4(d) (other than fiscal years completed within 90 days prior to such date for which audited financial statements have not been released) and consolidated statements of income, stockholders' equity and cash flows of the Company and its Subsidiaries for each such

year, accompanied by the opinion thereon of PricewaterhouseCoopers, L.L.P. (or, in the case of financial statements delivered subsequent to the date of this Agreement, accompanied by the opinion thereon of a registered public accounting firm of national standing); and (ii) a consolidated balance sheet of the Company and its Subsidiaries as at the end of each quarterly period ended after December 30, 2004 and prior to the date this representation is made or repeated as provided in Section 1.4(d) (other than quarterly periods completed within 45 days prior to such date for which financial statements have not been released) and consolidated statements of income, stockholders' equity and cash flows for the year-to-date periods ended on each such date, prepared by the Company. Such financial statements (including any related schedules and/or notes) are true and correct in all material respects (subject, as to interim statements, to changes resulting from audits and year-end adjustments), have been prepared in accordance with generally accepted accounting principles consistently followed throughout the periods involved and show all liabilities, direct and contingent, of the Company and its Subsidiaries required to be shown in accordance with such principles. The balance sheets fairly present the condition of the Company and its Subsidiaries as at the dates thereof, and the statements of income, stockholders' equity and cash flows fairly present the results of the operations of the Company and its Subsidiaries and their cash flows for the periods indicated. There has been no material adverse change in the business, condition (financial or otherwise) or operations of the Company and its Subsidiaries taken as a whole since December 31, 2004.

#### *Section 6.3 Actions Pending.*

Except as disclosed in the Company's Form 10-K most recently filed with the Securities and Exchange Commission before the date of this Agreement or subsequent Forms 10-Q or Forms 8-K filed with the Securities and Exchange Commission before the date of this Agreement, there is no action, suit, investigation or proceeding pending or, to the knowledge of the Company, threatened against the Company or any of its Subsidiaries, or any properties or rights of the Company or any of its Subsidiaries, by or before any court, arbitrator or administrative or governmental body not covered by insurance which could reasonably be expected to result in any material adverse change in the business, condition (financial or otherwise) or operations of the Company and its Subsidiaries taken as a whole.

#### *Section 6.4 Outstanding Indebtedness.*

Neither the Company nor any of its Subsidiaries has outstanding any Indebtedness except as permitted by Section 4.6. There does not exist any default under the provisions of any instrument evidencing such Debt or of any agreement relating thereto.

#### *Section 6.5 Title to Properties.*

The Company has and each of its Subsidiaries has good and marketable title to its respective real properties (other than properties which it leases) and good title to all of its other respective properties and assets, including the properties and assets reflected in the balance sheet as of December 31, 2004 referred to in Section 6.2 (other than properties and assets disposed of in the ordinary course of business), subject to no Lien of any kind except Liens permitted by Section 4.8. All leases necessary in any material respect for the conduct of the respective

businesses of the Company and its Subsidiaries are valid and subsisting and are in full force and effect.

*Section 6.6 Taxes.*

The Company has and each of its Subsidiaries has filed all federal, state and other income tax returns which, to the knowledge of the officers of the Company, are required to be filed, and each has paid all taxes as shown on such returns and on all assessments received by it to the extent that such taxes have become due, except such taxes as are being contested in good faith by appropriate proceedings for which adequate reserves have been established in accordance with generally accepted accounting principles.

*Section 6.7 Conflicting Agreements and Other Matters.*

Neither the execution nor delivery of this Agreement or the Notes, nor the offering, issuance and sale of the Notes, nor fulfillment of nor compliance with the terms and provisions hereof and of the Notes will conflict with, or result in a breach of the terms, conditions or provisions of, or constitute a default under, or result in any violation of, or result in the creation of any Lien upon any of the properties or assets of the Company or any of its Subsidiaries pursuant to, the charter or by-laws of the Company or any of its Subsidiaries, any award of any arbitrator or any agreement (including any agreement with stockholders), instrument, order, judgment, decree, statute, law, rule or regulation to which the Company or any of its Subsidiaries is subject. Neither the Company nor any of its Subsidiaries is a party to, or otherwise subject to any provision contained in, any instrument evidencing Indebtedness of the Company or such Subsidiary, any agreement relating thereto or any other contract or agreement (including its charter) which limits the amount of, or otherwise imposes restrictions on the incurring of, Debt of the Company of the type to be evidenced by the Notes except as set forth in the agreements listed in Schedule 6.7 attached hereto.

*Section 6.8 Offering of Notes.*

Neither the Company nor any agent acting on its behalf has, directly or indirectly, offered the Notes or any similar security of the Company for sale to, or solicited any offers to buy the Notes or any similar security of the Company from, or otherwise approached or negotiated with respect thereto with, any Person other than institutional investors, and neither the Company nor any agent acting on its behalf has taken or will take any action which would subject the issuance or sale of the Notes to the provisions of Section 5 of the Securities Act or to the provisions of any securities or Blue Sky law of any applicable jurisdiction.

*Section 6.9 ERISA.*

No accumulated funding deficiency (as defined in section 302 of ERISA and section 412 of the Code), whether or not waived, exists with respect to any Pension Plan (other than a Multiemployer Plan). No liability to the Pension Benefit Guaranty Corporation has been or is expected by the Company or any ERISA Affiliate to be incurred with respect to any Pension Plan (other than a Multiemployer Plan) by the Company, any Subsidiary or any ERISA Affiliate which is or would be materially adverse to the business, condition (financial or otherwise) or operations of the Company and its Subsidiaries taken as a whole. Neither the Company, any



Subsidiary nor any ERISA Affiliate has incurred or presently expects to incur any withdrawal liability under Title IV of ERISA with respect to any Multiemployer Plan which is or would be materially adverse to the business, condition (financial or otherwise) or operations of the Company and its Subsidiaries taken as a whole. The execution and delivery of this Agreement and the issuance and sale of the Notes will be exempt from, or will not involve any transaction which is subject to, the prohibitions of section 406 of ERISA and will not involve any transaction in connection with which a penalty could be imposed under section 502(i) of ERISA or a tax could be imposed pursuant to section 4975 of the Code. The representation by the Company in the next preceding sentence is made in reliance upon and subject to the accuracy of each Purchaser's representation in Section 9.5.

*Section 6.10 Governmental Consent.*

Neither the nature of the Company or of any Subsidiary, nor any of their respective businesses or properties, nor any relationship between the Company or any Subsidiary and any other Person, nor any circumstance in connection with the offering, issuance, sale or delivery of the Notes is such as to require any authorization, consent, approval, exemption or other action by or notice to or filing with any court or administrative or governmental body, including, without limitation, the Maryland State Commission, (other than routine filings after the date of closing with the Securities and Exchange Commission and/or state Blue Sky authorities, if any) in connection with the execution and delivery of this Agreement, the offering, issuance, sale or delivery of the Notes or fulfillment of or compliance with the terms and provisions hereof or of the Notes, other than (a) Order No. 6708 of the Public Service Commission of the State of Delaware entered in PSC Docket No. 05-290 dated September 6, 2005, which order has been duly issued, is final and in full force and effect, no appeal, review or contest thereof is pending and the time for appeal or to seek review or reconsideration thereof has expired, and (b) an order of the Florida Public Service Commission. The Company has delivered to each Purchaser true and complete copies of such order of the Public Service Commission of the State of Delaware and, prior to the Closing Date, the Company will have delivered to each Purchaser a true and complete copy of such order of Florida Public Service Commission.

*Section 6.11 Environmental Compliance.*

Except as disclosed in the Company's Form 10-K most recently filed with the Securities and Exchange Commission before the date of this Agreement or subsequent Forms 10-Q or Forms 8-K filed with the Securities and Exchange Commission before the date of this Agreement, the Company and its Subsidiaries and all of their respective properties and facilities have complied at all times and in all respects with all federal, state, local and regional statutes, laws, ordinances and judicial or administrative orders, judgments, rulings and regulations relating to protection of the environment except, in any such case, where failure to comply would not reasonably be expected to result in a material adverse effect on the business, condition (financial or otherwise) or operations of the Company and its Subsidiaries taken as a whole.

*Section 6.12 Permits and Other Operating Rights.*

The Company and each of its Subsidiaries has all such valid and sufficient franchises, licenses, permits, operating rights, certificates of convenience and necessity, other authorizations

from federal, state, regional, municipal and other local regulatory bodies or administrative agencies or other governmental bodies having jurisdiction over the Company or any of its Subsidiaries or any of its respective properties, easements and rights-of-way as are necessary for the ownership, operation and maintenance of its respective businesses and respective properties, subject to minor exceptions and deficiencies which do not materially affect its business and operations considered as a whole or any material part thereof, and neither the Company nor any of its Subsidiaries is in violation of any thereof in any material respect.

*Section 6.13 Disclosure.*

Neither this Agreement nor any other document, certificate or statement furnished to any Purchaser by or on behalf of the Company in connection herewith contains any untrue statement of a material fact or omits to state a material fact necessary in order to make the statements contained herein and therein not misleading. There is no fact peculiar to the Company or any of its Subsidiaries which materially adversely affects or in the future may (so far as the Company can now foresee) materially adversely affect the business, property or assets, or financial condition of the Company or any of its Subsidiaries taken as a whole and which has not been set forth in this Agreement or in the other documents, certificates and statements furnished to each Purchaser by or on behalf of the Company prior to the date hereof in connection with the transactions contemplated hereby.

*Section 6.14 Regulatory Status of Company; Trust Indenture Act.*

The Company is not an “investment company” or a company “controlled” by an “investment company,” within the meaning of the Investment Company Act of 1940, as amended. The Company is not a “holding company” or a “subsidiary company” or an “affiliate” of a “holding company” within the meaning of the Public Utility Holding Company Act of 1935, as amended, or the Energy Policy Act of 2005, and is not a “public utility” within the meaning of the Federal Power Act, as amended. By purchasing the Notes, no Purchaser will be (a) a “public utility company,” a “holding company” or an “affiliate” of a “holding company” or a “subsidiary company” of a “holding company” within the meaning of the Public Utility Holding Company Act of 1935, as amended, or the Energy Policy Act of 2005, (b) a “transmitting utility” or an “electric utility” within the meaning of the Federal Power Act, as amended, (c) a “public utility” or an “electric utility” under Delaware law, Florida law, Maryland law or the law of any other state or (d) subject to the jurisdiction of the Federal Energy Regulatory Commission, the Public Service Commission of the State of Delaware, the Public Service Commission of the State of Florida or any other commission or person in any other state.

*Section 6.15. Foreign Assets Control Regulations, Etc.*

(a) The use of the proceeds of the sale of the Notes by the Company hereunder will not violate the Trading with the Enemy Act, as amended, or any of the foreign assets control regulations of the United States Treasury Department (31 CFR, Subtitle B, Chapter V, as amended) or any enabling legislation or executive order relating thereto.

(b) Neither the Company nor any Subsidiary (i) is a Person described or designated in the Specially Designated Nationals and Blocked Persons List of the Office of Foreign Assets

Control or in Section 1 of the Anti-Terrorism Order or (ii) to its knowledge, engages in any dealings or transactions with any such Person. The Company and its Subsidiaries are in compliance, in all material respects, with the USA Patriot Act.

(c) No part of the proceeds from the sale of the Notes hereunder will be used, directly or indirectly, for any payments to any governmental official or employee, political party, official of a political party, candidate for political office, or anyone else acting in an official capacity, in order to obtain, retain or direct business or obtain any improper advantage, in violation of the United States Foreign Corrupt Practices Act of 1977, as amended.

*Section 6.16. First Mortgage Indenture.*

No Bonds are outstanding. The First Mortgage Indenture has been terminated and discharged and no further Bonds may be issued thereunder.

SECTION 7. INTERPRETATION OF THIS AGREEMENT

*Section 7.1 Terms Defined.*

As used in this Agreement (including Exhibits and Schedules), the following terms have the respective meanings set forth below or in the Section indicated. Unless the context otherwise requires, (a) words denoting the singular number only shall include the plural and vice versa and (b) references to a gender shall include all genders.

Affiliate--means a Person (other than a Subsidiary) (1) which directly or indirectly controls, or is controlled by, or is under common control with, the Company, (2) which owns 5% or more of the Voting Stock of the Company or (3) 5% or more of the Voting Stock (or in the case of a Person which is not a corporation, 5% or more of the equity interest) of which is owned by the Company or a Subsidiary. The term "control" means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of Voting Stock, by contract or otherwise.

Agreement--means this Note Agreement dated as of October 18, 2005 between the Company and each Purchaser (including Exhibits and Schedules), as amended or modified from time to time.

Annual Principal Amortization Dates--means (i) if the Closing Date is prior to December 28, 2006, then the dates which are the 5<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup>, 8<sup>th</sup>, 9<sup>th</sup>, 10<sup>th</sup>, 11<sup>th</sup>, 12<sup>th</sup> and 13<sup>th</sup> annual anniversary dates of the Closing Date, or (ii) if the Closing Date is on or after December 28, 2006, then December 28, 2011, December 28, 2012, December 28, 2013, December 28, 2014, December 28, 2015, December 28, 2016, December 28, 2017, December 28, 2018 and December 28, 2019.

Anti-Terrorism Order--means Executive Order No. 13,224 of September 24, 2001, Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit or Support Terrorism, 66 U.S. Fed. Reg. 49, 079 (2001), as amended.

Bonds--has the meaning that was specified in the First Mortgage Indenture.

Business Day--means any day other than a Saturday, a Sunday or a day on which commercial banks in New York City are required or authorized to be closed.

Called Principal--means, with respect to any Note, the principal of such Note that is to be prepaid pursuant to Section 2.2(a) or is declared to be due and payable pursuant to Section 2.1(b) or 5.2(a), as the context requires.

Cancellation Date--Section 2.6.

Cancellation Fee--Section 2.6.

Closing Date--means (i) except as otherwise provided in clause (ii) of this definition, the Business Day prior to December 28, 2006 specified as the "Closing Date" in a notice given to the Purchasers by the Company no less than 10 Business Days prior to and no more than 25 Business Days prior to the date so specified in such notice as the Closing Date, or (ii) if (a) the Company has provided a notice of a Closing Date pursuant to clause (i) of this definition but the Company fails to tender to any Purchaser the Notes to be purchased by such Purchaser on such Closing Date or any of the conditions specified in Section 1.4 shall not have been fulfilled on such Closing Date, or (b) the Company has not provided a notice of a Closing Date pursuant to clause (i) of this definition prior to November 29, 2006, then December 28, 2006, or, if the closing of the purchase and sale of the Notes is rescheduled pursuant to Section 2.4, the Rescheduled Closing Date. The Company may give only one notice pursuant to clause (i) of this definition and any additional notices that may be given by the Company shall be ineffective.

Code--means the Internal Revenue Code of 1986, as amended.

Confidential Information--means information delivered to any Purchaser by or on behalf of the Company or any Subsidiary in connection with the transactions contemplated by or otherwise pursuant to this Agreement that is proprietary in nature and that was clearly marked or labeled or otherwise adequately identified when received by such Purchaser as being confidential information of the Company or such Subsidiary, provided that such term does not include information that (a) was publicly known or otherwise known to such Purchaser prior to the time of such disclosure, (b) subsequently becomes publicly known through no act or omission by such Purchaser or any person acting on such Purchaser's behalf, (c) otherwise becomes known to such Purchaser other than through disclosure by the Company or any Subsidiary or (d) constitutes financial statements delivered to such Purchaser under Section 3.1 that are otherwise publicly available.

Company--Preamble.

Consolidated Fixed Charges--for any period, means the net amount deducted, in determining Consolidated Net Income for such period, for interest on Indebtedness and lease rental expense of the Company and its Subsidiaries.

Consolidated Net Earnings Available for Fixed Charges--for any period, means Consolidated Net Income for such period plus the net amount deducted in the determination thereof for (i) interest on Indebtedness, (ii) lease rental expense and (iii) income taxes.

Consolidated Net Income--for any period, means the gross revenue of the Company and its Subsidiaries determined on a consolidated basis minus all proper expenses (including income taxes) determined on a consolidated basis for such period, but in any event excluding:

- (1) any gain or loss on the sale of Investments or fixed assets, and any taxes on such excluded gain or loss;
- (2) any proceeds from life insurance;
- (3) any portion of the net earnings of any Subsidiary which for any reason is unavailable to pay dividends to the Company or any other Subsidiary;
- (4) any gain arising from any write-up or reappraisal of assets;
- (5) any deferred or other credit representing the excess of equity of an acquired Person over the amount invested by the Company and its Subsidiaries in such Person;
- (6) any gain arising from the acquisition of any Securities of the Company or any Subsidiary;
- (7) net earnings of any Person (other than a Subsidiary) in which the Company or any Subsidiary has an ownership interest unless those net earnings have actually been received by the Company or the Subsidiary in the form of cash distributions or, to the extent of their fair market value, in the form of any other freely transferable Property; and
- (8) earnings of any Person accrued prior to the date it becomes a Subsidiary or its assets are acquired by the Company or a Subsidiary.

Consolidated Net Worth--means as of any date, the sum of the amounts that would be shown on a consolidated balance sheet of the Company and its Subsidiaries at such date for (i) capital stock, (ii) capital surplus and (iii) retained earnings.

Consolidated Tangible Net Worth--means as of any date Consolidated Net Worth at such date minus the amount at which any assets other than Tangible Assets would be shown on a consolidated balance sheet of the Company and its Subsidiaries at such date.

Consolidated Total Assets--means as of any date the aggregate amount at which the assets of the Company and its Subsidiaries would be shown on a consolidated balance sheet at such date.

Current Indebtedness--with respect to any Person, means all liabilities for borrowed money and all liabilities secured by any Lien existing on Property owned by that Person (whether or not those liabilities have been assumed) which, in either case, are payable on demand or within one year from their creation, plus the aggregate amount of Guaranties by that Person of all such liabilities of other Persons, except:

- (1) any liabilities which are renewable or extendible at the option of the debtor to a date more than one year from the date of creation thereof; and
- (2) any liabilities which, although payable within one year, constitute principal payments on indebtedness expressed to mature more than one year from the date of its creation.

Default--means an event or condition which will, with the lapse of time or the giving of notice or both, become an Event of Default.

Defined Benefit Plan--means a plan (within the meaning of section 4001(a)(15) of ERISA) that is covered by Title IV of ERISA.

Delayed Delivery Fee--Section 2.5.

Discounted Value--means, with respect to the Called Principal of any Note, the amount obtained by discounting all Remaining Scheduled Payments with respect to such Called Principal from their respective scheduled due dates to the Settlement Date with respect to such Called Principal, in accordance with accepted financial practice and at a discount factor (as converted to reflect the periodic basis on which interest on such Note is payable, if interest is payable other than on a semi-annual basis) equal to the Reinvestment Yield with respect to such Called Principal.

Diversification Event--Section 2.1(b).

Energy Policy Act of 2005--means the Energy Policy Act of 2005.

ERISA--means the Employee Retirement Income Security Act of 1974, as amended.

ERISA Affiliate-- shall mean any corporation which is a member of the same controlled group of corporations as the Company within the meaning of section 414(b) of the Code, or any trade or business which is under common control with the Company within the meaning of section 414(b) of the Code.

Event of Default--Section 5.1.

Exchange Act--means the Securities Exchange Act of 1934, as amended.

Excluded Assets-- means (i) each of the following Subsidiaries or the assets of any of the following Subsidiaries: Sharp Water, Inc.; Sam Shannahan Well Co., Inc.; Sharp Water of Minnesota, Inc.; Sharp Water of Idaho, Inc.; BravePoint, Inc.; Skipjack, Inc.; Eastern Shore Real Estate, Inc.; aQuality Company, Inc.; Peninsula Pipeline Company, Inc.; Peninsula Energy Services Company, Inc.; and OnSight Energy LLC and (ii) any Subsidiary that the Company may create or acquire after the date hereof which is not (x) a "public utility company," a "holding company" or an "affiliate" of a "holding company" or a "subsidiary company" of a "holding company" within the meaning of the Public Utility Holding Company Act of 1935, as amended, or the Energy Policy Act of 2005 or (y) a "transmitting utility" within the meaning of the Federal Power Act, as amended.

FERC--means the Federal Energy Regulatory Commission or a successor thereto.

Financing Lease--means any lease which is shown or is required to be shown in accordance with generally accepted accounting principles as a liability on a balance sheet of the lessee thereunder.

Financing Lease Obligation--means the obligation of the lessee under a Financing Lease. The amount of a Financing Lease Obligation at any date is the amount at which the lessee's liability under the Lease would be required to be shown on its balance sheet at such date.

First Mortgage Indenture--means the Indenture formerly in effect dated as of December 1, 1959, between Chesapeake Utilities Corporation and Fidelity-Baltimore National Bank, Trustee, as amended and supplemented.

Funded Indebtedness--with respect to any Person, means without duplication:

- (1) its liabilities for borrowed money, other than Current Indebtedness;
- (2) liabilities secured by any Lien existing on Property owned by the Person (whether or not those liabilities have been assumed);
- (3) the aggregate amount of Guaranties by the Person, other than Guaranties which constitute Current Indebtedness; and
- (4) its Financing Lease Obligations.

Guaranty--with respect to any Person, means all guaranties of, and all other obligations which in effect guaranty, any indebtedness, dividend or other obligation of any other Person (the "primary obligor") in any manner (except any indebtedness or other obligation of any Subsidiary or any Funded Indebtedness of the Company), including obligations incurred through an agreement, contingent or otherwise, by such Person:

- (1) to purchase such indebtedness or obligation or any Property constituting security therefor;
- (2) to advance or supply funds
  - (A) for the purchase or payment of such indebtedness or obligation, or
  - (B) to maintain working capital or any balance sheet or income statement condition;
  - (C) to lease Property, or to purchase Securities or other Property or services, primarily for the purpose of assuring the owner of such indebtedness or obligation of the ability of the primary obligor to make payment of the indebtedness or obligation; or

- (D) otherwise to assure the owner of such indebtedness or obligation, or the primary obligor, against loss;

but excluding endorsements in the ordinary course of business of negotiable instruments for deposit or collection.

The amount of any Guaranty shall be deemed to be the maximum amount for which such Person may be liable, upon the occurrence of any contingency or otherwise, under or by virtue of the Guaranty.

Hedge Treasury Note(s)--means, with respect to any Note, the United States Treasury Note or Notes whose duration (as determined by Prudential) most closely matches the duration of such Note.

Indebtedness--means Current Indebtedness and Funded Indebtedness.

Institutional Holder--means a "qualified institutional buyer" as defined in Regulation 230.144A issued pursuant to the Securities Act of 1933, as amended.

Investments--Section 4.13.

Lien--means any interest in Property securing an obligation owed to, or a claim by, a Person other than the owner of the Property, whether the interest is based on common law, statute or contract (including the security interest lien arising from a mortgage, encumbrance, pledge, conditional sale or trust receipt or a lease, consignment or bailment for security purposes). The term "Lien" shall not include minor reservations, exceptions, encroachments, easements, rights-of-way, covenants, conditions, restrictions and other minor title exceptions affecting Property, provided that they do not constitute security for a monetary obligation. For the purposes of this Agreement, the Company or a Subsidiary shall be deemed to be the owner of any Property which it has acquired or holds subject to a Financing Lease or a conditional sale agreement or other arrangement pursuant to which title to the Property has been retained by or vested in some other Person for security purposes, and such retention or vesting shall be deemed to be a Lien.

Make Whole Amount--means, with respect to any Note, an amount equal to the excess, if any, of the Discounted Value of the Called Principal of such Note over the sum of (i) such Called Principal plus (ii) interest accrued thereon as of (including interest due on) the Settlement Date with respect to such Called Principal. The Make Whole Amount shall in no event be less than zero.

Maturity Date--means (i) if the Closing Date is prior to December 28, 2006, then the date which is the 14<sup>th</sup> annual anniversary date of the Closing Date, or (ii) if the Closing Date is on or after December 28, 2006, then December 28, 2020.

Notes--Section 1.1.



Pension Plan--means any "employee pension benefit plan" (as such term is defined in Section 3 of ERISA) maintained by the Company and its Related Persons, or in which employees of the Company or any Related Person are entitled to participate, as from time to time in effect.

Permitted Investments--means:

- (1) Investments in any Person outstanding on the date hereof, which are set forth in Schedule 7.1 hereto;
- (2) Investments in any Person which is or would immediately thereafter become a Subsidiary or a division of the Company or a Subsidiary, whether by acquisition of stock, indebtedness, other obligation or Security, or by loan, Guaranty, advance, capital contribution, or otherwise;
- (3) Investments in cash equivalent short-term investments maturing within one year of acquisition;
- (4) Investments in mutual funds which invest only in either money market securities or direct obligations of the United States of America or any of its agencies, or obligations fully guaranteed by the United States of America, which mature within three years from the date acquired;
- (5) Investments in related industries;
- (6) Direct obligations of the United States of America or any of its agencies, or obligations fully guaranteed by the United States of America, provided that such obligations mature within one year from the date acquired;
- (7) Negotiable certificates of deposit maturing within one year from the date acquired and issued by a bank or trust company organized under the laws of the United States or any of its states, and having capital, surplus and undivided profits aggregating at least \$100,000,000;
- (8) commercial paper rated A-1 or better by Standard & Poor's Corporation on the date of acquisition and maturing not more than 270 days from the date of creation thereof; and
- (9) other investments in an aggregate amount not in excess of 20% of Consolidated Net Worth at any one time.

Person--means an individual, partnership, corporation, limited liability company, trust or unincorporated organization, and a government or a governmental agency or political subdivision.

Prepayment Date--Section 2.2(b).

Process Agent--Section 7.4.

Property--means any interest in any kind of property or asset, whether real, personal or mixed, or tangible or intangible.

Prudential--means Prudential Investment Management, Inc.

PTE--Section 9.5.

Purchaser--Preamble.

Purchase Money Indebtedness--means Indebtedness of the Company which is secured by a Lien on Property of the Company which either existed at the time of the original acquisition of the Property by the Company or was granted or retained in connection with the acquisition or improvement of the Property by the Company in order to facilitate the financing of such acquisition or improvement.

Quarterly Interest Payment Date--means (i) if the Closing Date is prior to December 28, 2006, then each date which is a numerically corresponding date of the Closing Date in each 3<sup>rd</sup> month anniversary of the Closing Date in each year (provided that if there is no such numerically corresponding date in any such 3<sup>rd</sup> month, then the last date of such 3<sup>rd</sup> month), or (ii) if the Closing Date is on or after December 28, 2006, then each March 28, June 28, September 28 and December 28 in each year.

Reinvestment Yield--means, with respect to the Called Principal of any Note, 0.50% over the yield to maturity implied by (i) the yields reported as of 10:00 a.m. (New York City local time) on the Business Day next preceding the Settlement Date with respect to such Called Principal for actively traded U.S. Treasury securities having a maturity equal to the Remaining Average Life of such Called Principal as of such Settlement Date on the display designated as "Page PX1" on the Bloomberg Financial Services Screen (or such other display as may replace Page PX1 on the Bloomberg Financial Services Screen or, if Bloomberg Financial Services shall cease to report such yields or shall cease to be the customary source of information for calculating make-whole amounts on privately placed notes, then such source as is then the customary source of such information), or if such yields shall not be reported as of such time or the yields reported as of such time shall not be ascertainable, (ii) the Treasury Constant Maturity Series yields reported, for the latest day for which such yields shall have been so reported as of the Business Day next preceding the Settlement Date with respect to such Called Principal, in Federal Reserve Statistical Release H.15 (519) (or any comparable successor publication) for actively traded U.S. Treasury securities having a constant maturity equal to the Remaining Average Life of such Called Principal as of such Settlement Date. Such implied yield shall be determined, if necessary, by (a) converting U.S. Treasury bill quotations to bond equivalent yields in accordance with accepted financial practice and (b) interpolating linearly between yields reported for various maturities. The Reinvestment Yield shall be rounded to that number of decimal places as appears in the coupon of the applicable Note.

Related Person--means any Person (whether or not incorporated) which is under common control with the Company within the meaning of section 414(c) of the Internal Revenue Code of 1986, as amended, or of section 4001(b) of ERISA.

Remaining Average Life--means, with respect to the Called Principal of any Note, the number of years (calculated to the nearest one-twelfth year) obtained by dividing (i) such Called Principal into (ii) the sum of the products obtained by multiplying (a) each Remaining Scheduled Payment of such Called Principal (but not of interest thereon) by (b) the number of years (calculated to the nearest one-twelfth year) which will elapse between the Settlement Date with respect to such Called Principal and the scheduled due date of such Remaining Scheduled Payment.

Remaining Scheduled Payments--means, with respect to the Called Principal of any Note, all payments of such Called Principal and interest thereon that would be due on or after the Settlement Date with respect to such Called Principal if no payment of such Called Principal were made prior to its scheduled due date.

Required Payment Date--Section 2.1(b).

Rescheduled Closing Date--Section 2.4.

Restricted Payments--Section 4.9.

Security--shall have the same meaning as in Section 2(1) of the Securities Act of 1933, as amended.

Settlement Date--means, with respect to the Called Principal of any Note, the date on which such Called Principal is to be prepaid pursuant to Section 2.2(a) or is declared to be due and payable pursuant to Section 2.1(b) or 5.2(a), as the context requires.

Source--Section 9.5.

State Commissions--means the Delaware, Florida and Maryland public utilities commissions or other bodies which regulate the rates of the Company or its Subsidiaries as a natural gas distribution company or otherwise.

Subsidiary--means any corporation organized under the laws of any State of the United States of America, which conducts the major portion of its business in and makes the major portion of its sales to Persons located in the United States of America, and not less than 80% of the total combined voting power of all classes of Voting Stock, and 80% of all other equity securities, of which shall, at the time as of which any determination is being made, be owned by the Company either directly or through Subsidiaries.

Subsidiary Stock--Section 4.10.

Tangible Assets--means all assets except:

- (1) deferred assets, other than prepaid insurance and prepaid taxes;
- (2) patents, copyrights, trademarks, trade names, franchises, good will, experimental expense and other similar intangibles;

- (3) treasury stock;
- (4) unamortized debt discount and expense; and
- (5) assets located and notes and receivables due from obligors domiciled outside the United States of America or Canada.

Total Capitalization--means at any date, the aggregate amount at that date, as determined on a consolidated basis, of the Funded Indebtedness of the Company and its Subsidiaries, plus Consolidated Net Worth.

USA Patriot Act--means United States Public Law 107-56, Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001, as amended from time to time, and the rules and regulations promulgated thereunder from time to time in effect.

Voting Stock--means Securities, the holders of which are ordinarily, in the absence of contingencies, entitled to elect the corporate directors (or Persons performing similar functions).

Wholly-Owned Subsidiary--means any Subsidiary whose financial results are consolidated with the financial results of the Company, and all of the equity Securities of which (except director's qualifying shares) are owned by the Company and/or one or more Wholly-Owned Subsidiaries of the Company.

#### *Section 7.2 Accounting Principles.*

The character or amount of any asset or liability or item of income or expense required to be determined under this Agreement and each consolidation or other accounting computation required to be made under this Agreement, shall be determined or made in accordance with generally accepted accounting principles at the time in effect, to the extent applicable, except where such principles are inconsistent with the requirements of this Agreement.

#### *Section 7.3 Directly or Indirectly.*

Where any provision in this Agreement refers to any action which any Person is prohibited from taking, the provision shall be applicable whether the action is taken directly or indirectly by such Person, including actions taken by, or on behalf of, any partnership in which such Person is a general partner and all liabilities of such partnerships shall be considered liabilities of such Person under this Agreement.

#### *Section 7.4 Governing Law; Consent to Jurisdiction.*

This Agreement shall be construed and enforced in accordance with, and the rights of the parties shall be governed by, the law of the State of New York. The Company irrevocably agrees that any legal action or proceeding with respect to this Agreement or the Notes may be brought in the courts of the State of New York or any court of the United States of America located in the State of New York, and, by execution and delivery of this Agreement, the Company accepts for itself, generally and unconditionally, and agrees to submit to the

jurisdiction of each of the above-mentioned courts and irrevocably waives, to the fullest extent permitted by law, any objection which it may now or later have based on venue or *forum non conveniens* with respect to any action instituted therein. The Company hereby irrevocably appoints Corporation Service Company (the "Process Agent"), with an office on the date hereof at 80 State Street, 6th Floor, Albany, New York 12207-2543, United States, as its agent to receive, on the Company's behalf and on behalf of the Company's property, service of copies of the summons and complaint and any other process which may be served in any such action or proceeding. Such service may be made by mailing or delivering a copy of such process to the Company in care of the Process Agent at the Process Agent's above address, and the Company hereby irrevocably authorizes and directs the Process Agent to accept such service on its behalf.

## SECTION 8. PURCHASERS' SPECIAL RIGHTS

### *Section 8.1 Note Payment.*

The Company agrees that, so long as any Purchaser shall hold any Note, it will make payments of principal of, interest on and any Make Whole Amount payable with respect to such Note, which comply with the terms of this Agreement, by wire transfer of immediately available funds for credit (not later than 12:00 noon, New York City time, on the date due) to the account or accounts as specified in the Purchaser Schedule attached hereto or such other account or accounts in the United States as any Purchaser may designate in writing, notwithstanding any contrary provision herein or in any Note with respect to the place of payment. Each Purchaser agrees that, before disposing of any Note, such Purchaser will make a notation thereon (or on a schedule attached thereto) of all principal payments previously made thereon and of the date to which interest thereon has been paid. The Company agrees to afford the benefits of this paragraph 8.1 to any transferee of any Note which shall have made the same agreement as made in this paragraph 8.1.

### *Section 8.2 Issue Taxes.*

The Company will pay all issuance, stamp and similar taxes in connection with the issuance and sale of the Notes to the Purchasers and in connection with any modification of the Notes and will save each Purchaser harmless against any and all liabilities relating to such taxes. The obligations of the Company under this Section 8.2 shall survive the payment of the Notes and the termination of this Agreement.

### *Section 8.3 Registration of Notes.*

The Company will cause to be kept a register for the registration and transfer of the Notes. The names and addresses of the holders of the Notes, and all transfers of and the names and addresses of the transferees of any of the Notes, will be registered in the register. The Person in whose name any Note is registered shall be deemed and treated as the owner thereof for all purposes of this Agreement, and the Company shall not be affected by any notice or knowledge to the contrary.

*Section 8.4 Exchange of Notes.*

Upon surrender of any Note to the Company, the Company, upon request, will execute and deliver at its expense (except as provided below), new Notes, in denominations of at least \$1,000,000 (or, if less, the outstanding principal amount of the surrendered Note), in an aggregate principal amount equal to the outstanding principal amount of the surrendered Note. Each new Note (a) shall be payable to any Person as the surrendering holder may request and (b) shall be dated and bear interest from the date to which interest has been paid on the surrendered Note or dated the date of the surrendered Note if no interest has been paid thereon. The Company may require payment of a sum sufficient to cover any stamp tax or governmental charge imposed in respect of any transfer.

*Section 8.5 Replacement of Notes.*

Upon receipt by the Company of evidence reasonably satisfactory to it (provided that if the holder of the Note is an Institutional Holder, its own certification shall be deemed to be satisfactory evidence) of the ownership of and the loss, theft, destruction or mutilation of any Note and

(a) in the case of loss, theft or destruction, of indemnity reasonably satisfactory to it (provided that if the holder of the Note is an Institutional Holder, its own agreement of indemnity shall be deemed to be satisfactory), or

(b) in the case of mutilation, upon surrender and cancellation of the Note,

the Company at its expense will execute and deliver a new Note, dated and bearing interest from the date to which interest has been paid on the lost, stolen, destroyed or mutilated Note or dated the date of the lost, stolen, destroyed or mutilated Note if no interest has been paid thereon.

SECTION 9. MISCELLANEOUS

*Section 9.1 Notices.*

(a) All notices, requests, demands or other communications under this Agreement or under the Notes will be in writing and will be given by telecopy, telex, first class registered or certified mail (postage prepaid) or personal delivery:

(i) if to Prudential or any holder of any Note, in the manner provided in the Purchaser Schedule or in any other manner as Prudential or such holder may have most recently advised the Company in writing, or

(ii) if to the Company, at its address shown at the beginning of this Agreement, or at any other address as it may have most recently furnished in writing to Prudential and each Purchaser and to all other holders of the Notes.

(b) Notice shall be deemed to be given upon the receipt thereof at the notice address specified.

*Section 9.2 Payments Due on Non-Business Days.*

Anything in this Agreement or the Note to the contrary notwithstanding, any payment of principal of or interest on any Note that is due on a date other than a Business Day shall be made on the next succeeding Business Day.

*Section 9.3 Reproduction of Documents.*

This Agreement and all related documents, including (a) consents, waivers and modifications which may subsequently be executed, (b) documents received by each Purchaser at the closing of each Purchaser's purchase of the Notes (except the Notes themselves), and (c) financial statements, certificates and other information previously or subsequently furnished to any Purchaser, may be reproduced by any Purchaser by any photographic, photostatic, microfilm, micro-card, miniature photographic or other similar process and any Purchaser may destroy any original document so reproduced. The Company agrees and stipulates that any such reproduction shall, to the extent permitted by applicable law, be admissible in evidence as the original itself in any judicial or administrative proceeding (whether or not the original is in existence and whether or not the reproduction was made by any Purchaser in the regular course of business) and that any enlargement, facsimile or further reproduction of the reproduction shall likewise be admissible in evidence.

*Section 9.4 Purchase for Investment.*

Each Purchaser represents to the Company that such Purchaser (i) is a "qualified institutional buyer" as defined by Rule 144A and (ii) is purchasing the Notes for its own account for investment or for resale under Rule 144A under the Securities Act of 1933, as amended, and with no present intention of distributing or reselling any of the Notes, but without prejudice to such Purchaser's right at all times to sell or otherwise dispose of all or part of the Notes under an effective registration statement under the Securities Act of 1933, as amended, or under a registration exemption available under that Act.

*Section 9.5 Source of Funds.*

Each Purchaser represents to the Company that at least one of the following statements is an accurate representation as to each source of funds (a "Source") to be used by such Purchaser to pay the purchase price of the Notes to be purchased by it hereunder:

- (a) the Source is an "insurance company general account" (as that term is defined in the United States Department of Labor's Prohibited Transaction Exemption ("**PTE**") 95-60) in respect of which the reserves and liabilities (as defined by the annual statement for life insurance companies approved by the National Association of Insurance Commissioners (the "**NAIC Annual Statement**")) for the general account contract(s) held by or on behalf of any employee benefit plan together with the amount of the reserves and liabilities for the general account contract(s) held by or on behalf of any other employee benefit plans maintained by the same employer (or affiliate thereof as defined in PTE 95-60) or by the same employee organization in the general account do not exceed 10% of the total reserves and liabilities of the general account (exclusive of

separate account liabilities) plus surplus as set forth in the NAIC Annual Statement filed with such Purchaser's state of domicile; or

(b) the Source is a separate account that is maintained solely in connection with such Purchaser's fixed contractual obligations under which the amounts payable, or credited, to any employee benefit plan (or its related trust) that has any interest in such separate account (or to any participant or beneficiary of such plan (including any annuitant)) are not affected in any manner by the investment performance of the separate account; or

(c) the Source is either (i) an insurance company pooled separate account, within the meaning of PTE 90-1, or (ii) a bank collective investment fund, within the meaning of the PTE 91-38 and, except as disclosed by such Purchaser to the Company in the writing most recently delivered pursuant to this clause (c) before the date the Company's representation in Section 6.9 is being made or repeated, no employee benefit plan or group of plans maintained by the same employer or employee organization beneficially owns more than 10% of all assets allocated to such pooled separate account or collective investment fund; or

(d) the Source constitutes assets of an "investment fund" (within the meaning of Part V of PTE 84-14 (the "**QPAM Exemption**")) managed by a "qualified professional asset manager" or "QPAM" (within the meaning of Part V of the QPAM Exemption), no employee benefit plan's assets that are included in such investment fund, when combined with the assets of all other employee benefit plans established or maintained by the same employer or by an affiliate (within the meaning of Section V(c)(1) of the QPAM Exemption) of such employer or by the same employee organization and managed by such QPAM, exceed 20% of the total client assets managed by such QPAM, the conditions of Part I(c) and (g) of the QPAM Exemption are satisfied, neither the QPAM nor a person controlling or controlled by the QPAM (applying the definition of "control" in Section V(e) of the QPAM Exemption) owns a 5% or more interest in the Company and (i) the identity of such QPAM and (ii) the names of all employee benefit plans whose assets are included in such investment fund have been disclosed to the Company in writing pursuant to this clause (d); or

(e) the Source constitutes assets of a "plan(s)" (within the meaning of Section IV of PTE 96-23 (the "**INHAM Exemption**")) managed by an "in-house asset manager" or "INHAM" (within the meaning of Part IV of the INHAM Exemption), the conditions of Part I(a), (g) and (h) of the INHAM Exemption are satisfied, neither the INHAM nor a person controlling or controlled by the INHAM (applying the definition of "control" in Section IV(h) of the INHAM Exemption) owns a 5% or more interest in the Company and (i) the identity of such INHAM and (ii) the name(s) of the employee benefit plan(s) whose assets constitute the Source have been disclosed to the Company in writing pursuant to this clause (e); or

(f) the Source is a governmental plan; or



(g) the Source is one or more employee benefit plans, or a separate account or trust fund comprised of one or more employee benefit plans, each of which has been identified to the Company in writing pursuant to this clause (g); or

(h) the Source does not include assets of any employee benefit plan, other than a plan exempt from the coverage of ERISA.

As used in this Section 9.5, the terms “**employee benefit plan**”, “**governmental plan**”, and “**separate account**” shall have the respective meanings assigned to such terms in Section 3 of ERISA.

*Section 9.6 Successors and Assigns.*

This Agreement shall inure to the benefit of and be binding upon the successors and assigns of each of the parties except that each Purchaser’s obligations to purchase the Notes (as provided in Section 1.2) shall be a right which is personal to the Company and such right shall not be transferable or assignable by the Company to any other Person (including successors at law) whether voluntarily or involuntarily. The provisions of this Agreement are intended to be for the benefit of all holders, from time to time, of the Notes, and shall be enforceable by any holder, whether or not an express assignment of rights under this Agreement has been made by any Purchaser or any Purchaser’s successor or assign.

*Section 9.7 Amendment and Waiver; Acquisition of Notes.*

(a) Amendment and Waiver. This Agreement may be amended, and the observance of any term of this Agreement may be waived, with (and only with) the written consent of the Company and the holders of at least 66-2/3% of the outstanding principal amount of the Notes (exclusive of Notes then owned by the Company, Subsidiaries and Affiliates), provided that no amendment or waiver of any of the provisions of Sections 1, 6 and 8 shall be effective as to any holder of the Notes unless consented to by such holder in writing, and provided further, that no amendment or waiver shall, without the written consent of the holders of all the outstanding Notes, (1) subject to Section 5.2(b), change the amount or time of any prepayment, payment of principal or premium or the rate or time of payment of interest, (2) amend Section 5, or (3) amend this Section 9.7(a). Executed or complete and correct copies of any amendment or waiver effected pursuant to the provisions of this Section 9.7(a) shall be delivered by the Company to each holder of outstanding Notes promptly following the date on which the same shall become effective.

(b) Acquisition of Notes. The Company will not, and will cause each Subsidiary and, insofar as it is within its power to do so, each Affiliate not to, directly or indirectly, acquire or make any offer to acquire any Notes unless the Company or such Subsidiary or Affiliate shall contemporaneously offer to acquire Notes, pro rata, from all holders of the Notes and upon the same terms. Any Notes acquired by the Company, any Subsidiary or any Affiliate shall not be considered outstanding for any purpose under this Agreement.

*Section 9.8 Duplicate Originals.*

Two or more duplicate originals of this Agreement may be signed by the parties, each of which shall be an original but all of which together shall constitute one and the same instrument.

*Section 9.9 Confidential Information.*

Each Purchaser shall maintain the confidentiality of such Confidential Information in accordance with procedures adopted by such Purchaser in good faith to protect confidential information of third parties delivered to such Purchaser, provided that such Purchaser may deliver or disclose Confidential Information to (a) its directors, officers, employees, agents, attorneys and affiliates (to the extent such disclosure reasonably relates to the administration of the investment represented by its Notes), (b) its financial advisors and other professional advisors who agree to hold confidential the Confidential Information substantially in accordance with the terms of this Section 9.9, (c) any other holder of any Note, (d) any Institutional Holder to which it sells or offers to sell such Note or any part thereof or any participation therein (if such Person has agreed in writing prior to its receipt of such Confidential Information to be bound by the provisions of this Section 9.9), (e) any Person from which it offers to purchase any security of the Company (if such Person has agreed in writing prior to its receipt of such Confidential Information to be bound by the provisions of this Section 9.9), (f) any federal or state regulatory authority having jurisdiction over such Purchaser, (g) the National Association of Insurance Commissioners or the Securities Valuation Office of the National Association of Insurance Commissioners (or any successor to such Office) or, in each case, any similar organization, or any nationally recognized rating agency that requires access to information about such Purchaser's investment portfolio, or (h) any other Person to which such delivery or disclosure may be necessary or appropriate (w) to effect compliance with any law, rule, regulation or order applicable to such Purchaser, (x) in response to any subpoena or other legal process, (y) in connection with any litigation to which such Purchaser is a party or (z) if an Event of Default has occurred and is continuing, to the extent such Purchaser may reasonably determine such delivery and disclosure to be necessary or appropriate in the enforcement or for the protection of the rights and remedies under such Purchaser's Notes and this Agreement. Each holder of a Note, by its acceptance of a Note, will be deemed to have agreed to be bound by and to be entitled to the benefits of this Section 9.9 as though it were a party to this Agreement. On reasonable request by the Company in connection with the delivery to any holder of a Note of information required to be delivered to such holder under this Agreement or requested by such holder (other than a holder that is a party to this Agreement or its nominee), such holder will enter into an agreement with the Company embodying the provisions of this Section 9.9.

[Signatures Follow]

If this Agreement is satisfactory to each Purchaser, please so indicate by signing the acceptance at the foot of a counterpart of this Agreement and return a counterpart to the Company, whereupon this Agreement will become binding between us in accordance with its terms.

Very truly yours,

**CHESAPEAKE UTILITIES CORPORATION**

By: Beth W. Cooper  
Name: Beth W. Cooper  
Title: Vice President, Treasurer and Secretary

Accepted:

**THE PRUDENTIAL INSURANCE COMPANY  
OF AMERICA**

By: \_\_\_\_\_  
Vice President

**PRUDENTIAL RETIREMENT INSURANCE  
AND ANNUITY COMPANY**

By: Prudential Investment Management, Inc.,  
as investment manager

By: \_\_\_\_\_  
Vice President

If this Agreement is satisfactory to each Purchaser, please so indicate by signing the acceptance at the foot of a counterpart of this Agreement and return a counterpart to the Company, whereupon this Agreement will become binding between us in accordance with its terms.

Very truly yours,

**CHESAPEAKE UTILITIES CORPORATION**

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


Accepted:

**THE PRUDENTIAL INSURANCE COMPANY  
OF AMERICA**

By:   
Vice President TPD

**PRUDENTIAL RETIREMENT INSURANCE  
AND ANNUITY COMPANY**



By: Prudential Investment Management, Inc.,  
as investment manager

By:   
Vice President TPD

**UNITED OF OMAHA LIFE INSURANCE COMPANY**

By: Prudential Private Placement Investors, L.P.  
(as Investment Advisor)

By: Prudential Private Placement Investors, Inc.  
(as its General Partner)

By:   
Vice President 

**PURCHASER SCHEDULE**  
**Chesapeake Utilities Corporation**  
**5.50% Senior Notes**

	<b><u>Aggregate Principal Amount of Notes to be Purchased</u></b>	<b><u>Note Denomination(s)</u></b>
<b>THE PRUDENTIAL INSURANCE COMPANY OF AMERICA</b>	<b>\$12,450,000</b>	\$6,000,000 \$6,450,000

- (1) All payments on account of Notes held by such purchaser shall be made by wire transfer of immediately available funds for credit to:

Account No.: P86188 (please do not include spaces) (in the case of payments on account of the Note originally issued in the principal amount of \$6,000,000)

Account No.: P86189 (please do not include spaces) (in the case of payments on account of the Note originally issued in the principal amount of \$6,450,000)

JPMorgan Chase Bank  
New York, NY  
ABA No.: 021-000-021

Each such wire transfer shall set forth the name of the Company, a reference to "5.50% Senior Notes, Security No. INV00925, PPN \_\_\_\_" and the due date and application (as among principal, interest and Make-Whole Amount) of the payment being made.

- (2) Address for all notices relating to payments:

The Prudential Insurance Company of America  
c/o Investment Operations Group  
Gateway Center Two, 10th Floor  
100 Mulberry Street  
Newark, NJ 07102-4077

Attention: Manager, Billings and Collections

(3) Address for all other communications and notices:

The Prudential Insurance Company of America  
c/o Prudential Capital Group  
2200 Ross Avenue, Suite 4200E  
Dallas, TX 75201

Attention: Managing Director

(4) Recipient of telephonic prepayment notices:

Manager, Trade Management Group

Telephone: (973) 367-3141  
Facsimile: (800) 224-2278

(5) Address for Delivery of Notes:

Send physical security by nationwide overnight delivery  
service to:

Prudential Capital Group  
2200 Ross Avenue, Suite 4200E  
Dallas, TX 75201

Attention: Thomas P. Donahue  
Telephone: (214) 720-6202

(6) Tax Identification No.: 22-1211670

	<b><u>Aggregate Principal Amount of Notes to be Purchased</u></b>	<b><u>Note Denomination(s)</u></b>
<b>PRUDENTIAL RETIREMENT INSURANCE AND ANNUITY COMPANY</b>	<b>\$4,000,000</b>	<b>\$4,000,000</b>

- (1) All payments on account of Notes held by such purchaser shall be made by wire transfer of immediately available funds for credit to:

JP Morgan Chase Bank  
 New York, NY  
 ABA No. 021000021  
 Account No. P86327 (please do not include spaces)

Each such wire transfer shall set forth the name of the Company, a reference to "5.50% Senior Notes, Security No. INV00925, PPN \_\_\_\_\_" and the due date and application (as among principal, interest and Make-Whole Amount) of the payment being made.

- (2) Address for all notices relating to payments:

Prudential Retirement Insurance and Annuity Company  
 c/o Prudential Investment Management, Inc.  
 Private Placement Trade Management  
 PRIAC Administration  
 Gateway Center Four, 7th Floor  
 100 Mulberry Street  
 Newark, NJ 07102

Telephone: (973) 802-8107  
 Facsimile: (800) 224-2278



(3) Address for all other communications and notices:

Prudential Retirement Insurance and Annuity Company  
c/o Prudential Capital Group  
2200 Ross Avenue, Suite 4200E  
Dallas, TX 75201

Attention: Managing Director

(4) Address for Delivery of Notes:

Send physical security by nationwide overnight delivery  
service to:

Prudential Capital Group  
2200 Ross Avenue, Suite 4200E  
Dallas, TX 75201

Attention: Thomas P. Donahue  
Telephone: (214) 720-6202

(5) Tax Identification No.: 06-1050034

<u>Aggregate Principal Amount of Notes to be Purchased</u>	<u>Note Denomination(s)</u>
--	---------------------------------

**UNITED OF OMAHA LIFE INSURANCE COMPANY**

**\$3,550,000**

**\$3,550,000**

- (1) All principal, interest and Make-Whole Amount payments on account of Notes held by such purchaser shall be made by wire transfer of immediately available funds for credit to:

JPMorgan Chase Bank  
 ABA No. 021-000-021  
 Private Income Processing

For credit to:  
 United of Omaha Life Insurance Company  
 Account No. 900-9000200  
 a/c: G09588

Each such wire transfer shall set forth the name of the Company, a reference to "5.50% Senior Notes, PPN \_\_\_\_" and the due date and application (as among principal, interest and Make-Whole Amount) of the payment being made.

- (2) All payments, other than principal, interest or Make-Whole Amount, on account of Notes held by such purchaser shall be made by wire transfer of immediately available funds for credit to:

JPMorgan Chase Bank  
 ABA No. 021-000-021  
 Account No. G09588  
 Account Name: United of Omaha Life Insurance Co.

Each such wire transfer shall set forth the name of the Company, a reference to "5.50% Senior Notes, PPN \_\_\_\_" and the due date and application (e.g., type of fee) of the payment being made.

- (3) Address for all notices relating to payments:

JPMorgan Chase Bank  
14201 Dallas Parkway - 13th Floor  
Dallas, TX 75254-2917

Attn: Income Processing - G. Ruiz  
a/c: G09588

- (4) Address for all other communications and notices:

Prudential Private Placement Investors, L.P.  
Gateway Center 3, 18th Floor  
100 Mulberry Street  
Newark, NJ 07102

Attention: Albert Trank, Managing Director  
Telephone: (973) 802-8608  
Facsimile: (973) 367-3234

- (5) Address for Delivery of Notes:

- (a) Send physical security by nationwide overnight delivery service to:

JPMorgan Chase Bank  
4 New York Plaza  
Ground Floor Receive Window  
New York, NY 10004

Please include in the cover letter accompanying the Notes a reference to the Purchaser's account number (United of Omaha Life Insurance Company; Account Number: G09588).

- (b) Send copy by nationwide overnight delivery service to:

Prudential Capital Group  
Gateway Center 4  
100 Mulberry, 7th Floor  
Newark, NJ 07102

Attention: Trade Management, Manager  
Telephone: (973) 367-3141

- (6) Tax Identification No.: 47-0322111

**EXHIBIT A**

**[FORM OF NOTE]**

**CHESAPEAKE UTILITIES CORPORATION**

5.50% Senior Note due \_\_\_\_\_ [Insert the Maturity Date]

No. R- \_\_\_\_\_

PPN \_\_\_\_\_

\$ \_\_\_\_\_

[Date]

CHESAPEAKE UTILITIES CORPORATION, a Delaware corporation (the "Company"), for value received, hereby promises to pay to \_\_\_\_\_ or registered assigns the principal sum of \_\_\_\_\_ Dollars (\$\_\_\_\_\_) on \_\_\_\_\_ [Insert the Maturity Date]; and to pay interest (computed on the basis of a 360-day year of twelve 30-day months) on the unpaid principal balance hereof from the date of this Note at the rate of 5.50% per annum, quarterly on the \_\_\_ day of \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_ and \_\_\_\_\_ [Insert Quarterly Interest Payment Dates] in each year, commencing on the first such date after the date hereof, until the principal amount hereof shall become due and payable; and to pay on demand interest on any overdue principal (including any overdue prepayment of principal) and premium, if any, and (to the extent permitted by applicable law) on any overdue payment of interest, at a rate per annum from time to time equal to the greater of (i) 7.50% or (ii) the rate of interest publicly announced by JPMorgan Chase Bank, or its successor, from time to time in New York City as its Prime Rate.

Subject to Section 8.1 of the Note Agreement referred to below, payments of principal, premium, if any, and interest shall be made in such coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts by check mailed and addressed to the registered holder hereof at the address shown in the register maintained by the Company for such purpose, or, at the option of the holder hereof, in such manner and at such other place in the United States of America as the holder hereof shall have designated to the Company in writing.

This Note is one of an issue of Notes of the Company issued in an aggregate principal amount limited to \$20,000,000 pursuant to the Company's Note Agreement dated as of October 18, 2005 between the Company and the respective Purchasers named therein and is entitled to the benefits thereof. As provided in such Agreement, this Note is subject to prepayment, in whole or in part, with a premium as specified in said Agreement. The Company agrees to make required payments on account of said Notes in accordance with the provisions of said Agreement.

This Note is a registered Note and is transferable only by surrender hereof at the principal office of the Company in Dover, Delaware, duly endorsed or accompanied by a written instrument of transfer duly executed by the registered holder of this Note or his attorney duly authorized in writing.

Under certain circumstances, as specified in said Agreement, the principal of this Note may be declared due and payable in the manner and with the effect provided in said Agreement.

This Note and said Agreement are governed by and construed in accordance with New York law.

**CHESAPEAKE UTILITIES CORPORATION**

(CORPORATE SEAL)

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

**[COVINGTON & BURLING]**

[Closing Date]

[Purchasers]

Ladies and Gentlemen:

We have acted as special counsel for Chesapeake Utilities Corporation, a Delaware corporation (the "Company"), in connection with the Note Agreement, dated as of October 18, 2005, between the Company and each of you (the "Note Agreement"), pursuant to which the Company has issued to each of you on the date hereof its 5.50% Senior Notes due \_\_\_\_\_ in the aggregate principal amount of \$20,000,000. Unless otherwise defined herein, capitalized terms used herein have the respective meanings specified in the Note Agreement. This letter is being delivered to each of you pursuant to Section 1.4(c) of the Note Agreement.

In rendering the opinions set forth herein, we have reviewed (i) the Note Agreement, (ii) the Notes and (iii) such corporate records, certificates and other documents, and such questions of law, as we have deemed necessary or appropriate for the purposes of this opinion.

We have assumed that all signatures are genuine (other than, in the case of the Note Agreement and the Notes, those of the Company), that all documents submitted to us as originals are authentic and that all copies of documents submitted to us conform to the originals. We also have assumed:

(i) as to factual matters, the accuracy of the warranties and representations contained in the Note Agreement, including the representations of the Purchasers in Section 9.4 of the Note Agreement and in the certificates delivered by officers of the Company pursuant to Section 1.4(d) of the Note Agreement;

(ii) that any authorization, consent, approval, exemption or other action by, or notice to or filing with, any court, administrative or governmental body that is required for the execution and delivery of the Note Agreement and the Notes or the consummation of the transactions contemplated thereby in accordance with the terms thereof (other than to the extent addressed in paragraph 6 below) has been duly obtained or made or shall be timely and duly obtained or made;

(iii) that, other than to the extent addressed in paragraph 7 below, the execution and delivery of the Note Agreement and the Notes, the offering, issuance and sale of the Notes and the consummation by the Company of the transactions contemplated in the Note Agreement and the Notes in accordance with the terms thereof do not violate or contravene any statute, law, rule or regulation or any judgment, order, decree or permit issued by any court, arbitrator or governmental or regulatory authority; and

(iv) that the Note Agreement is a binding and enforceable agreement of each party thereto other than the Company.

We have made no investigation for the purpose of verifying these assumptions.

Where statements in this opinion are qualified by the expression "known to us," such statements refer to the actual knowledge, but not constructive or imputed knowledge, of the attorneys in our firm who have given substantive attention to the transaction that is the subject of this opinion, without any representation or implication that any inquiry has been made with respect to such statements.

Based on the foregoing, and subject to the qualifications and assumptions set forth herein, we are of the opinion that, insofar as the law of the State of New York, the Delaware General Corporation Law (the "DGCL") and the Federal law of the United States of America are concerned:

1. The Company is a corporation duly incorporated, validly existing and in good standing under the laws of the State of Delaware.

2. The Company has the corporate power and authority to execute, deliver and perform its obligations under the Note Agreement and the Notes.

3. The Note Agreement and the Notes have been duly authorized by all requisite corporate action and duly executed and delivered by authorized officers of the Company and constitute the valid and binding obligations of the Company, enforceable against the Company in accordance with their terms, subject to bankruptcy, insolvency, fraudulent transfer, reorganization, moratorium, and other similar laws of general applicability relating to or affecting creditors' rights and to general equity principles.

4. It is not necessary in connection with the offer, issuance, sale and delivery of the Notes to the Purchasers under the circumstances contemplated by the Note Agreement to register the Notes under the Securities Act of 1933, as amended, or to qualify an indenture in respect of the Notes under the Trust Indenture Act of 1939, as amended.

5. Neither the issuance and the sale of the Notes by the Company nor the use of the proceeds thereof as described in the Note Agreement violates Regulation X of the Board of Governors of the Federal Reserve System or will cause any of the Purchasers to violate Regulation T or U of the Board of Governors of the Federal Reserve System to the extent any of them may be subject thereto.

6. No consent, approval, authorization or other action by or filing with any governmental agency or instrumentality of the State of New York or the United States of America or under the DGCL is required on the part of the Company for the execution and delivery of the Note Agreement and the Notes or for the consummation by the Company of the transactions contemplated thereby, or the performance of its obligations thereunder, in accordance with the terms thereof.

7. The execution and delivery of the Note Agreement and the Notes, the offering, issuance and sale of the Notes and the consummation by the Company of the transactions contemplated thereby, and the performance of its obligations thereunder, in accordance with the terms thereof (i) do not violate the DGCL, any New York or Federal statute, law, rule or regulation to which the Company is subject, or the usury laws of the State of New York or (ii) do not conflict with, breach the terms, conditions or provisions of, or constitute a default under, violate, or result in the creation of any Lien upon any of the properties or assets of the Company pursuant to (A) the Certificate of Incorporation or Bylaws of the Company or (B) any of the instruments or agreements listed on Schedule 6.7 of the Note Agreement.

The foregoing opinion is subject to the following qualifications:

(a) We express no opinion as to:

- (i) waivers of the rights to object to venue or other rights or benefits bestowed by operation of law;
- (ii) provisions for liquidated damages and penalties, penalty interest and interest on interest, it being understood that the provisions of Section 2.2 and 5.2 of the Note Agreement are not excluded under this clause (ii);
- (iii) provisions purporting to require a prevailing party in a dispute to pay attorneys' fees and expenses, or other costs, to a non-prevailing party;
- (iv) provisions purporting to supersede equitable principles, including provisions requiring amendments and waivers to be in writing;
- (v) provisions purporting to make a party's determination conclusive; or
- (vi) exclusive jurisdiction or venue provisions.

(b) We express no opinion with regard to (i) any state securities or Blue Sky laws, (ii) any commodities, insurance or tax laws or (iii) the Employee Retirement Income Security Act of 1974, or any comparable state laws.

(c) Except as addressed in paragraphs 5 and 7(i), we express no opinion as to any legal requirements or restrictions applicable to the Purchasers.

(d) Our opinions in paragraphs 6 and 7(i) above are limited to laws and regulations normally applicable to transactions of the type contemplated by the Note Agreement and do not extend to laws or regulations relating to, or to licenses, permits, approvals and filings necessary for, the conduct of the business of the Company or any of its subsidiaries, including, without limitation, any environmental laws or regulations.

We are members of the bars of the District of Columbia and the State of New York. We do not express any opinion herein on any laws other than the laws of the State of New York, the DGCL and the Federal law of the United States.



This letter is given solely for your benefit as Purchasers of Notes and for the benefit of any other person or entity to whom you may transfer any of the Notes. It may not be relied upon by any other person or entity and, except with respect to regulatory authorities exercising jurisdiction over any of you (which shall be deemed to include the National Association of Insurance Commissioners), this opinion may not be disclosed to any other person or entity without our written consent.

Very truly yours,

**[PARKOWSKI, GUERKE & SWAYZE, P.A.]**

[Closing Date]

[Purchasers]

Ladies and Gentlemen:

We have acted as special Delaware counsel for Chesapeake Utilities Corporation (the "Company") in connection with the Note Agreement, dated as of October 18, 2005, between the Company and each of you (the "Note Agreement"), pursuant to which the Company has issued to each of you today 5.50% Senior Notes due \_\_\_\_\_ of the Company in the aggregate principal amount of \$20,000,000. All terms used herein that are defined in the Note Agreement have the respective meanings specified in the Note Agreement. This letter is being delivered to each of you in satisfaction of the condition set forth in Section 1.4(c) of the Note Agreement and with the understanding that each of you is purchasing the Notes in reliance on the opinions expressed herein.

In this connection, we have examined such certificates of public officials, certificates of officers of the Company and copies certified to our satisfaction of corporate documents and records of the Company and of other papers, and have made such other investigations, as we have deemed relevant and necessary as a basis for our opinion hereinafter set forth. We have relied upon such certificates of public officials and of officers of the Company with respect to the accuracy of material factual matters contained therein which were not independently established. With respect to the opinion expressed in paragraph 3 below, we have also relied upon the representations made by each of you in Sections 9.4 and 9.5 of the Note Agreement.

Based on the foregoing, it is our opinion that:

a. The Company has the corporate power and authority to carry on the business as now being conducted.

b. The execution and delivery of the Note Agreement and the Notes, the offering, issuance and sale of the Notes and fulfillment of and compliance with the respective provisions of the Note Agreement and the Notes will not require any authorization, consent, approval, exemption or other action by or notice to or filing with any Delaware court, Delaware administrative or Delaware governmental body (other than the State of Delaware Public Service Commission and routine filings after the date hereof with the Securities and Exchange Commission and/or State Blue Sky authorities) pursuant to, any Delaware applicable law (including any securities or Blue Sky law), statute, rule or regulation of the State of Delaware. The Public Service Commission of the State of Delaware has duly entered Order No. 6708 in PSC Docket No. 05-290 dated September 6, 2005, such Order is final and in full force and effect, no appeal, review or contest thereof is pending, and no further action by the Public Service Commission of the State of Delaware is a requirement to execution and delivery of the Note

Agreement or the Notes or the offering, issuance or sale of the Notes or the fulfillment of compliance with the requisite provisions of the Note Agreement and the Notes.

Our opinions may not be relied upon by any person or entity other than each of you, transferees of each of you and Schiff Hardin LLP, your special counsel, in connection with the matters referred to herein.

Our opinions are limited to the laws of the State of Delaware.

Sincerely yours,

PARKOWSKI, GUERKE & SWAYZE, P.A.

BY:

\_\_\_\_\_  
William A. Denman, Esq.

**DLA Piper Rudnick Gray Cary US LLP**  
The Marbury Building  
6225 Smith Avenue  
Baltimore, Maryland 21209-3600  
T 410.580.3000  
F 410.580.3001  
W [www.dlapiper.com](http://www.dlapiper.com)

MARTA D. HARTING  
marta.harting@piperrudnick.com  
T 410.580.4171 F 410.580.3794

[Closing Date]

[Purchasers]

Ladies and Gentlemen:

We have acted as special Maryland regulatory counsel for Chesapeake Utilities Corporation (the "Company") in connection with the Note Agreement, dated as of October 18, 2005, between the Company and each of you (the "Note Agreement"), pursuant to which the Company has issued to each of you today 5.50% Senior Notes due \_\_\_\_\_ of the Company in the aggregate principal amount of \$20,000,000. All terms used herein that are defined in the Note Agreement have the respective meanings specified in the Note Agreement. This letter is being delivered to each of you with the understanding that each of you is purchasing the Notes in reliance on the opinions expressed herein.

Based on the foregoing and assuming approval of the subject transaction by the Delaware Public Service Commission in PSC Docket No. \_\_\_\_\_, it is our opinion that:

The execution and delivery of the Note Agreement and the Notes, the offering, issuance and sale of the Notes and fulfillment of and compliance with the respective provisions of the Note Agreement and the Notes do not require any authorization, consent, approval, exemption or other action by or notice to or filing with any Maryland state administrative or governmental body, including, without limitation, the Public Service Commission of Maryland, pursuant to any applicable law (including any securities or Blue Sky law), statute, rule, regulation or other requirement of the State of Maryland.

Our opinion may not be relied upon by any person or entity other than each of you, transferees of each of you and Schiff Hardin LLP your special counsel in connection with the matters referred to herein, and neither this opinion nor this opinion letter may be circulated, quoted, or relied upon by any other person for any other purpose without prior written consent (except to regulatory authorities having jurisdiction over you, including the National Association of Insurance Commissioners).

Very truly yours,

Marta D. Harting

MDH/vc

**[ROSE, SUNDSTROM & BENTLEY, LLP]**

[Closing Date]

[Purchasers]

Ladies and Gentlemen:

We have acted as special Florida counsel for Chesapeake Utilities Corporation (the "Company") in connection with the Note Agreement, dated as of October 18, 2005, between the Company and each of you (the "Note Agreement"), pursuant to which the Company has issued to each of you today 5.50% Senior Notes due \_\_\_\_\_ of the Company in the aggregate principal amount of \$20,000,000. All terms used herein that are defined in the Note Agreement have the respective meanings specified in the Note Agreement. This letter is being delivered to each of you in satisfaction of the condition set forth in Section 1.4(c) of the Note Agreement and with the understanding that each of you is purchasing the Notes in reliance on the opinions expressed herein.

In this connection, we have examined such certificates of public officials, certificates of officers of the Company and copies certified to our satisfaction of corporate documents and records of the Company and of other papers, and have made such other investigations, as we have deemed relevant and necessary as a basis for our opinion hereinafter set forth. We have relied upon such certificates of public officials and of officers of the Company with respect to the accuracy of material factual matters contained therein which were not independently established.

Based on the foregoing, it is our opinion that:

a. The Company is qualified to do business and is in good standing under the laws of the State of Florida.

b. The execution and delivery of the Note Agreement and the Notes, the issuance and sale of the Notes and fulfillment of and compliance with the respective provisions of the Note Agreement and the Notes will not require any authorization, consent, approval, exemption or other action by or notice to or filing with any court, administrative or governmental body (other than the Public Service Commission of the State of Florida) pursuant to any applicable law, statute, rule or regulation of the State of Florida. The Public Service Commission of the State of Florida has duly entered Order No. \_\_\_\_\_ dated \_\_\_\_\_, which order is final and in full force and effect, no appeal, review or contest thereof is pending and the time for appeal or to seek review or reconsideration thereof has expired and no further action by the Public Service Commission of the State of Florida is a requirement to execution and delivery of the Note Agreement or the Notes or the issuance or sale of the Notes or the fulfillment of compliance with the requisite provisions of the Note Agreement and the Notes.

Our opinion may not be relied upon by any person or entity other than each of you, transferees of each of you and Schiff Hardin LLP your special counsel in connection with the matters referred to herein.

Our opinion is limited to the laws of the State of Florida.

Sincerely,

**SCHEDULE 4.6**

**EXISTING INDEBTEDNESS**

The Existing Indebtedness of the Company and Subsidiaries as of June 30, 2005 is as follows:

Funded Debt:

\$ 2,463,000	8.25% Convertible Debentures, Due March 1, 2014
\$ 3,000,000	7.97% Senior Unsecured Notes, due February 1, 2008
\$ 5,454,545	6.91% Senior Unsecured Note, due October 1, 2010
\$ 7,000,000	6.85% Senior Unsecured Note, due January 1, 2012
\$ 20,000,000	7.83% Senior Unsecured Note, due January 1, 2015
\$ 30,000,000	6.64% Senior Unsecured Notes, due October 31, 2017
\$ 120,000	Promissory Note of Sharp Energy

Current Debt:

\$ 0	Short-term borrowing under line of credit agreements with Bank of America
\$ 0	Short-term borrowing under line of credit agreements with PNC Bank
\$ 0	Short-term borrowing under line of credit agreement with Wilmington Trust

**SCHEDULE 4.8(e)**

**EXISTING LIENS**

The Liens of Property of the Company and Subsidiaries as of June 30, 2005 (other than Liens of the types described in clauses (i) through (iv) of Section 4.8(a)) and the obligations secured thereby are as follows:

None.



**SCHEDULE 6.1(a)**

**SUBSIDIARIES**

**Subsidiary**

**Jurisdiction of Incorporation**

Chesapeake Utilities Corporation	Delaware
Eastern Shore Natural Gas Company	Delaware
Skipjack, Inc.	Delaware
Sharpgas, Inc.	Delaware
BravePoint, Inc.	Georgia
Sharp Energy, Inc.	Delaware
Chesapeake Investment Company	Delaware
Chesapeake Service Company	Delaware
Tri-County Gas Co., Inc.	Maryland
Eastern Shore Real Estate, Inc.	Maryland
Sam Shannahan Well Co., Inc.	Maryland
Xeron, Inc.	Mississippi
Sharp Water, Inc.	Delaware
Sharp Water of Minnesota, Inc.	Delaware
Sharp Water of Idaho, Inc.	Delaware
AQuality Company, Inc.	Delaware
Peninsula Pipeline Company, Inc.	Delaware
OnSight Energy, LLC	Delaware
Peninsula Energy Services Company, Inc.	Delaware

**SCHEDULE 6.7**

**LIST OF AGREEMENTS RESTRICTING DEBT**

The contracts or agreements of the Company or a Subsidiary which restrict the right of ability of the Company to issue the Notes or to perform its obligation under the Agreement are as follows:

- a. 8.25% Convertible Debentures, due March 1, 2014.
- b. 7.97% Senior Unsecured Notes, due February 1, 2008, by and between Chesapeake Utilities Corporation, Massachusetts Mutual Life Insurance Company and Massachusetts Mutual Life Pension Insurance Company.
- c. 6.91% Senior Unsecured Note, due October 1, 2010, by and between Chesapeake Utilities Corporation and Prudential Insurance Company of America.
- d. 6.85% Senior Unsecured Note, due January 1, 2012, by and between Chesapeake Utilities Corporation and Swanbird and Company.
- e. 7.83% Senior Unsecured Note, due January 1, 2015, by and between Chesapeake Utilities Corporation and Pacific Life Insurance Company.
- f. 6.64% Senior Unsecured Notes, due October 31, 2017, by and between Chesapeake Utilities Corporation, The State Life Insurance Company, Massachusetts Mutual Life Insurance Company, C.M. Life Insurance Company, American United Life Insurance Company and Pioneer Mutual Life Insurance Company.
- g. \$10,000,000 Committed Line of Credit for short-term borrowing, by and between Chesapeake Utilities Corporation and PNC Bank.
- h. \$5,000,000 Committed Line of Credit for short-term borrowing, by and between Chesapeake Utilities Corporation and Bank of America.

**SCHEDULE 7.1**

**EXISTING INVESTMENTS**

The outstanding Investments of the Company and Subsidiaries as of June 30, 2005, are as follows:

- 1) Rabbi Trust - Investment of \$335,000 associated with the acquisition of Xeron, Inc.
- 2) Rabbi Trust - 401(k) Supplemental Executive Retirement Plan of \$1,247,000.

CHESAPEAKE UTILITIES CORPORATION

5.50% Senior Note due October 12, 2020

No. R-1

PPN 165303 D@ 4

\$6,000,000.00

October 12, 2006

CHESAPEAKE UTILITIES CORPORATION, a Delaware corporation (the "Company"), for value received, hereby promises to pay to THE PRUDENTIAL INSURANCE COMPANY OF AMERICA or registered assigns the principal sum of SIX MILLION AND NO/100 DOLLARS (\$6,000,000.00) on October 12, 2020; and to pay interest (computed on the basis of a 360-day year of twelve 30-day months) on the unpaid principal balance hereof from the date of this Note at the rate of 5.50% per annum, quarterly on the 12<sup>th</sup> day of October, January, April and July in each year, commencing on the first such date after the date hereof, until the principal amount hereof shall become due and payable; and to pay on demand interest on any overdue principal (including any overdue prepayment of principal) and premium, if any, and (to the extent permitted by applicable law) on any overdue payment of interest, at a rate per annum from time to time equal to the greater of (i) 7.50% or (ii) the rate of interest publicly announced by JPMorgan Chase Bank, or its successor, from time to time in New York City as its Prime Rate.

Subject to Section 8.1 of the Note Agreement referred to below, payments of principal, premium, if any, and interest shall be made in such coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts by check mailed and addressed to the registered holder hereof at the address shown in the register maintained by the Company for such purpose, or, at the option of the holder hereof, in such manner and at such other place in the United States of America as the holder hereof shall have designated to the Company in writing.

This Note is one of an issue of Notes of the Company issued in an aggregate principal amount limited to \$20,000,000 pursuant to the Company's Note Agreement dated as of October 18, 2005 between the Company and the respective Purchasers named therein and is entitled to the benefits thereof. As provided in such Agreement, this Note is subject to prepayment, in whole or in part, with a premium as specified in said Agreement. The Company agrees to make required payments on account of said Notes in accordance with the provisions of said Agreement.

This Note is a registered Note and is transferable only by surrender hereof at the principal office of the Company in Dover, Delaware, duly endorsed or accompanied by a written instrument of transfer duly executed by the registered holder of this Note or his attorney duly authorized in writing.

*Done* 10/12/06

Under certain circumstances, as specified in said Agreement, the principal of this Note may be declared due and payable in the manner and with the effect provided in said Agreement.

This Note and said Agreement are governed by and construed in accordance with New York law.

**CHESAPEAKE UTILITIES CORPORATION**

(CORPORATE SEAL)

By: *Beth W. Cooper*  
Name: *Beth W. Cooper*  
Title: *Vice President, Treasurer, and  
Corporate Secretary*

*10/18/06*

CHESAPEAKE UTILITIES CORPORATION

5.50% Senior Note due October 12, 2020

No. R-2

PPN 165303 D@ 4

\$6,450,000.00

October 12, 2006

CHESAPEAKE UTILITIES CORPORATION, a Delaware corporation (the "Company"), for value received, hereby promises to pay to THE PRUDENTIAL INSURANCE COMPANY OF AMERICA or registered assigns the principal sum of SIX MILLION FOUR HUNDRED FIFTY THOUSAND AND NO/100 DOLLARS (\$6,450,000.00) on October 12, 2020; and to pay interest (computed on the basis of a 360-day year of twelve 30-day months) on the unpaid principal balance hereof from the date of this Note at the rate of 5.50% per annum, quarterly on the 12<sup>th</sup> day of October, January, April and July in each year, commencing on the first such date after the date hereof, until the principal amount hereof shall become due and payable; and to pay on demand interest on any overdue principal (including any overdue prepayment of principal) and premium, if any, and (to the extent permitted by applicable law) on any overdue payment of interest, at a rate per annum from time to time equal to the greater of (i) 7.50% or (ii) the rate of interest publicly announced by JPMorgan Chase Bank, or its successor, from time to time in New York City as its Prime Rate.

Subject to Section 8.1 of the Note Agreement referred to below, payments of principal, premium, if any, and interest shall be made in such coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts by check mailed and addressed to the registered holder hereof at the address shown in the register maintained by the Company for such purpose, or, at the option of the holder hereof, in such manner and at such other place in the United States of America as the holder hereof shall have designated to the Company in writing.

This Note is one of an issue of Notes of the Company issued in an aggregate principal amount limited to \$20,000,000 pursuant to the Company's Note Agreement dated as of October 18, 2005 between the Company and the respective Purchasers named therein and is entitled to the benefits thereof. As provided in such Agreement, this Note is subject to prepayment, in whole or in part, with a premium as specified in said Agreement. The Company agrees to make required payments on account of said Notes in accordance with the provisions of said Agreement.

This Note is a registered Note and is transferable only by surrender hereof at the principal office of the Company in Dover, Delaware, duly endorsed or accompanied by a written instrument of transfer duly executed by the registered holder of this Note or his attorney duly authorized in writing.

*KWC* 10/12/06

Under certain circumstances, as specified in said Agreement, the principal of this Note may be declared due and payable in the manner and with the effect provided in said Agreement.

This Note and said Agreement are governed by and construed in accordance with New York law.

**CHESAPEAKE UTILITIES CORPORATION**

(CORPORATE SEAL)

By: Beth W. Cooper  
Name: Beth W. Cooper  
Title: Vice President, Treasurer and  
Corporate Secretary

10/2/11

CHESAPEAKE UTILITIES CORPORATION

5.50% Senior Note due October 12, 2020

No. R-3

PPN 165303 D@ 4

\$4,000,000.00

October 12, 2006

CHESAPEAKE UTILITIES CORPORATION, a Delaware corporation (the "Company"), for value received, hereby promises to pay to PRUDENTIAL RETIREMENT INSURANCE AND ANNUITY COMPANY or registered assigns the principal sum of FOUR MILLION AND NO/100 DOLLARS (\$4,000,000.00) on October 12, 2020; and to pay interest (computed on the basis of a 360-day year of twelve 30-day months) on the unpaid principal balance hereof from the date of this Note at the rate of 5.50% per annum, quarterly on the 12<sup>th</sup> day of October, January, April and July in each year, commencing on the first such date after the date hereof, until the principal amount hereof shall become due and payable; and to pay on demand interest on any overdue principal (including any overdue prepayment of principal) and premium, if any, and (to the extent permitted by applicable law) on any overdue payment of interest, at a rate per annum from time to time equal to the greater of (i) 7.50% or (ii) the rate of interest publicly announced by JPMorgan Chase Bank, or its successor, from time to time in New York City as its Prime Rate.

Subject to Section 8.1 of the Note Agreement referred to below, payments of principal, premium, if any, and interest shall be made in such coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts by check mailed and addressed to the registered holder hereof at the address shown in the register maintained by the Company for such purpose, or, at the option of the holder hereof, in such manner and at such other place in the United States of America as the holder hereof shall have designated to the Company in writing.

This Note is one of an issue of Notes of the Company issued in an aggregate principal amount limited to \$20,000,000 pursuant to the Company's Note Agreement dated as of October 18, 2005 between the Company and the respective Purchasers named therein and is entitled to the benefits thereof. As provided in such Agreement, this Note is subject to prepayment, in whole or in part, with a premium as specified in said Agreement. The Company agrees to make required payments on account of said Notes in accordance with the provisions of said Agreement.

This Note is a registered Note and is transferable only by surrender hereof at the principal office of the Company in Dover, Delaware, duly endorsed or accompanied by a written instrument of transfer duly executed by the registered holder of this Note or his attorney duly authorized in writing.

*Done 10/12/06*



Under certain circumstances, as specified in said Agreement, the principal of this Note may be declared due and payable in the manner and with the effect provided in said Agreement.

This Note and said Agreement are governed by and construed in accordance with New York law.

**CHESAPEAKE UTILITIES CORPORATION**

(CORPORATE SEAL)

By: Beth W. Cooper  
Name: Beth W. Cooper  
Title: Vice President, Treasurer and  
Corporate Secretary

10/12/05

CHESAPEAKE UTILITIES CORPORATION

5.50% Senior Note due October 12, 2020

No. R-4

PPN 165303 D@ 4

\$3,550,000.00

October 12, 2006

CHESAPEAKE UTILITIES CORPORATION, a Delaware corporation (the "Company"), for value received, hereby promises to pay to UNITED OF OMAHA LIFE INSURANCE COMPANY or registered assigns the principal sum of THREE MILLION FIVE HUNDRED FIFTY THOUSAND AND NO/100 DOLLARS (\$3,550,000.00) on October 12, 2020; and to pay interest (computed on the basis of a 360-day year of twelve 30-day months) on the unpaid principal balance hereof from the date of this Note at the rate of 5.50% per annum, quarterly on the 12<sup>th</sup> day of October, January, April and July in each year, commencing on the first such date after the date hereof, until the principal amount hereof shall become due and payable; and to pay on demand interest on any overdue principal (including any overdue prepayment of principal) and premium, if any, and (to the extent permitted by applicable law) on any overdue payment of interest, at a rate per annum from time to time equal to the greater of (i) 7.50% or (ii) the rate of interest publicly announced by JPMorgan Chase Bank, or its successor, from time to time in New York City as its Prime Rate.

Subject to Section 8.1 of the Note Agreement referred to below, payments of principal, premium, if any, and interest shall be made in such coin or currency of the United States of America as at the time of payment is legal tender for the payment of public and private debts by check mailed and addressed to the registered holder hereof at the address shown in the register maintained by the Company for such purpose, or, at the option of the holder hereof, in such manner and at such other place in the United States of America as the holder hereof shall have designated to the Company in writing.

This Note is one of an issue of Notes of the Company issued in an aggregate principal amount limited to \$20,000,000 pursuant to the Company's Note Agreement dated as of October 18, 2005 between the Company and the respective Purchasers named therein and is entitled to the benefits thereof. As provided in such Agreement, this Note is subject to prepayment, in whole or in part, with a premium as specified in said Agreement. The Company agrees to make required payments on account of said Notes in accordance with the provisions of said Agreement.

This Note is a registered Note and is transferable only by surrender hereof at the principal office of the Company in Dover, Delaware, duly endorsed or accompanied by a written instrument of transfer duly executed by the registered holder of this Note or his attorney duly authorized in writing.

*RMC* 10/12/06

Under certain circumstances, as specified in said Agreement, the principal of this Note may be declared due and payable in the manner and with the effect provided in said Agreement.

This Note and said Agreement are governed by and construed in accordance with New York law.

**CHESAPEAKE UTILITIES CORPORATION**

(CORPORATE SEAL)

By: *Berk W. Cooper*  
Name: *Berk W. Cooper*  
Title: *Vice President, Treasurer and  
Corporate Secretary*