

Wayne L. Schiefelbein

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October 20, 1999

RECORDS AND  
REPORTING

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RECEIVED-FPSC

991631-GW

HAND DELIVERY

ORIGINAL

Blanca S. Bayo, Director  
Division of Records and Reporting  
Florida Public Service Commission  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399-0850

Re: 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

Dear Ms. Bayo:

Enclosed for filing on behalf of Chesapeake Utilities Corporation for filing in the  
above docket are an original and five (5) copies of the above-referenced  
application.

Please open a docket for processing this petition.

Please acknowledge receipt of the foregoing by stamping the enclosed extra  
copy of this letter and returning same to my attention.

Thank you for your assistance.

Sincerely,



Wayne L. Schiefelbein

WLS:ls  
Enclosures

cc: Robert V. Elias, Esq. (w/out encl.)  
Beth Salak (w/out encl.)  
Andrew Maurey (w/out encl.)

RECEIVED & FILED

FPSC-BUREAU OF RECORDS

DOCUMENT NUMBER-DATE

12864 OCT 20 99

FPSC-RECORDS/REPORTING

**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 Exceed Limitation )  
Placed on Short-Term Borrowings in 2000 )

**ORIGINAL**  
991631-6U

**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**

Chesapeake Utilities Corporation (Chesapeake, the Company or Applicant) respectfully files this Application, pursuant to Section 366.04 (1), Florida Statutes, seeking authority to issue up to 6,000,000 shares of Chesapeake common stock; up to 1,000,000 shares of Chesapeake preferred stock; and up to \$80,000,000 in secured and/or unsecured debt 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 an amount not to exceed \$40,000,000.

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  
P.O. Box 960  
1015 6th Street N.W.  
Winter Haven, Florida 33881

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FPSC-RECORDS/REPORTING

(c) Chesapeake Utilities Corporation  
Florida Division  
1514 Alexander Street, Suite 107  
Plant City, Florida 33566

and

(d) Chesapeake Utilities Corporation  
Florida Division  
1639 West Gulf to Lake Highway  
Lecanto, Florida 33461

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:

Wayne L. Schiefelbein  
P.O. Box 13688  
Tallahassee, Florida 32317  
(850) 385-8598

Attorney for Chesapeake Utilities Corporation

4. Capital Stock and Funded Debt:

Chesapeake has authority by provisions contained in its 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, 1999: 5,139,498 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.

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, 1999: 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 a 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, 1999, there is a remaining balance of \$3,773,000 on this issue.

- (a)2 9.37% First Mortgage Sinking Fund Bonds, Series I, due December 15, 2004, issued on December 15, 1989, and secured by the Original Indenture dated as of December 1, 1959 between Chesapeake and Maryland National Bank in the principal amount of \$8,200,000 bearing interest payable semi-annually with provisions for payment of interest only prior to December 15, 1991; thereafter, principal shall be payable, in addition to interest on the unpaid balance, on or before the fifteenth days of December and June in each year (a) commencing on December 15, 1991, and ending on December 15, 1999, in the sum of \$260,000 and (b) commencing on June 15, 2000, and ending on June 15, 2004, in the sum of \$378,000. As of June 30, 1999, there is a remaining balance of \$4,040,000 on this issue.
- (a)3 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, 1999, there is a remaining balance of \$9,000,000 on this issue.
- (a)4 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, 1999, there is a remaining balance of \$10,000,000 on this issue.

(a)5 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, 1999, there is a remaining balance of \$10,000,000 on this issue.

(a)6 As of the filing date, the Company had three unsecured bank lines of credit. Two of these lines were \$10,000,000, while the remaining line was \$8,000,000. For one of the \$10,000,000 lines of credit, \$5,000,000 of the total line can be used to guarantee letters of credit issued by Chesapeake's unregulated subsidiary, Xeron, Inc. for up to 364 days.

(b) The amounts authorized are set forth above.

(c) The amounts presently outstanding 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.

5. Authorizations Requested:

Chesapeake requests authorization from the FPSC to issue up to 949,347 new shares of its common stock during 2000 for the purpose of administering Chesapeake's Retirement Savings Plan, Performance Incentive Plan, Automatic Dividend Reinvestment and Stock

Purchase Plan and conversion of the Company's Convertible Debentures. The share breakdown for each specific purpose is as follows:

<u>Number of Shares</u>	<u>Purpose</u>
105,638	Issuance pursuant to the Company's Retirement Savings Plan.
372,071	Issuance under the terms of the Company's Performance Incentive Plan.
249,827	Issuance pursuant to the Company's Automatic Dividend Reinvestment and Stock Purchase Plan.
221,811	Issuance under the terms of the Company's outstanding 8 1/4% Convertible Debentures.

Chesapeake requests FPSC authorization to issue up to \$40,000,000 in secured and/or unsecured debt during 2000 for general corporate purposes including, but not limited to, working capital, retirement of short-term debt, retirement of long-term debt and capital improvements. In addition, Chesapeake expects to continue its historically aggressive acquisition program. For this purpose, Chesapeake is requesting FPSC authorization during 2000 to issue up to 5,050,653 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 \$40,000,000 during 2000. The bridge

financing would subsequently be refinanced as unsecured long-term debt with an estimated rate of interest of up to 250 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 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.

6. Purpose for which Securities are to be issued:

- (a) Chesapeake's Retirement Savings Plan ("RSP") was implemented on February 1, 1977. As of June 30, 1999, the RSP had 423 participants; a total market valuation of \$13,777,041; and 247,446 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, all employer matching contributions made on behalf of the participants are invested in common stock of Chesapeake. The RSP was amended at the end of 1998 to provide for a larger employer matching amount, 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. In addition, the number of



participating employees has increased as a result of two acquisitions completed in 1998.

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 as 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 "open ended" in the sense that there is no time limit by which approved securities need to be issued. A copy of this Order is filed herewith as Exhibit C and is hereby incorporated by reference. Pursuant to these Orders, Chesapeake has issued 94,362 new shares of common stock for the RSP as of June 30, 1999. Thus, there remains to be issued 105,638 shares as authorized by the Delaware Public Service Commission.

The FPSC approved the issuance and sale of up to 45,082 shares of common stock for the Plan during 1999 by Order No. PSC-98-1678-FOF-GU, issued December 10, 1998. On August 4, 1999, the FPSC granted Chesapeake's Application to modify its authority to issue and sell up to 50,000 additional shares of common stock for the purpose of administering the RSP by Order No. PSC-99-1540-FOF-GU, as amended by Order No. PSC-99-1540A-FOF-GU, issued August 17, 1999. Chesapeake now seeks FPSC authorization to issue up to 105,638 new shares of Chesapeake common stock for the purpose of administering Chesapeake's Retirement Savings Plan during 2000.

- (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 as 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 as 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 is increased from 200,000 shares to 400,000 shares; (2) the term of the PIP is extended for five years through December 31, 2006; and (3) the Board of Directors is 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 approved securities need to be issued. A copy of this Order is filed herewith as Exhibit C and is hereby incorporated by reference.

Pursuant to the PIP, Chesapeake has issued 27,929 new shares of common stock as June 30, 1999. Thus, there remains to be issued 372,071 shares as previously authorized by the Delaware Public Service Commission. The FPSC approved the issuance and sale of up to 173,771 shares of common stock for the PIP during 1999 by Order No. PSC-98-1678-FOF-GU, issued December 10, 1998. Chesapeake now seeks FPSC authorization to issue up to 372,071 new shares of Chesapeake common stock for the purpose of administering Chesapeake's Performance Incentive Plan during 2000. The 372,071 shares should be adequate to cover any awards granted to executives and other key officers of the Company and its subsidiaries in 2000.

- (c) Chesapeake's Automatic 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, 1999, the DRP had 1,311 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 as 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 "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 as 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. Pursuant to the Orders above, Chesapeake has issued 250,173 new shares of common stock as of June 30, 1999. Thus, there remains to be issued 249,827 shares as authorized by the Delaware Public Service Commission. The FPSC approved the issuance and sale of up to 285,726 shares for the DRP during 1999 by Order No. PSC-98-1678-FOF-GU, issued on December 10, 1998. Chesapeake now seeks FPSC authorization to issue up to 249,827 new shares of Chesapeake common stock for the purpose of administering Chesapeake's Automatic Dividend Reinvestment and Stock Purchase Plan during 2000.

- (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, 1999, \$3,773,000 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 221,811. 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 have a conversion premium greater than the offering price of the common stock issue, 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

debentureholder to present any Debenture for redemption, at par, on the anniversary date of the issue, subject to annual limitations of \$10,000 per debentureholder 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 debentureholder and \$200,000 in the aggregate, Chesapeake will redeem the Debentures of deceased debentureholders 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 as 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, 1999, a cumulative \$321,000 of the Convertible Debentures have been converted. The FPSC approved the issuance and sale of up to 226,455 new shares of Chesapeake common stock for the purpose of honoring conversion rights pursuant to the Company's Convertible Debentures during 1999, by Order No. PSC-98-1678-FOF-GU, issued on December 10, 1998. Chesapeake now seeks

FPSC authorization to issue up to 221,811 new shares of Chesapeake common stock for the purpose of honoring these conversion rights during 2000.

- (e) Chesapeake seeks FPSC authorization to issue during 2000 up to \$40,000,000 in secured and/or unsecured long-term debt with an estimated rate of interest of up to 250 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 \$30,000,000 in secured and/or unsecured long-term debt during 1999 by Order No. PSC-98-1678-FOF-GU, issued on December 10, 1998.
- (f) Chesapeake seeks FPSC authorization to issue during 2000 up to 5,050,653 shares of common stock and \$40,000,000 in secured and/or unsecured long-term debt with an estimated rate of interest of up to 250 basis points above U.S. Treasury rates (or extrapolated U.S. Treasury rates) with equivalent average life. This stock and debt would be used to finance Chesapeake's ongoing acquisition program of related businesses. 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 4,268,966 shares of common stock and \$40,000,000 in unsecured long-term debt during 1999 by Order No. PSC-98-1678-FOF-GU, issued on December 10, 1998.

(g) Chesapeake seeks FPSC authorization to issue up to 1,000,000 shares of Chesapeake preferred stock during 2000 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. A copy of the Forms 8-A and 8-K filed with the Securities and Exchange Commission in conjunction with the Rights Agreement are filed herewith as Exhibit D. The Form 8-A includes as exhibits copies of the Rights Agreement and the Summary of Rights to Purchase Preferred Shares. Chesapeake will be seeking authorization for the issuance of up to 1,000,000 shares of preferred stock from the Delaware Public Service Commission before the end of 1999.

7. Lawful object and purpose:

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, Automatic Dividend Reinvestment and Stock Purchase 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. This is for a lawful object within the corporate purposes of Chesapeake and compatible with the public interest and is 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, Schmittinger & Rodriguez, 414 South State Street, P.O. Box 497, Dover, Delaware 19903, who will rely on Wayne L. Schiefelbein, Esquire, P.O. Box 13688, Tallahassee, Florida 32317, 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 Petitions in Docket Nos. 981213-GU, 961194-GU and 931112-GU, respectively, are incorporated in the instant Application by reference:

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 Automatic 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 Automatic 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: Orders of the Delaware Public Service Commission Authorizing the Issuance of Common Stock.

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, 1998.

A(2) Chesapeake Utilities Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 1999.

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

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

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 Application 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 Application 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 to issue up to 6,000,000 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 exceed the limitation placed on short-term borrowings by Section 366.04, Florida Statutes, so as to issue up to \$40,000,000 in short-term obligations.

Respectfully submitted,

Date: 10/20/99

Wayne L. Schiefelbein  
Wayne L. Schiefelbein  
P.O. Box 13688  
Tallahassee, Florida 32317  
(850) 385-8598

Attorney for  
Chesapeake Utilities Corporation

Date: 10/19/99

By: Michael P. McMasters  
Michael P. McMasters  
Vice President, Treasurer, & CFO

STATE OF DELAWARE \*

COUNTY OF KENT \* SS

BE IT REMEMBERED that on this 19<sup>th</sup> day of October, 1999, personally appeared before me, a Notary Public for the State of Delaware, Michael P. McMasters, who being by me duly sworn, did depose and say that he is Vice President, Treasurer and CFO 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 his personal knowledge, they are true; and insofar as those facts that are not within his personal knowledge, he believes them to be true, and that the exhibits accompanying this Application and attached hereto are true and correct copies of the originals of the aforesaid exhibits, and that he has executed this Application on behalf of the Company and pursuant to the authorization of its Board of Directors.



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Michael P. McMasters  
Vice President, Treasurer & CFO

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



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Notary Public  
My Commission Expires: 2/19/00

## **EXHIBIT A**

- A(1) Chesapeake Utilities Corporation Annual Report on Form 10-K for the year ended December 31, 1998.
  
- A(2) Chesapeake Utilities Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 1999.



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

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**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, 1998      Commission File Number: 001-11590

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**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.

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

8.25% Convertible Debentures Due 2014  
(Title of class)

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]

As of March 26, 1999, 5,115,971 shares of common stock were outstanding. The aggregate market value of the common shares held by non-affiliates of Chesapeake Utilities Corporation, based on the last trade price on March 26, 1999, as reported by the New York Stock Exchange, was approximately \$67 million.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 1999 Annual Meeting of Stockholders are incorporated by reference in Part III.

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**CHESAPEAKE UTILITIES CORPORATION**  
**FORM 10-K**

**YEAR ENDED DECEMBER 31, 1998**

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## **PART I**

### **ITEM 1. BUSINESS**

#### **(a) General Development of Business**

Chesapeake Utilities Corporation (“Chesapeake” or “the Company”) is a diversified utility company engaged primarily in natural gas distribution and transmission, propane distribution and marketing and advanced information services.

Chesapeake’s three natural gas distribution divisions serve approximately 37,100 residential, commercial and industrial customers in southern Delaware, Maryland’s Eastern Shore and Central Florida. The Company’s natural gas transmission subsidiary, Eastern Shore Natural Gas Company (“Eastern Shore”), operates a 273-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 Delaware and on the Eastern Shore of Maryland. The Company’s propane distribution operation serves approximately 35,000 customers in southern Delaware and on the Eastern Shore of Maryland and Virginia. The advanced information services segment provides consulting, custom programming, training and development tools for national and international clients.

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

Financial information by business segment is included in Item 7 under the heading “Notes to Consolidated Financial Statements — Note C”.

#### **(c) Narrative Description of Business**

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

##### ***(i) (a) Natural Gas Transmission***

###### ***General***

Eastern Shore, the Company’s wholly owned transmission subsidiary, 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 to Delaware and the Eastern Shore of Maryland. Eastern Shore also provides contract storage services as well as the purchase and sale of small quantities of gas for system balancing purposes (“swing gas”). Eastern Shore’s rates are subject to regulation by the Federal Energy Regulatory Commission (“FERC”).

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

Eastern Shore has 4,916 thousand cubic feet (“Mcf”) of firm transportation capacity under Rate Schedule FT under contract with Transcontinental Gas Pipe Line Corporation (“Transco”) which expires in 2005. Eastern Shore also has 7,046 Mcf of firm peak day entitlements and total storage capacity of 278,264Mcf under Rate Schedules GSS, LSS and LGA, respectively, under contract with Transco. The GSS and LSS contracts expire in 2013 and the LGA contract expires in 2006.

Eastern Shore also has firm storage service under Rate Schedule FSS and firm storage transportation capacity under Rate Schedule SST under contract with Columbia Gas Transmission (“Columbia”). These contracts, which expire in 2004, provide for 1,073 Mcf of firm peak day entitlement and total storage capacity of 53,738 Mcf.

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

###### ***Competition***

Under the open access environment, interstate pipeline companies have unbundled the traditional components of their service — gas gathering, transportation and storage — from the sale of the commodity. Pipelines that choose

to be merchants of gas must form separate marketing operations independent of their pipeline operations. Hence, gas marketers have developed as a viable option for many companies because they are providing expertise in gas purchasing along with collective purchasing capabilities which, when combined, may reduce the end-user cost. Additional discussion on competition is included in Item 7 under the heading "Management's Discussion and Analysis — Competition".

### ***Rates and Regulation***

***General.*** 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 and fees Eastern Shore can charge to its transportation customers. In addition, the FERC regulates the rates Eastern Shore is charged for transportation and transmission line capacity and services provided by Transco and Columbia.

### ***Regulatory Proceedings***

***Amendment to Rt. 72 and Porter Road filing.*** On March 6, 1998, the FERC authorized Eastern Shore to replace 2.3 miles of 6-inch pipeline with 10-inch pipeline along Route 72 and Power Road, all in conjunction with a Delaware Department of Transportation highway relocation project. On September 15, 1998, Eastern Shore filed an amendment in Docket No. CP97-279-001 requesting that the FERC authorize an increase in the diameter of the previously approved 2.3-mile pipeline from 10 inches to 16 inches. Eastern Shore filed this amendment in connection with the 1999 System Expansion described below. The FERC issued an Order Amending Certificate in this docket on October 16, 1998, approving Eastern Shore's proposal. Construction has started and is expected to be completed during 1999.

***1999 System Expansion.*** On September 25, 1998, Eastern Shore filed an application before the FERC requesting authorization to construct and operate a total of eight miles (4.5 miles in Pennsylvania and 3.5 miles in Delaware) of 16-inch pipeline looping on Eastern Shore's existing system and to install 1,085 horsepower of additional compression at its Delaware City compressor station. The purpose of these new facilities is to enable Eastern Shore to provide 16,540 dekatherms of additional firm transportation capacity on its system for two existing customers, Delmarva Power and Light Company and Star Enterprise. The proposed expansion has been targeted for completion on November 1, 1999. The estimated project cost is approximately \$7.0 million and is expected to generate approximately \$1.8 million in additional annual revenue. Eastern Shore also requested the FERC to issue a preliminary determination of rolled-in treatment of the costs incurred in this project into existing rates. The Company is awaiting FERC approval.

***Rate Case Filing.*** In October 1996, Eastern Shore filed for a general rate increase with the FERC. The filing proposed an increase in Eastern Shore's jurisdictional rates that would generate additional annual operating revenue of approximately \$1.4 million. Eastern Shore also stated in the filing that it intended to use the cost-of-service submitted in the general rate increase filing to develop rates in the pending Open Access Docket. In September 1997, the FERC approved a rate increase of \$1.2 million.

***Open Access Filing.*** In December 1995, Eastern Shore filed its abbreviated application for a blanket certificate of public convenience and necessity authorizing the transportation of natural gas on behalf of others. Eastern Shore proposed to unbundle the sales and storage services it had provided. Customers who had previously received firm sales and storage services on Eastern Shore (the "Converting Customers") would receive entitlements to firm transportation service on Eastern Shore's pipeline in a quantity equivalent to their existing service rights. Eastern Shore proposed to retain some of its pipeline entitlements and storage capacity for operational issues and to facilitate "no-notice" (no prior notification required to receive service) transportation service on its pipeline system. Eastern Shore would release or assign to the remaining Converting Customers the firm transportation capacity, including contract storage, it held on its upstream pipelines so that the Converting Customers would be able to become direct customers of such upstream pipelines. Converting Customers who previously received bundled sales service having no-notice characteristics would have the right to elect no-notice firm transportation service.

In connection with the rate increase settlement, the issues listed above pertaining to Eastern Shore operating as an open access pipeline were also settled in September 1997, with open access implementation occurring on November 1, 1997.

***Delaware City Compressor Station Filing.*** In December 1995, Eastern Shore filed an application before the FERC pursuant to Sections 7(b) and (c) of the Natural Gas Act for a certificate of public convenience and necessity authorizing Eastern Shore to: (1) construct and operate a 2,170 horsepower compressor station in Delaware City, New Castle County, Delaware on a portion of its existing pipeline system known as the "Hockessin Line", such new station to be known as the "Delaware City Compressor Station"; (2) construct and operate slightly less than one mile of 16-inch pipeline in Delaware City, New Castle County, Delaware to tie the suction side of the proposed Delaware City Compressor Station into the Hockessin Line; and (3) increase the maximum allowable operating pressure on 28.7 miles of Eastern Shore's pipeline from Eastern Shore's existing Bridgeville Compressor Station in Bridgeville, Sussex County, Delaware to its terminus in Salisbury, Wicomico County, Maryland.

In September 1996 the FERC issued its Final Order, which: authorized Eastern Shore to: (1) construct and operate the facilities requested in its application; (2) roll-in the cost of the facilities into its existing rates if the revenues from the increase in services exceed the cost associated with the expansion portion of the project; and (3) abandon the 100 Mcf per day of firm sale service to one of its direct sale customers. The FERC's Final Order also denied Eastern Shore the authority to increase the level of sales and storage service it provides its customers until it completes its restructuring in its open access proceeding. The compressor facility and associated piping were needed to stabilize capacity on Eastern Shore's system as a result of steadily declining inlet pressures at the Hockessin interconnect with Transcontinental Gas Pipe Line Corporation. Construction of the facilities started during the second half of 1996 and was completed during the first quarter of 1997.

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

Chesapeake distributes natural gas to approximately 37,100 residential, commercial and industrial customers in southern Delaware, the Salisbury and Cambridge, Maryland areas on Maryland's Eastern Shore, and Central Florida. These activities are conducted through three utility divisions, one division in Delaware, another in Maryland and a third division in Florida. In 1993, the Company started natural gas supply management services in the state of Florida under the name of Peninsula Energy Services Company ("PESCO").

***Delaware and Maryland.*** The Delaware and Maryland divisions serve an average of approximately 27,900 customers, of which approximately 27,800 are residential and commercial customers purchasing gas primarily for heating purposes. Annually, residential and commercial customers account for approximately 56% of the volume delivered by the divisions and 75% of the divisions' revenue. The divisions' industrial customers purchase gas, primarily on an interruptible basis, for a variety of manufacturing, agricultural and other uses. Most of Chesapeake's customer growth in these divisions comes from new residential construction using gas heating equipment.

***Florida.*** The Florida division distributes natural gas to an average of approximately 9,100 residential and commercial and 90 industrial customers in Polk, Osceola and Hillsborough Counties. Currently 41 of the division's industrial customers, which purchase and transport gas on a firm and interruptible basis, account for approximately 89% of the volume delivered by the Florida division and 50% of the division's annual natural gas and transportation revenues. These customers are primarily engaged in the citrus and phosphate industries and electric cogeneration. The Company's Florida division also provides natural gas supply management services to compete in the open access environment. Currently, twenty-two customers receive such services, which generated net income of \$66,000 in 1998.

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

***General.*** Chesapeake's Delaware and Maryland utility divisions ("Delaware", "Maryland" or "the Divisions") have firm and interruptible contracts with four (4) interstate "open access" pipelines. The Divisions are directly interconnected with Eastern Shore and services upstream of Eastern Shore are contracted with Transco, Columbia,

and Columbia Gulf Transmission Company ("Gulf"). The Divisions use their firm supply sources to meet a significant percentage of their projected demand requirements. In order to meet the difference between firm supply and firm demand, Delaware and Maryland obtain gas supply on the "spot market" from various other suppliers that is transported by the upstream pipelines and delivered to the Divisions' interconnects with Eastern Shore as needed. The Company believes that Delaware and Maryland's available firm and "spot market" supply is ample to meet the anticipated needs of their customers.

Delaware. Delaware's contracts with Transco include: (a) firm transportation capacity of 8,663 dekatherms ("Dt") per day, which expires in 2005; (b) firm transportation capacity of 311 Dt per day for December through February, expiring in 2006; and (c) firm storage service, providing a total capacity of 142,830 Dt. Delaware and Transco are currently engaged in negotiations with regard to an extension of the term of the firm storage service. Although the original contract expired in 1998, Transco and Delaware have continued under the previous terms and conditions until an agreement is finalized.

Delaware's contracts with Columbia include: (a) firm transportation capacity of 852 Dt per day, which expires in 2004; (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 storage service providing a peak day entitlement of 6,193 Dt and a total capacity of 298,195 Dt, expiring in 2004; and (f) firm storage service, providing a peak day entitlement of 583 Dt per day and a total capacity of 52,460 Dt, which expires in 2018. 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.

Delaware's contract with Gulf, which expires in 2004, provides firm transportation capacity of 868 Dt per day for the period November through March and 798 Dt per day for the period April through October.

Delaware's contracts with Eastern Shore include: (a) firm transportation capacity of 25,560 Dt per day for the period December through February, 24,338 Dt per day for the months of November, March and April, and 15,262 Dt per day for the period May through October, with various expiration dates ranging from 2004 to 2017; (b) firm storage capacity under Eastern Shore's Rate Schedule GSS 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 under Eastern Shore's Rate Schedule LSS providing a peak day entitlement of 580 Dt and a total capacity of 29,000 Dt, which expires in 2013; and (d) firm storage capacity under Eastern Shore's Rate Schedule LGA providing a peak day entitlement of 911 Dt and a total capacity of 5,708 Dt, which expires in 2006. Delaware's firm transportation contracts with Eastern Shore also include Eastern Shore's provision of swing transportation service. This service includes: (a) firm transportation capacity of 1,846 Dt per day on Transco's pipeline system, retained by Eastern Shore, in addition to Delaware's Transco capacity referenced earlier and (b) an interruptible storage service under Transco's Rate Schedule ESS that supports a swing supply service provided under Transco's Rate Schedule FS.

Delaware currently has contracts for the purchase of firm natural gas supply with four (4) suppliers. These contracts provide the availability of a maximum firm daily entitlement of 12,200 Dt and the supplies are transported by Transco, Columbia, Gulf and Eastern Shore under Delaware's transportation contracts. The gas purchase contracts have various expiration dates.

Maryland. Maryland's contracts with Transco include: (a) firm transportation capacity of 4,738 Dt per day, which expires in 2005; (b) firm transportation capacity of 155 Dt per day for December through February, expiring in 2006; and (c) firm storage service providing a total capacity of 33,120 Dt. Maryland and Transco are currently engaged in negotiations with regard to an extension of the term of the firm storage service. Although the original contract expired in 1998, Transco and Maryland have continued under the previous terms and conditions until an agreement is finalized.

Maryland's contracts with Columbia include: (a) firm transportation capacity of 442 Dt per day, which expires in 2004; (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 2004; and (e) firm storage service providing a peak day entitlement of 521 Dt and a total capacity of 46,881 Dt, which expires in 2017. Maryland'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.

Maryland's contract with Gulf, which expires in 2004, 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.

Maryland's contracts with Eastern Shore include: (a) firm transportation capacity of 13,378 Dt per day for the period December through February, 12,654 Dt per day for the months of November, March and April, and 8,093 Dt per day for the period May through October; (b) firm storage capacity under Eastern Shore's Rate Schedule GSS 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 under Eastern Shore's Rate Schedule LSS 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 under Eastern Shore's Rate Schedule LGA providing a peak day entitlement of 569 Dt and a total capacity of 3,560 Dt, which expires in 2006. Maryland's firm transportation contracts with Eastern Shore also include Eastern Shore's provision of swing transportation service. This service includes: (a) firm transportation capacity of 969 Dt per day on Transco's pipeline system, retained by Eastern Shore, in addition to Maryland's Transco capacity referenced earlier and (b) an interruptible storage service under Transco's Rate Schedule ESS that supports a swing supply service provided under Transco's Rate Schedule FS.

Maryland currently has contracts for the purchase of firm natural gas supply with four (4) suppliers. These contracts provide the availability of a maximum firm daily entitlement of 7,239 Dt and the supplies are transported by Transco, Columbia, Gulf and Eastern Shore under Maryland's transportation contracts. The gas purchase contracts have various expiration dates.

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 21,123 Dt in May through September, 27,105 Dt in October, and 27,519 Dt in November through April under FGT's firm transportation service (FTS-1) rate schedule; (b) daily firm transportation capacity of 5,100 Dt in May through October, and 8,100 Dt in November through April under FGT's firm transportation service (FTS-2) rate schedule; and (c) daily interruptible transportation capacity of 20,000 Dt under FGT's interruptible transportation services (ITS-1) rate schedule. The firm transportation contract (FTS-1) expires on August 1, 2000 with the Company retaining a unilateral right to extend the term for an additional ten years. After the expiration of the primary or secondary term, Chesapeake has the right to first refuse to match the terms of any competing bids for the capacity. The firm transportation contract (FTS-2) expires on March 1, 2015. The interruptible transportation contract is effective until August 1, 2010 and month to month thereafter unless canceled by either party with thirty days notice.

The Florida division currently receives its gas supply from various suppliers. If needed, some supply is bought on the spot market; however, the majority is bought under the terms of two firm supply contracts with Dynegy Marketing and Trade and Duke Energy. Availability of gas supply to the Florida division is also expected to be adequate under existing arrangements.

### **Competition**

Competition with Alternative Fuels. Historically, the Company's natural gas distribution divisions have successfully competed with other forms of energy such as electricity, oil and propane. The principal consideration in the competition between the Company and suppliers of other sources of energy is price and, to a lesser extent,

accessibility. All of the Company's divisions have the capability of adjusting their interruptible rates to compete with alternative fuels.

The divisions 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 remain depressed relative to the price of natural gas. However, oil prices as well as the prices of other fuels are subject to change at any time for a variety of reasons; therefore, there is always uncertainty in the continuing competition among natural gas and other fuels. In order to address this uncertainty, the Company uses flexible pricing arrangements on both the supply and sales side of its business to maximize sales volumes.

To a lesser extent than price, availability of equipment and operational efficiency are also factors in competition among fuels, primarily in residential and commercial settings. Heating, water heating and other domestic or commercial equipment is generally designed for a particular energy source, and especially with respect to heating equipment, the cost of conversion is a disincentive for individuals and businesses to change their energy source.

*Competition within the Natural Gas Industry.* FERC Order 636 enables all natural gas suppliers to compete for customers on an equal footing. Under this open access environment, interstate pipeline companies have unbundled the traditional components of their service such as gas gathering, transportation and storage from the sale of the commodity. If they choose to be a merchant of gas, they must form a separate marketing operation independent of their pipeline operations. Hence, gas marketers have developed as a viable option for many companies because they are providing expertise in gas purchasing along with collective purchasing capabilities which, when combined, may reduce end-user cost.

Also resulting from an open access environment, the distribution division can be in competition with the interstate transmission company if the distribution customer is located close to the transmission company's pipeline. The customers at risk are usually large volume commercial and industrial customers with the financial resources and capability to bypass the distribution division. In certain situations the distribution divisions may adjust rates and services for these customers to retain their business.

### ***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 Company's business, including the rates for sales to all of their customers in each jurisdiction. All of Chesapeake's firm distribution rates are subject to purchased gas adjustment clauses, which match revenues with gas costs and normally allow eventual full recovery of gas costs. Adjustments under these clauses require periodic filings and hearings with the relevant regulatory authority, but do not require a general rate proceeding. Rates on interruptible sales by the Florida division are also subject to purchased gas adjustment clauses.

Management monitors the rate of return in each jurisdiction in order to ensure the timely filing of rate adjustment applications.

### ***Regulatory Proceedings***

*Maryland.* During the month of March 1997, the Maryland Public Service Commission ("MPSC") approved an order authorizing Chesapeake to implement new service offerings and rate design for services rendered on and after April 1, 1997. The approved changes included: (1) class revenue requirements and restructured sales services which provide for separate firm commercial and industrial rate schedules for general service, medium volume, large volume and high load factor customer groups; (2) unbundling of gas costs from distribution charges; (3) a new gas cost recovery mechanism, which utilizes a projected period under which the fixed cost portion of the gas rate will be forecasted on an annual basis and the commodity cost portion of the gas rate will be estimated quarterly, based on projected market prices; and (4) a new sharing agreement under which interruptible margins will continue to be shared, 90% to customers and 10% to the Company, but distribution costs incurred for incremental load additions



can be recovered with carrying charges utilizing 100% of the incremental margin if the payback period is within three years.

At the request of the MPSC Staff, consideration of the Company's proposed new transportation services was postponed until Eastern Shore Natural Gas Company's open access filing was settled with the FERC. As mentioned previously, Eastern Shore Natural Gas Company became an open access pipeline on November 1, 1997.

Chesapeake's Maryland division was involved in a roundtable collaborative process with the MPSC Staff, customer representatives, third party suppliers or marketers and the Maryland Office of People's Counsel during the last half of 1997 and the first half of 1998, developing initial transportation services for its commercial and industrial customers. The MPSC issued an order in July 1998 authorizing the Company to implement transportation and balancing services effective October 1, 1998 for commercial and industrial customers with annual consumption over 30,000 Ccf per year to transport customer-owned gas on the Company's distribution system.

Delaware. In September 1998, Chesapeake's Delaware division filed an application with the Delaware Public Service Commission ("DPSC") to propose certain rate design changes to its existing margin sharing mechanism which was approved in the Company's 1997 rate restructuring. Chesapeake filed this application as an alternative to a base rate proceeding in order to provide the Company an opportunity to earn its allowed rate of return, without increasing the price of its natural gas services from the Company's last rate case in 1995.

The Company proposed certain rate design changes to its currently existing margin sharing mechanism in order to address the level of recovery of fixed distribution costs from the residential heating service customers and smaller commercial heating customers. Chesapeake proposed to modify the existing margin sharing thresholds to address the actual level of fixed distribution cost recovered from the residential and smaller commercial customers based on the base tariff rates established in PSC Docket No. 95-73, Phase II. Chesapeake's base tariff rates established in the last rate case were designed to recover a certain amount of fixed distribution costs in order for Chesapeake to earn its authorized rate of return. The proposal increases or decreases the current margin sharing thresholds based on the actual level of recovery of fixed distribution costs from these respective customer classes as compared to the level which the base tariff rates were designed to recover in the last rate case.

The Company also proposed to change the existing margin sharing mechanism to take into consideration the appropriate treatment of margins achieved by the addition of new interruptible customers on the distribution system for which the Company makes capital investments to serve these customers. Currently, Chesapeake is required to include in its margin sharing calculation the margins achieved from all of its interruptible customers. Chesapeake does not have the opportunity to earn a return on its capital investments until base tariff rates are established in the context of a base rate proceeding. The Company proposes to exclude from the margin sharing mechanism the margins achieved from the addition of new interruptible customers in order to provide the Company a reasonable opportunity to earn its authorized rate of return until the Company's next base rate proceeding.

During October 1998, the DPSC suspended the Company's tariff filing, pending the completion of full evidentiary hearing(s) and a final decision by the DPSC during 1999. During February 1999, the scheduled evidentiary hearing was convened to introduce the Company's testimony and exhibits, as well as DPSC Staff's testimony, into the record of evidence. The parties deferred any cross-examination in this docket until March 1999 when the hearing will reconvene. At this time, the Company and the respective parties are engaged in discussions in an effort to reach a settlement on the issues beneficial to all parties prior to the next scheduled hearing. If a settlement cannot be reached among the parties in this docket, then the hearing will reconvene in March 1999 and the issues will be determined based on a formal commission proceeding. The DPSC most likely would issue a final order in this docket during May or June 1999.

In February 1997, the DPSC approved an order authorizing Chesapeake to implement new service offerings and rate design for services rendered on and after March 1, 1997. The approved changes included: (1) restructured sales services which provided commercial and industrial customers with various service classifications such as general

service, medium volume, large volume, and high load factor services; (2) a modified purchased gas cost recovery mechanism which takes into consideration the unbundling of gas costs from distribution charges as well as charging certain firm service classifications different gas cost rates based on the service classification's load factor; (3) the implementation of a mechanism for sharing interruptible, capacity release and off-system sales margins between firm sales customers and the Company, with changing margin sharing percentages based on the level of total margin achieved; and (4) a provision for transportation and balancing services for commercial and industrial customers with annual consumption over 30,000 Ccf per year to transport customer-owned gas on the Company's distribution system. The Company's Delaware division implemented these initial transportation and balancing services on December 1, 1997 as a result of its pipeline supplier, Eastern Shore Natural Gas Company, becoming an open access pipeline on November 1, 1997.

Florida. On August 7, 1998, the Florida Division filed an administrative request for approval to revise its tariff sheets to include Citrus County, Florida in its service territory. On August 19, 1998, we received notification that the tariff sheets had been approved by the PSC Staff. The Company has executed service agreements with several customers in the area and is in the process of securing franchise agreements with the cities of Crystal River and Inverness. The Company's approved tariff sheets became effective on September 10, 1998.

On July 15, 1998, the Florida Division filed a petition seeking the authority to implement a flexible gas service tariff. This tariff is designed to meet the Company's need to compete for potential customers who have other viable energy options and to increase load by working with customers with regard to specific terms and conditions of service. Approval of this tariff would enable the Company to provide potential and existing customers with flexible pricing and contract terms which would be precluded under our existing tariff. On October 6, 1998, the Commission voted to approve our Flexible Gas Service tariff. The tariff became effective upon approval and is now available for use in negotiations with customers at the sole option of the Company.

On May 7, 1998, the Company filed for approval of two transportation agreements with Quincy Farms and Fernlea Nurseries. Both customers are located in Gadsden County, Florida. The agreements provide for a transportation rate equal to the non-fuel rate in existence prior to the rate restructuring for the first two years of each contract. The majority of our negotiations with these two customers took place prior to the rate restructuring proceeding. The Company also requested modification of its tariff sheets to include Gadsden County in its service territory. PSC Staff issued its recommendation supporting the petition on June 18, 1998. The Commission voted to approve the contracts and tariff sheet revisions on June 30, 1998.

On November 26, 1997, the Florida Division filed a request with the Florida Public Service Commission (FPSC) in Docket No. 971559-GU, for a Limited Proceeding to Restructure Rates and for Approval of Gas Transportation Agreements. The Florida Division has entered into Gas Transportation Contracts with its two largest customers which resulted in retaining these two customers on the Company's distribution system at rates lower than previously achieved. As a result of this reduction in non-fuel revenue, the Company has proposed in its application to restructure rates for its remaining customers to more closely reflect the cost of service for each rate class and to recover the level of revenues previously generated by the two Contract customers.

The Company's restructuring proposal is revenue neutral. Approval of this request would not result in additional revenues to the Company; however, FPSC approval would enable the Company to retain its two largest customers while providing the Company with the opportunity to achieve its FPSC authorized rate of return.

FPSC Staff issued their recommendation in this docket on March 12, 1998. The Commission voted to approve the Company's restructuring proposal on March 24, 1998. A Commission Order on this docket was issued on March 31, 1998.

## ***(i) (c) Propane Distribution and Marketing***

### ***General***

Chesapeake's propane distribution group consists of Sharp Energy, Inc. ("Sharp Energy"), a wholly owned subsidiary of Chesapeake, its wholly owned subsidiary, Sharpgas, Inc. ("Sharpgas") and Tri-County Gas Company, Inc. ("Tri-County") a wholly owned subsidiary of Chesapeake. The propane marketing group consists of Xeron, Inc. ("Xeron"), a wholly owned subsidiary of Chesapeake.

On May 30, 1998, Chesapeake acquired Xeron, a natural gas liquids trading company located in Houston, Texas. Xeron markets propane to a number of large independent and petrochemical companies, resellers, and southeastern retail propane companies.

On March 6, 1997, the Company acquired Tri-County, a family-owned and operated propane distribution business located in Salisbury and Pocomoke, Maryland. The combined operations of the Company and Tri-County served approximately 35,000 propane customers on the Delmarva Peninsula and delivered approximately 26 million retail and wholesale gallons of propane during 1998.

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

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 gaseous at normal pressures, 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 pipelines. 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.

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

Sharp Energy and Tri-County 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 a take-or-pay premiums) and maximum purchase provisions.

Sharp Energy and Tri-County use trucks and railroad cars to transport propane from refineries, natural gas processing plants or pipeline terminals to the Company's bulk storage facilities. From these facilities, propane is delivered in portable cylinders or by "bobtail" trucks, owned and operated by the Companies, to tanks located at the customer's premises.

Xeron has no physical storage facilities or equipment to transport propane; however, they contract for storage and pipeline capacity to facilitate the sale of propane on a wholesale basis.

### ***Competition***

Sharp Energy and Tri-County 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 local because distributors located in close proximity to customers incur lower costs of providing service. Propane competes with electricity as an energy source, because it is typically less expensive than electricity, based on equivalent BTU value. 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.

Xeron competes against various marketers that may have significantly great resources and are able to obtain price or volumetric advantages over Xeron.

The Company's propane distribution and 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 \$35,000,000 per occurrence, but there is no assurance that such insurance will be adequate.

#### ***(i) (d) Advanced Information Services***

##### ***General***

Chesapeake's advanced information services segment is comprised of United Systems, Inc. ("USI") and Capital Data Systems, Inc. ("CDS"), both wholly owned subsidiaries of the Company. CDS provided programming support for application software, until the first quarter of 1997, at which time it disposed of substantially all of its assets.

USI is an Atlanta-based company that primarily provides support for users of PROGRESS™, a fourth generation computer language and Relational Database Management System. USI offers consulting, training, software development "tools", web development and customer software development for its client base, which includes many large domestic and international corporations.

##### ***Competition***

The advanced information services businesses face significant competition from a number of larger competitors having substantially greater resources available to them than the Company. In addition, changes in the advanced information services businesses are occurring rapidly, which could adversely impact the markets for the Company's products and services.

#### ***(i) (e) Other Subsidiaries***

Skipjack, Inc. ("Skipjack") and Chesapeake Investment Company ("Chesapeake Investment"), are wholly owned subsidiaries of Chesapeake Service Company. Skipjack owns and leases two office buildings in Dover, Delaware to affiliates. Chesapeake Investment is a Delaware affiliated investment company.

On March 30, 1998, the Company acquired Sam Shannahan Well Co., based in Salisbury, Maryland, operating as Tolan Water Service ("Tolan"). Tolan was a privately owned company serving 3,000 customers on the Delmarva Peninsula with divisions supporting residential, commercial and industrial water treatment.

On March 6, 1997, in connection with the acquisition of Tri-County, the Company acquired Eastern Shore Real Estate, Inc. ("ESR"), which became a wholly owned subsidiary of Chesapeake Service Company. ESR owns and leases office buildings to affiliates and external companies.

#### ***(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 is included in Item 7 under the heading "Management Discussion and Analysis — Liquidity and Capital Resources".

**(iv) Employees**

Chesapeake has 456 employees, including 165 in natural gas distribution and transmission, 135 in propane distribution, 7 in propane marketing, 81 in advanced information services and 25 in water conditioning. The remaining 43 employees are considered general and administrative and include officers of the Company, treasury, accounting, information technology, human resources and other administrative personnel. The acquisition of Tolan Water Service added 25 employees, while the Xeron acquisition added 7 employees.

**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, Delaware; Plant City, Florida; Chincoteague and Belle Haven, Virginia; Easton and Pocomoke, Maryland; Detroit, Michigan; Houston, Texas and Atlanta, Georgia. In general, the properties of the Company 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 576 miles of natural gas distribution mains (together with related service lines, meters and regulators) located in its Delaware and Maryland service areas, and 474 miles of such 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. Portions of the properties constituting Chesapeake's distribution system are encumbered pursuant to Chesapeake's First Mortgage Bonds.

**(c) Natural Gas Transmission**

Eastern Shore owns approximately 273 miles of transmission lines extending from Parkesburg, Pennsylvania to Salisbury, Maryland. Eastern Shore also owns three compressor stations located in Delaware City, Delaware; Daleville, Pennsylvania and Bridgeville, Delaware. The Delaware City compressor facility and associated piping are needed to stabilize capacity on Eastern Shore's system as a result of steadily declining inlet pressures at the Hockessin interconnect with Transco. The Daleville station is used to increase Columbia supply pressures to match Transco supply pressures, and to increase Eastern Shore's pressures in order to serve Eastern Shore's firm customers' demands, including those of Chesapeake's Delaware and Maryland divisions. The Bridgeville station is being used to provide increased pressures required to meet demands on the system.

**(d) Propane Distribution and Marketing**

Sharpgas and Tri-County own bulk propane storage facilities with an aggregate capacity of approximately 1.9 million gallons at 32 plant facilities in Delaware, Maryland and Virginia, located on real estate they either own or lease. Xeron has no physical storage facilities or equipment to transport propane.

**ITEM 3. LEGAL PROCEEDINGS**

**(a) General**

The Company and its subsidiaries are 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 of the Company.

**(b) Environmental**

**Dover Gas Light Site**

In 1984, the State of Delaware notified the Company that a parcel of land it purchased in 1949 from Dover Gas Light Company, a predecessor gas company, contained hazardous substances. The State also asserted that the Company is responsible for any clean-up and prospective environmental monitoring of the site. The Delaware Department of Natural

Resources and Environmental Control (“DNREC”) investigated the site and surroundings, finding coal tar residue and some ground-water contamination.

In October 1989, the Environmental Protection Agency Region III (“EPA”) listed the Dover site on the National Priorities List under the Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA” or “Superfund”). At that time under CERCLA, both the State of Delaware and the Company were named as potentially responsible parties (“PRPs”) for clean-up of the site.

The EPA issued the site Record of Decision (“ROD”) dated August 16, 1994. The remedial action selected by the EPA in the ROD addressed the ground-water contamination with a combination of hydraulic containment and natural attenuation. Remediation selected for the soil at the site was to meet stringent cleanup standards for the first two feet of soil and less stringent standards for the soil below two feet. The ROD estimated the costs of selected remediation of ground-water and soil at \$2.7 million and \$3.3 million, respectively.

In May 1995, EPA issued an order to the Company under section 106 of CERCLA (the “Order”), which required the Company to fund or implement the ROD. The Order was also issued to General Public Utilities Corporation, Inc. (“GPU”), which both EPA and the Company believe is liable under CERCLA. Other PRPs such as the State of Delaware were not ordered to perform the ROD. EPA may seek judicial enforcement of its Order, as well as significant financial penalties for failure to comply. Although notifying EPA of objections to the Order, the Company agreed to comply. GPU informed EPA that it did not intend to comply with the Order.

In March 1995, the Company commenced litigation against the State of Delaware for contribution to the remedial costs being incurred to carry out the ROD. In December of 1995, this case was dismissed without prejudice based on a settlement agreement between the parties (the “Settlement”). Under the Settlement, the State agreed to: support the Company’s proposal to reduce the soil remedy for the site, described below; contribute \$600,000 toward the cost of implementing the ROD and reimburse the EPA for \$400,000 in oversight costs. The Settlement is contingent upon a formal settlement agreement between EPA and the State of Delaware. Upon satisfaction of all conditions of the Settlement, the litigation will be dismissed with prejudice.

In June 1996, the Company initiated litigation against GPU for contribution to the remedial costs incurred by Chesapeake in connection with complying with the ROD. At this time, management cannot predict the outcome of the litigation or the amount of proceeds to be received, if any.

In July 1996, the Company began the design phase of the ROD, on-site pre-design and investigation. A pre-design investigation report (“the report”) was filed in October 1996 with the EPA. The report, which required EPA approval, provided up to date status on the site, which the EPA used to determine if the remedial design selected in the ROD was still the appropriate remedy.

In the report, the Company proposed a modification to the soil clean-up remedy selected in the ROD to take into account an existing land use restriction banning future development at the site. In April of 1997, the EPA issued a fact sheet stating that the EPA was considering the proposed modification. The fact sheet included an overall cost estimate of \$5.7 million for the proposed modified remedy and a new overall cost estimate of \$13.2 million for the remedy selected in the ROD. On August 28, 1997, the EPA issued a Proposed Plan to modify, with respect to soil remediation only, the current clean-up plan that would involve the following three elements: (1) excavation and off-site thermal treatment of the contents of the former subsurface gas holders; (2) implementation of soil vaporization extraction; and (3) pavement of the parking lot. The overall estimated clean-up cost of the site under the proposed plan was \$4.2 million (\$1.5 million for soil remediation and \$2.7 million for ground-water remediation) as compared to the ROD cleanup estimate of \$6.0 million (\$3.3 million for soil remediation and \$2.7 million for ground-water remediation). In January 1998, the EPA issued a ROD Amendment, which modified the soil remediation to conform to the proposed plan and included the estimated soil clean-up costs of \$4.2 million.

During the fourth quarter of 1998 the Company completed the first element of the soil remediation at the Dover site at a cost of \$450,000. Over the next twelve to eighteen months the Company will finalize the remaining two elements of the soil remediation and initiate the ground-water remedial activities.

The Company's independent consultants have prepared preliminary cost estimates of two potentially acceptable alternatives to complete the ground-water remediation activities at the site. The costs range from a low of \$390,000 in capital and \$37,000 per year of operating costs for 30 years for natural attenuation to a high of \$4.0 million in capital and \$500,000 per year in operating costs for 30 years for a pump and treat system. A decision by the EPA as to the most appropriate ground-water remediation method is likely in 1999. The capital costs necessary to begin ground-water remediation are expected to be incurred over the next twelve to eighteen months.

The Company cannot predict which ground-water remediation method will be selected by the EPA and accordingly, has accrued \$2.1 million at December 31, 1998 for the Dover site, as well as a regulatory asset for an equivalent amount. Of this amount, \$1.5 million is for ground-water remediation and \$600,000 is for the remaining soil remediation. The \$1.5 million represents the low end of the ground-water remedy estimates described above. As of December 31, 1997, the Company had accrued both a liability and a regulatory asset of \$4.2 million. The Company is currently engaged in investigations related to additional parties who may be PRPs. Based upon these investigations, the Company will consider suit against other PRPs. The Company expects continued negotiations with PRPs in an attempt to resolve these matters.

Management believes that in addition to the \$600,000 expected to be contributed by the State of Delaware under the Settlement, the Company will be equitably entitled to contribution from other responsible parties for a portion of the expenses to be incurred in connection with the remedies selected in the ROD. The Company expects that it will be able to recover actual costs incurred (exclusive of carrying costs), which are not recovered from other responsible parties, through the ratemaking process in accordance with the existing environmental cost recovery rider provisions described below.

As of December 31, 1998, the Company has incurred approximately \$6.6 million in costs relating to environmental testing and remedial action studies. In 1990, the Company entered into settlement agreements with a number of insurance companies resulting in proceeds to fund actual environmental costs incurred over a five to seven-year period. In 1995, the Delaware Public Service Commission, authorized recovery of all unrecovered environmental costs incurred by a means of a rider (supplement) to base rates, applicable to all firm service customers. The costs, exclusive of carrying costs, would be recovered through a five-year amortization offset by the deferred tax benefit associated with those environmental costs. The deferred tax benefit equals the projected cash flow savings realized by the Company in connection with a reduced income tax liability due to the possibility of accelerated deduction allowed on certain environmental costs when incurred. Each year a new rider rate is calculated to become effective December 1. The rider rate is based on the amortization of expenditures through September of the filing year plus amortization of expenses from previous years. The advantage of the rider is that it is not necessary to file a rate case every year to recover expenses incurred. As of December 31, 1998, the unamortized balance and amount of environmental costs not included in the rider, effective January 1, 1999 were \$2.5 million and \$679,000, respectively. With the rider mechanism established, it is management's opinion that these costs and any future cost, net of the deferred income tax benefit, will be recoverable in rates.

#### **Salisbury Town Gas Light Site**

In cooperation with the Maryland Department of the Environment ("MDE"), the Company completed assessment of the Salisbury manufactured gas plant site, determining that there was localized ground-water contamination. During 1996, the Company completed construction and began the Air Sparging and Soil-Vapor Extraction remediation procedures. Chesapeake has been reporting the remediation and monitoring results to the Maryland Department of the Environment on an ongoing basis since 1996.

The cost of remediation is estimated at \$136,000 per year for operating expenses for five years. Based on these estimated costs, the Company recorded both a liability and a deferred regulatory asset of \$600,000 on December 31, 1998, to cover

the Company's projected remediation costs for this site. As of December 31, 1998, the Company has incurred approximately \$2.5 million for remedial actions and environmental studies and has charged such costs to accumulated depreciation. In January 1990, the Company entered into settlement agreements with a number of insurance companies resulting in proceeds to fund actual environmental costs incurred over a three to five-year period beginning in 1990. The final insurance proceeds were requested and received in 1992. In December 1995, the Maryland Public Service Commission approved recovery of all environmental cost incurred through September 30, 1995 less amounts previously amortized and insurance proceeds. The amount approved for a 10-year amortization was \$964,251. Of the \$2.5 million in costs reported above, approximately \$770,000 has not been recovered through insurance proceeds or received ratemaking treatment. It is management's opinion that these costs incurred and future costs incurred, if any, will be recoverable in rates.

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

In May 1996, the Company filed an Air Sparging and Soil Vapor Extraction Pilot Study Work Plan for the Winter Haven site with the Florida Department of Environmental Protection ("FDEP"). The Work Plan described the Company's proposal to undertake an Air Sparging and Soil Vapor Extraction ("AS/SVE") pilot study to evaluate at the site. After discussions with the FDEP, the Company filed a modified AS/SVE Pilot Study Work Plan, scope of work to complete the site assessment activities and a report describing a limited sediment investigation performed recently. The Company is awaiting FDEP's comments to the modified Work Plan. It is not possible to determine whether remedial action will be required by FDEP and, if so, the cost of such remediation.

The Company has spent and received ratemaking treatment of approximately \$697,000 on these investigations as of December 31, 1998. The Company has been allowed by the Florida Public Service Commission to continue to accrue for future environmental costs. At December 31, 1998, the Company had \$501,000 accrued. It is management's opinion that future costs, if any, will be recoverable in rates.

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

None

#### **ITEM 10. EXECUTIVE OFFICERS OF THE REGISTRANT**

Information pertaining to the Executive Officers of the Company is as follows:

Ralph J. Adkins (age 56) Mr. Adkins is Chairman of the Board of Chesapeake. He has served as Chairman of the Board since August 1997. Previously, Mr. Adkins served as Chairman of the Board and Chief Executive Officer, President and Chief Executive Officer, President and Chief Operating Officer, Executive Vice President, Senior Vice President, Vice President and Treasurer of Chesapeake. Mr. Adkins is Chairman of Chesapeake Service Company, Sharp Energy, Inc., Tri-County Gas Company, Inc., Chesapeake Investment Company, Xeron, Inc., Sam Shannahan Well Co. and Eastern Shore Natural Gas Company, all wholly owned subsidiaries of Chesapeake. He has been a director of Chesapeake since 1989.

John R. Schimkaitis (age 51) Mr. Schimkaitis is President and Chief Executive Officer. He has served in this position since January 1, 1999. Mr. Schimkaitis is also Chief Executive Officer of Chesapeake Service Company, Sharp Energy, Inc., Tri-County Gas Company, Chesapeake Investment Company, Xeron, Inc., Sam Shannahan Well Co. and Eastern Shore Natural Gas Company, all wholly owned subsidiaries of Chesapeake. He previously served as President and Chief Operating Officer, Executive Vice President, Chief Financial Officer, Senior Vice President, Treasurer and Assistant Secretary. From 1983 to 1986, Mr. Schimkaitis was Vice President of Cooper & Rutter, Inc., a consulting firm providing financial services to the utility and cable industries. He was appointed as a director of Chesapeake in February 1996.

Michael P. McMasters (age 40) Mr. McMasters is Vice President, Chief Financial Officer and Treasurer of Chesapeake Utilities Corporation. He has served as Vice President, Chief Financial Officer and Treasurer since December 1996. He previously served as Vice President of Eastern Shore, 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 38) Mr. Thompson is Vice President of the Natural Gas Operations, as well as Vice President of Chesapeake Utilities Corporation. He has served as Vice President since May 1997. He has served as President, Vice President, Manager, Director of Gas Supply and Marketing, Superintendent of Eastern Shore and Regional Manager for the Florida distribution Operations.

Philip S. Barefoot (age 51) Mr. Barefoot joined Chesapeake as Division Manager of Florida Operations in July 1988. In May 1994, he was elected Vice President of Chesapeake Utilities Corporation. Prior to joining Chesapeake, he was employed by Peoples Natural Gas Company where he held the positions of Division Sales Manager, Division Manager and Vice President of Florence Operations.

## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED SECURITY HOLDER MATTERS

#### (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 1998 and 1997 were as follows:

Quarter Ended	High	Low	Close	Dividends Declared Per Share
<b>1998</b>				
March 31.....	\$20.500	\$18.250	\$18.375	\$0.2500
June 30.....	18.500	17.125	17.625	0.2500
September 30.....	18.500	16.500	17.938	0.2500
December 31.....	18.500	17.000	18.938	0.2500
<b>1997</b>				
March 31.....	\$18.000	\$16.500	\$17.375	\$0.2425
June 30.....	17.500	16.000	17.000	0.2425
September 30.....	18.500	16.250	18.375	0.2425
December 31.....	21.750	18.375	20.500	0.2425

In addition to the dividends declared by the Company, Xeron paid total dividends of \$27,000 during 1998.

Indentures to the long-term debt of the Company and its subsidiaries contain a restriction that the Company cannot, until the retirement of its Series I Bonds, pay any dividends after December 31, 1988 which exceed the sum of \$2,135,188 plus consolidated net income recognized on or after January 1, 1989. As of December 31, 1998, the amounts available for future dividends permitted by the Series I covenant are \$14.7 million.

At December 31, 1998, there were approximately 2,271 shareholders of record.

#### (b) Issuance of shares:

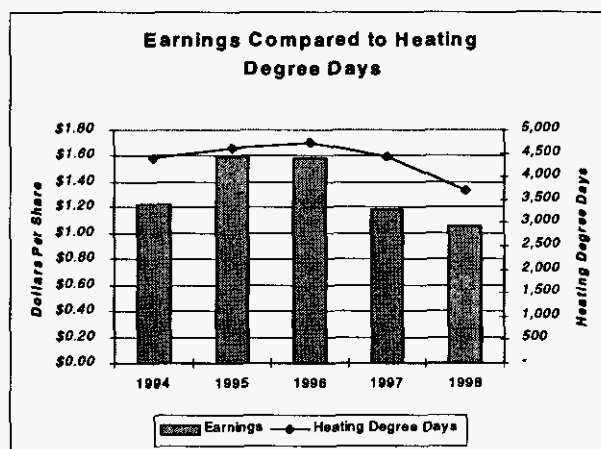
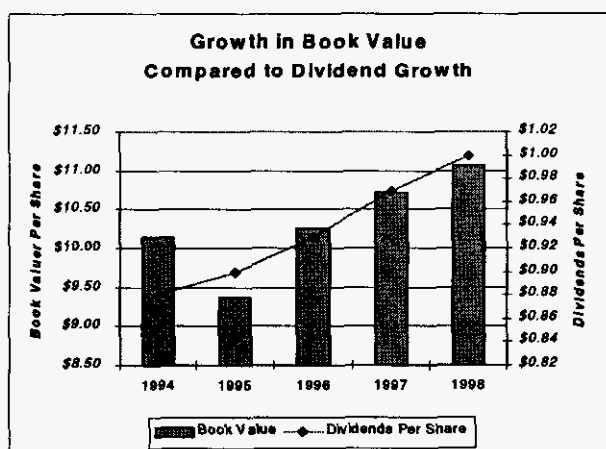
On May 29, 1998, in conjunction with the acquisition of Xeron, Inc., the Company issued 475,000 shares of common stock to J. Phillip Keeter, Earnest Allen Jr. and Patrick E. Armand in reliance on the private placement exemption provided by Section 4(c) of the Securities Act of 1933 and Regulation D, thereunder.

On March 31, 1998, in conjunction with the acquisition of Sam Shannahan Well Co., the Company issued 25,000 shares of company stock to Deshield J. Shannahan and Joyce C. Shannahan in reliance on the private placement exemption provided by Section 4(c) of the Securities Act of 1933 and Regulation D, thereunder.

## ITEM 6. SELECTED FINANCIAL DATA

	(dollars in thousands except stock data)				
For the Years Ended December 31,	1998	1997	1996	1995	1994 <sup>(1)</sup>
<b>Operating</b>					
Operating revenues	\$ 183,569	\$ 222,489	\$ 260,102	\$ 235,285	\$ 98,572
Operating income	\$ 8,441	\$ 8,666	\$ 10,099	\$ 9,962	\$ 7,227
Net income	\$ 5,303	\$ 5,868	\$ 7,782	\$ 7,696	\$ 4,460
<b>Balance Sheet</b>					
Gross plant	\$ 152,991	\$ 144,251	\$ 134,001	\$ 120,746	\$ 110,023
Net plant	\$ 104,266	\$ 99,879	\$ 94,014	\$ 85,055	\$ 75,313
Total assets	\$ 145,234	\$ 145,719	\$ 155,786	\$ 130,998	\$ 108,271
Long-term debt, net	\$ 37,597	\$ 38,226	\$ 28,984	\$ 31,619	\$ 24,329
Common stockholders' equity	\$ 56,356	\$ 53,656	\$ 50,699	\$ 45,587	\$ 37,063
Capital expenditures	\$ 12,650	\$ 13,471	\$ 15,399	\$ 12,887	\$ 10,653
<b>Common Stock</b>					
Earnings per share:					
Basic	\$ 1.05	\$ 1.18	\$ 1.58	\$ 1.59	\$ 1.23
Diluted	\$ 1.04	\$ 1.17	\$ 1.55	\$ 1.56	\$ 1.20
Average shares outstanding	5,060,328	4,972,086	4,912,136	4,836,430	3,628,056
Cash dividends per share	\$ 1.00	\$ 0.97	\$ 0.93	\$ 0.90	\$ 0.88
Book value per share	\$ 11.06	\$ 10.72	\$ 10.26	\$ 9.38	\$ 10.15
Common equity/Total capitalization	59.98%	58.40%	63.63%	59.05%	60.37%
Return on equity	9.41%	10.94%	15.35%	16.88%	12.03%
<b>Other</b>					
Number of employees	456	429	418	415	320
Number of registered shareholders	2,271	2,178	2,213	2,098	1,721
Heating degree days	3,704	4,430	4,717	4,594	4,398
Heating degree days (10-year average)	4,579	4,596	4,586	4,564	4,588

<sup>(1)</sup> 1994 has not been restated to include the business combinations with Tri-County Gas Company, Inc., Tolan Water Service or Xeron, Inc.



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

### **Liquidity and Capital Resources**

The capital requirements of Chesapeake Utilities Corporation ("Chesapeake" or "the Company") reflect the capital-intensive nature of its business and are attributable principally to the construction program 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 temporarily finance capital expenditures. During 1998, net cash provided by operating activities was \$11.0 million, cash used by investing activities was \$12.5 million and cash used by financing activities was \$737,000.

The Board of Directors has authorized the Company to borrow up to \$20.0 million from various banks and trust companies. As of December 31, 1998, Chesapeake had three unsecured bank lines of credit, totaling \$28.0 million, for short-term cash needs to meet seasonal working capital requirements and to temporarily fund portions of its capital expenditures. The outstanding balances of short-term borrowing at December 31, 1998 and 1997 were \$11.6 million and \$7.6 million, respectively.

In 1998, Chesapeake used cash provided by operations and short-term borrowing to fund capital expenditures. During 1997, the Company used cash provided by operations and the issuance of long-term debt to fund capital expenditures and reduce short-term borrowing.

During 1998, 1997 and 1996, capital expenditures were approximately \$12.0 million, \$12.4 million and \$14.0 million, respectively. Chesapeake has budgeted \$22.7 million for capital expenditures during 1999. This amount includes \$10.5 million and \$8.6 million for natural gas distribution and transmission, respectively, \$1.8 million for propane distribution and marketing, \$336,000 for advanced information services and \$1.5 million for general plant. The natural gas distribution expenditures are for expansion and improvement of facilities in existing service territories. Natural gas transmission expenditures are for improvement and expansion of the pipeline system, specifically, the construction of eight miles of pipeline to provide additional firm transportation capacity to two existing customers. The propane expenditures are to support customer growth and the replacement of older equipment. The advanced information services expenditures are for computer hardware, software and related equipment. General expenditures are for building improvements, computer software and hardware. Financing for the 1999 construction program is expected to be provided from short-term borrowing and cash from operations. The construction program is subject to continuous review and modification. Actual construction expenditures may vary from the above estimates due to a number of factors including acquisition opportunities, changing economic conditions, customer growth in existing areas, regulation and new growth opportunities.

Chesapeake has budgeted \$2.2 million for environmental related expenditures during 1999 and expects to incur additional expenditures in future years, a portion of which may need to be financed through external sources (see Note L to the Consolidated Financial Statements). Management does not expect such financing to have a material adverse effect on the financial position or capital resources of the Company.

### **Capital Structure**

As of December 31, 1998, common equity represented 60.0% of permanent capitalization, compared to 58.4% in 1997 and 63.6% in 1996. 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, helps to ensure that Chesapeake will be able to attract capital from outside sources at a reasonable cost. The achievement of these objectives will provide benefits to customers and creditors, as well as to the Company's investors.

### **Financing Activities**

On March 31, 1998, Chesapeake acquired Sam Shannahan Well Co., Inc., operating as Tolan Water Service ("Tolan" or "Tolan Water") in exchange for 25,000 shares of Chesapeake's common stock. Tolan provides water conditioning services to approximately 3,000 residential, commercial and industrial customers on the Delmarva Peninsula.

All of the outstanding common stock of Xeron, Inc. ("Xeron") was acquired by Chesapeake on May 29, 1998. Xeron markets propane to a number of large independent oil and petrochemical companies, resellers, and southeastern retail propane companies. Four hundred seventy-five thousand shares of the Company's common stock were exchanged in the transaction.

On March 6, 1997, the Company acquired all of the outstanding common stock of Tri-County Gas Company, Inc. ("Tri-County") and associated properties. Tri-County distributes propane to both retail and wholesale customers on the Delmarva Peninsula. The transaction was effected through the exchange of 639,000 shares of the Company's common stock.

Each of these business combinations was accounted for as a pooling of interests.

During 1998, Chesapeake repaid approximately \$1.1 million of long-term debt. In December 1997, Chesapeake finalized a private placement of \$10 million of 6.85% Senior Notes due January 1, 2012. Debt repayments during 1997 totaled \$3.1 million. In 1996, Chesapeake repaid \$881,000 in long-term debt.

Chesapeake issued 32,925, 32,169 and 33,926 shares of common stock in connection with its Automatic Dividend Reinvestment and Stock Purchase Plan during the years of 1998, 1997 and 1996, respectively.

### Results of Operations

Net income for 1998 was \$5.3 million as compared to \$5.9 million for 1997 and \$7.8 million for 1996. The decrease in net income is primarily related to warmer temperatures in the Company's northern service territory, partially offset by a one-time reduction in pension costs of \$1.2 million resulting from Chesapeake's 1998 restructuring of the Company's retirement benefits plans. Temperatures in 1998, based upon heating degree days, were 19% warmer than normal, 16% warmer than 1997 and 21% warmer than 1996. Temperatures in 1997 were approximately 6% warmer than those experienced in 1996. Normal weather conditions are calculated from the most recent ten years of temperature data measured in heating degree days. The warmer weather resulted in a reduction in volumes sold by both the natural gas distribution and propane segments. The lower volumes contributed to the reduction in Earnings Before Interest and Taxes ("EBIT") for both segments as shown in the table below.

### EARNINGS BEFORE INTEREST AND TAXES (in thousands):

For the Years Ended December 31,	1998	1997	Increase (decrease)	1997	1996	Increase (decrease)
<b>EBIT by Business Segment:</b>						
Natural gas distribution	\$ 4,697	\$ 5,498	\$ (801)	\$ 5,498	\$ 7,167	\$ (1,669)
Natural gas transmission	4,117	3,721	396	3,721	2,458	1,263
Propane distribution and marketing	971	1,158	(187)	1,158	2,669	(1,511)
Advanced information services	1,316	1,046	270	1,046	1,056	(10)
Other	522	671	(149)	671	633	38
<b>Total EBIT</b>	<b>\$ 11,623</b>	<b>\$ 12,094</b>	<b>\$ (471)</b>	<b>\$ 12,094</b>	<b>\$ 13,983</b>	<b>\$ (1,889)</b>

### Natural Gas Distribution

The \$801,000 reduction in EBIT from 1997 to 1998 was primarily the result of a reduction in gross margin, as indicated in the following table. Exclusive of the expense reductions related to the restructuring of the Company's retirement benefits plans, the decrease in EBIT of \$1.5 million or 27% was attributable to warmer than normal weather conditions. The reduction in gross margin of \$832,000 from the prior year is primarily due to the negative impact of warmer temperatures on volumes sold, partially offset by customer growth during the year. After taking into account customer growth of 4% for residential and commercial customers in the northern service territory, overall volumes declined by 12% for these customer classifications. Under normal temperatures and customer usage, the 4% customer growth is estimated to generate an additional margin of \$550,000 annually within this segment. Also contributing to the decline in margin is an 11% reduction in volumes sold and transported to industrial customers in the Florida service territory. Although operating expenses remained relatively unchanged, specific expense categories such as marketing, building

rent, legal costs and depreciation and amortization increased. These were offset by decreases in pension expense, administrative fees associated with the pension plan, compensation and outside services.

The reduction in EBIT of \$1.7 million from 1996 to 1997 is primarily related to a decline in total gross margin, as indicated in the following table, coupled with an overall increase in expenses. The reduction in gross margin is primarily the result of a 4% decline in volumes sold to residential and commercial customers and a 5% decrease in volumes sold and transported to industrial customers in Chesapeake's Florida service territory. The reduction in volumes sold to residential and commercial customers was directly related to warmer temperatures, primarily during the first quarter of 1997. Operating expenses increased \$996,000 due to increases in compensation, regulatory commission expenses, and costs related to data processing and billable service revenue. In addition, there was a greater level of maintenance to the gas pipeline system and increased depreciation and amortization due to additional plant being placed in service.

#### NATURAL GAS DISTRIBUTION GROSS MARGIN SUMMARY (in thousands)

For the Years Ended December 31,	1998	1997	Increase (decrease)	1997	1996	Increase (decrease)
<b>Revenues:</b>						
Gas sold	\$ 50,466	\$ 54,205	\$ (3,739)	\$ 54,205	\$ 52,290	\$ 1,915
Gas transported	2,875	3,061	(186)	3,061	2,991	70
Gas marketed	11,683	18,419	(6,736)	18,419	19,382	(963)
Other	401	275	126	275	193	82
<b>Total Revenues</b>	<b>\$ 65,425</b>	<b>\$ 75,960</b>	<b>\$ (10,535)</b>	<b>\$ 75,960</b>	<b>\$ 74,856</b>	<b>\$ 1,104</b>
<b>Cost of Sales: *</b>						
Gas sold	\$ 32,529	\$ 35,507	\$ (2,978)	\$ 35,507	\$ 32,846	\$ 2,661
Gas marketed	11,508	18,233	(6,725)	18,233	19,117	(884)
<b>Total Cost of Sales</b>	<b>\$ 44,037</b>	<b>\$ 53,740</b>	<b>\$ (9,703)</b>	<b>\$ 53,740</b>	<b>\$ 51,963</b>	<b>\$ 1,777</b>
<b>Gross Margin:</b>						
Gas sold	\$ 17,937	\$ 18,698	\$ (761)	\$ 18,698	\$ 19,444	\$ (746)
Gas transported	2,875	3,061	(186)	3,061	2,991	70
Gas marketed	175	186	(11)	186	265	(79)
Other	401	275	126	275	193	82
<b>Total Gross Margin</b>	<b>\$ 21,388</b>	<b>\$ 22,220</b>	<b>\$ (832)</b>	<b>\$ 22,220</b>	<b>\$ 22,893</b>	<b>\$ (673)</b>

\* Transportation service does not have an associated cost of sales.

#### Natural Gas Transmission

The Earnings Before Interest and Taxes of the Company's natural gas transmission segment increased \$396,000 from 1997 to 1998. This was the result of an increase in gross margin of \$468,000 offset by an \$87,000 increase in operating expenses. Exclusive of the expense reduction related to the restructuring of the Company's retirement benefits plans, EBIT increased \$221,000 or 6%. Gross margin increased under a full year of open access pipeline operations, as well as the full year's effect of both a rate increase and the implementation of new services which were both effective in 1997. Operating expenses were higher due to increases in regulatory commission expenses, legal fees, pipeline system maintenance and depreciation. These costs were offset by declines in pension costs, compensation and administrative fees associated with the pension plan.

The transmission segment's EBIT increased \$1.3 million from 1996 to 1997. The rise in EBIT was partially attributable to a rate increase and an increase in firm services implemented in 1997, as well as an overall reduction in expenses. Also contributing to the increase in EBIT were additional revenues generated by the increase in transportation services that were effective with the implementation of open access. Operating expenses decreased by \$124,000 or 3%, primarily due to reduced compensation, relocation costs, property insurance and pipeline system maintenance. These reductions were offset by higher depreciation expenses generated by capital additions during the year.

#### Propane Distribution and Marketing

In May 1998, the Company acquired Xeron, Inc., a wholesale marketer of propane, expanding Chesapeake's propane operations (see Note B to the Consolidated Financial Statements). The EBIT contribution of the propane distribution and marketing segment declined by \$187,000 from 1997 to 1998 due to a decrease in gross margin which was partially

offset by a decline in operating expenses. Exclusive of the expense reduction related to the restructuring of the Company's retirement benefits plans, EBIT decreased \$463,000 or 40%. The propane distribution operation was negatively affected by the warmer temperatures realized in 1998, resulting in a decline in sales volumes of 8%, after taking into account a 3% increase in customer growth. Somewhat offsetting this volume-related decline in margin was an increase of 6% in the margin earned per gallon delivered as compared to the prior year. In addition, the lack of volatility in the wholesale propane market resulted in a reduction to propane marketing margins due to fewer gallons being marketed. Wholesale marketing is a high volume, low margin business. During 1998, marketing revenues declined by \$18.1 million or 18% while margins declined by \$250,000 or 16%. Operating expenses declined primarily due to compensation linked to Xeron's earnings, pension expense and administrative fees associated with the pension plan.

The Company estimates that the warm temperatures experienced in 1998 reduced EBIT by \$1.9 million when compared to normal temperatures. In addition, margins during 1998 were lower than historical norms, further reducing EBIT by approximately \$1.6 million.

The reduction in EBIT of \$1.5 million from 1996 to 1997 was primarily due to a reduction in gross margin earned by the distribution operation, partially offset by a reduction in operating expenses. Distribution margins decreased due to a 14% reduction in sales volumes coupled with a 13% lower margin per gallon sold. The decline in sales volumes is directly related to the warmer temperatures which averaged 6% warmer than those experienced in 1996. Furthermore, during the first quarter of 1997, temperatures were 14% warmer than normal. The marketing operation contributed an additional \$240,000 to EBIT due to a reduction in compensation expense.

#### **Advanced Information Services**

The results of the advanced information services segment consisted primarily of those of United Systems, Inc. ("USI"). Exclusive of the expense reductions related to the restructuring of the Company's retirement benefits plans, EBIT contributed by USI increased 15% or \$156,000 from 1997 to 1998. Due to increased opportunities in areas such as website development, training and consulting, gross margin increased 38%, or \$1.5 million from 1997 to 1998.

Although the EBIT contribution of this segment remained virtually unchanged from 1996 to 1997, USI's gross margin increased by \$970,000 or 34%. Operating expenses increased due to the opening of a new office in Detroit, Michigan and the expansion of staff training and marketing efforts to position USI to be able to provide new services and for future growth of current services. Since the rise in operating costs offset most of the growth in gross margin, EBIT remained constant.

#### **Income Taxes**

Operating income taxes decreased \$245,000 in 1998 due to the reduction in EBIT. Income taxes also decreased in 1997 due to the reduction in EBIT. This was partially offset by a one-time expense to establish the deferred income tax liability in connection with the 1997 acquisition of Tri-County. The 1996 financial statements do not include any income tax expense for the acquisition due to its subchapter S status during that year.

#### **Other**

Non-operating income was \$241,000, \$545,000 and \$688,000 for the years 1998, 1997 and 1996, respectively. The decrease in 1998 is primarily attributable to one-time pre-tax gains of \$452,000 and \$300,000 on the sale of fixed assets included in 1997 and 1996, respectively. Also contributing to the 1998 decline is a reduction in interest income from \$288,000 for 1997 to \$188,000 for 1998.

#### **Environmental Matters**

The Company continues to work with federal and state environmental agencies to assess the environmental impact and explore corrective action at several former gas manufacturing plant sites (see Note L to the Consolidated Financial Statements). The Company believes that future costs associated with these sites will be recoverable in rates.

#### **Market Risk**

Market risk represents the potential loss arising from adverse changes in market rates and prices. The Company's long-term debt consists of first mortgage bonds, senior notes and convertible debentures (see Note G 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 was \$38.1 million at December 31, 1998. The fair value was \$41.6 million at December 31, 1998, based mainly on current market prices or discounted cash flows using current rates for similar issues with similar terms and remaining maturities. The Company is exposed to changes in interest rates as a result of financing through its issuance of fixed rate long-term debt. The Company evaluates whether to refinance existing debt or permanently finance existing short-term borrowing based on the fluctuation in interest rates.

At December 31, 1998, the wholesale propane marketing operation was a party to natural gas liquids ("NGL") forward contracts, primarily propane contracts, with various third parties. These contracts require that the wholesale propane 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 respective party. The wholesale propane 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 wholesale propane marketing operation is subject to commodity price risk on their open positions to the extent that NGL market prices deviate from fixed contract settlement amounts. Market risks 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. In order to manage exposures to changing market prices, open positions are marked to market 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. Listed below is quantitative information on the forward and futures contracts at December 31, 1998. All of the contracts mature during 1999.

<b>At December 31, 1998</b>	<b>Quantity in gallons</b>	<b>Estimated Market Prices</b>	<b>Weighted Average Contract Prices</b>
<b>Forward Contracts</b>			
Sale	20,647,200	\$.2125 — \$.2550	\$0.2569
Purchase	24,263,400	\$.2125 — \$.2550	\$0.2424
<b>Futures Contracts</b>			
Sale	4,200,000	\$.2125 — \$.2550	\$0.2194
Purchase	714,000	\$.2125 — \$.2550	\$0.2110

Estimated market prices and weighted average contract prices are in dollars per gallon.

### **The Year 2000**

Chesapeake is dependent upon a variety of information systems to operate efficiently and effectively. In order to address the impact of the Year 2000 ("Year 2000" or "Y2K") on its information systems, Chesapeake is in the process of evaluating and remediating any deficiencies. The Company's evaluation of its readiness and the potential impact of the Year 2000 on its systems have been separated into five components: primary internal applications, embedded systems, vendors/suppliers, end-user computing systems and customers.

- Chesapeake's primary internal applications include company maintained software systems for its financial information; natural gas customer information and billing; and propane customer information, billing and delivery. The Company completed testing of these three applications in 1998 and deems them Year 2000 ready.
- Embedded systems include the supervisory control and data acquisition ("SCADA") system for the natural gas transmission segment, telecommunications, metering and other facilities related systems. Chesapeake has currently identified 64 vendors that support the Company's embedded systems. Chesapeake expects to finalize the review for additional vendors and/or embedded systems by the end of the first quarter of 1999. The Company has prioritized these vendors into three potential impact classifications: 15 high impact

vendors, supporting items such as the SCADA system; 19 medium impact vendors, supporting systems such as telecommunications; and 30 low impact vendors, supporting items such as copiers and postage meters. The Company has been testing these systems and has contacted all of the vendors currently identified, with 85% responding. Of the vendors contacted, a total of 20 vendors — four high impact, six medium impact and ten low impact vendors — indicated they were Y2K ready. The Company has been either working with vendors to reach a state of readiness with the applicable systems or has changed to vendors or systems that are Y2K ready. The SCADA system, the most critical embedded system, is scheduled to be Y2K ready during the second quarter of 1999. Chesapeake will continue to follow up with vendors that are not Y2K ready and will consider alternate providers as necessary to the extent available.

- Chesapeake has identified 101 vendors/suppliers that supply the Company with products and services that impact various elements of the Company's business. The Company has classified these vendors into three impact classifications: 27 high impact vendors such as suppliers of natural gas or propane; 31 medium impact vendors such as regional communication vendors; and 43 low impact vendors. The Company has requested a Y2K status statement from each of these vendors. The Company has received 72 responses, which indicated that nine medium impact and 13 low impact vendors were Y2K ready. The Company will continue to follow up with vendors that are not Y2K ready and will consider alternate providers as necessary to the extent available.
- End-user computing systems are upgraded periodically through the Company's ongoing replacement program. Almost all of the Company's personal computers are currently Year 2000 ready. Additional personal computers will be replaced during the first quarter of 1999. Chesapeake's local area network is Year 2000 ready as is all PC-based and network-based software.
- Customers, primarily industrial interruptible natural gas customers, must ensure that their plant controls are Year 2000 ready for their alternative fuel. The Company has identified 107 interruptible customers and will contact each of them by the end of the first quarter of 1999. The Company will take into account the results of the survey in developing the natural gas contingency plan.

The Company believes the most significant potential risks with respect to its internal operations, those over which it has direct control, are its ability to: (1) use electronic devices to control and operate its natural gas delivery systems; (2) maintain continuous operation of its computer systems; (3) render timely bills to its customers; and (4) enforce tariffs and contracts applicable to interruptible customers.

The Company relies on the producers of natural gas and suppliers of interstate transportation capacity to deliver natural gas to the Company's natural gas delivery systems. The Company is also dependent on propane producers, suppliers and railroad facilities to receive propane supply. Chesapeake is also dependent on various suppliers of communication services. Should any of these critical vendors fail, the impact of any such failure could become a significant challenge to the Company's ability to meet the demands of its customers, to operate its delivery systems and to communicate with its customers. It could also have a material adverse financial impact, including but not limited to, lost sales revenues, increased operating costs and claims from customers related to business interruptions. The Company's Year 2000 evaluation process is addressing each of these risks and the required remediation. The Company is developing its contingency plan for the Year 2000, which will address various alternatives and will include assessing a variety of scenarios that could emerge and require the Company to react. Chesapeake expects to have its contingency plan finalized by the end of the second quarter of 1999. The contingency plan will continue to be modified as warranted by changing events.

The costs incurred as of December 31, 1998 in addressing Year 2000 issues have been immaterial. The Company has estimated costs of \$270,000 to replace and/or remediate specific embedded systems. However, until the Company has completed further analysis of the impact of the Year 2000 issue on its embedded systems, vendors/suppliers, end-user computing systems, customers and contingency planning; it is unable to estimate any additional costs it may incur as a result of its efforts.



Presently, no Year 2000-impacted internal applications or embedded systems have been identified that cannot be upgraded or modified within acceptable time frames. The target date for completion of all Year 2000-related activities remains at mid-1999.

### **Competition**

Historically, the Company's natural gas operations have successfully competed with other forms of energy such as electricity, oil and propane. The principal considerations have been price, and to a lesser extent, accessibility. As a result of Eastern Shore's recent conversion to open access, the Company expects to be subject to competitive pressures from other sellers of natural gas. With open access transportation services available on Eastern Shore's system, third party suppliers will compete with Chesapeake to sell gas to the local distribution companies and the end-users on Eastern Shore's system. Eastern Shore has shifted from providing sales service to providing transportation and contract storage services.

The Company's natural gas distribution operation located in Maryland began to offer transportation services to certain industrial customers during 1998. During 1997, the distribution operation located in Delaware also began offering transportation services. The Company expects to expand the availability of transportation services to additional customers in the future. The Florida distribution operation has been open to certain industrial customers since 1994. The Company established a natural gas brokering and supply operation in Florida to compete for these customers.

Both the propane and advanced information services businesses face significant competition from a number of larger competitors with substantially greater resources available to them than those of the Company. In addition, in the advanced information services business, changes are occurring rapidly which could adversely affect the markets for the Company's services.

### **Inflation**

Inflation affects the cost of labor and other goods and services required for operation, maintenance and capital improvements. While the impact of inflation has lessened in recent years, natural gas prices are subject to rapid fluctuations. These fluctuations 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.

### **Cautionary Statement**

We make statements in this report that are considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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. These statements relate to such topics as customer growth, increases in revenues or margins, Year 2000 readiness, regulatory approvals, market risk associated with the Company's new propane marketing operation, 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. These factors include, among other things:

- the seasonality and temperature sensitivity of Chesapeake's natural gas and propane businesses (that is, the Company's earnings vary depending on the season and, in the winter months, how cold the weather is);
- consumption patterns of the Company's existing and expected customers in these businesses;
- the wholesale price of propane and market movements in these prices, which affect both the margins in the Company's propane business and the profitability of the propane marketing operation;
- the relative price of alternative energy sources, to which some of Chesapeake's customers have access;
- the effects of competition on both unregulated and regulated businesses;
- the ability of the transmission segment to attract new customers in an open access environment;
- the ability of the Company's new and planned facilities to generate expected revenues;

- the Company's ability to obtain the rate relief requested from utility regulators and the timing of that rate relief; and
- the Company's ability to identify and address Year 2000 issues successfully, in a timely manner and at a reasonable cost, as well as the ability of the Company's vendors, suppliers, and other service providers and customers to successfully address their own Year 2000 issues in a timely manner.

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

Information related to 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**

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**REPORT OF INDEPENDENT ACCOUNTANTS**

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To the Stockholders of Chesapeake Utilities Corporation

In our opinion, the consolidated financial statements listed in the index appearing under item 14(a)(1) of this Form 10-K present fairly, in all material respects, the financial position of Chesapeake Utilities Corporation and its subsidiaries at December 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles.

In addition, in our opinion, the consolidated financial statement schedule listed in the index appearing under item 14(a)(2) of this Form 10-K 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 generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 the opinion expressed above.

*PricewaterhouseCoopers LLP*

PRICEWATERHOUSECOOPERS LLP  
Washington, D.C.  
February 12, 1999

## Consolidated Statements of Income

For the Years Ended December 31,	1998	1997	1996
<b>Operating Revenues</b>	\$ 183,568,795	\$ 222,489,264	\$ 260,102,200
<b>Cost of Sales</b>	136,019,813	175,191,090	207,655,979
<b>Gross Margin</b>	47,548,982	47,298,174	52,446,221
<b>Operating Expenses</b>			
Operations	23,669,514	23,686,774	26,485,013
Maintenance	2,123,456	2,068,114	2,550,197
Depreciation and amortization	6,109,202	5,475,417	5,605,930
Other taxes	4,024,129	3,974,097	3,822,200
Income taxes	3,181,599	3,427,308	3,884,377
<b>Total operating expenses</b>	39,107,900	38,631,710	42,347,717
<b>Operating Income</b>	8,441,082	8,666,464	10,098,504
<b>Other Income</b>			
Interest income	188,394	288,339	248,632
Other income, net	97,005	533,704	642,238
Income taxes	(44,145)	(276,888)	(202,239)
<b>Total other income</b>	241,254	545,155	688,631
<b>Income Before Interest Charges</b>	8,682,336	9,211,619	10,787,135
<b>Interest Charges</b>			
Interest on long-term debt	2,966,043	2,387,641	2,434,321
Amortization of debt expense	123,335	119,401	120,345
Other	290,372	836,965	450,536
<b>Total interest charges</b>	3,379,750	3,344,007	3,005,202
<b>Net Income</b>	\$ 5,302,586	\$ 5,867,612	\$ 7,781,933
<b>Earnings Per Share of Common Stock :</b>			
Basic	\$ 1.05	\$ 1.18	\$ 1.58
Diluted	\$ 1.04	\$ 1.17	\$ 1.55

## Consolidated Statements of Comprehensive Income

For the Years Ended December 31,	1998	1997	1996
<b>Net Income</b>	\$ 5,302,586	\$ 5,867,612	\$ 7,781,933
<b>Unrealized gain on marketable securities, net of income taxes</b>	566,472	258,274	111,437
<b>Total Comprehensive Income</b>	\$ 5,869,058	\$ 6,125,886	\$ 7,893,370

See accompanying notes

# Consolidated Balance Sheets

## Assets

At December 31,	1998	1997
<b><i>Property, Plant and Equipment</i></b>		
Natural gas distribution	\$ 81,844,066	\$ 75,564,462
Natural gas transmission	35,388,440	33,856,873
Propane distribution and marketing	27,287,807	27,091,102
Advanced information services	1,087,910	841,757
Other plant	7,382,965	6,896,899
<b>Total property, plant and equipment</b>	<b>152,991,188</b>	<b>144,251,093</b>
<b>Less: Accumulated depreciation and amortization</b>	<b>(48,725,412)</b>	<b>(44,371,890)</b>
<b>Net property, plant and equipment</b>	<b>104,265,776</b>	<b>99,879,203</b>
 <b><i>Investments, at fair market value</i></b>	 <b>4,165,194</b>	 <b>2,721,443</b>
<b><i>Current Assets</i></b>		
Cash and cash equivalents	2,598,084	4,829,176
Accounts receivable (less allowance for uncollectibles of \$302,513 and \$331,775 in 1998 and 1997, respectively)	14,861,255	16,415,922
Materials and supplies, at average cost	1,728,513	1,424,312
Propane inventory, at average cost	1,787,038	2,436,200
Storage gas prepayments	2,152,605	2,926,618
Underrecovered purchased gas costs	1,552,265	1,673,389
Income taxes receivable	344,311	766,178
Deferred income taxes	-	247,487
Prepaid expenses	1,596,595	1,107,825
<b>Total current assets</b>	<b>26,620,666</b>	<b>31,827,107</b>
<b><i>Deferred Charges and Other Assets</i></b>		
Environmental regulatory assets	2,700,000	4,865,073
Environmental expenditures	3,418,166	2,372,929
Other deferred charges and intangible assets	4,063,811	4,053,068
<b>Total deferred charges and other assets</b>	<b>10,181,977</b>	<b>11,291,070</b>
 <b><i>Total Assets</i></b>	 <b>\$ 145,233,613</b>	 <b>\$ 145,718,823</b>

See accompanying notes

# Consolidated Balance Sheets

## Capitalization and Liabilities

At December 31,	1998	1997
<b>Capitalization</b>		
Stockholders' equity		
Common stock	\$ 2,479,019	\$ 2,435,142
Additional paid-in capital	24,192,188	22,581,463
Retained earnings	28,892,384	28,533,145
Less: Unearned compensation related to restricted stock awarded	(71,041)	(190,886)
Accumulated other comprehensive income	863,344	296,872
<b>Total stockholders' equity</b>	<b>56,355,894</b>	<b>53,655,736</b>
Long-term debt, net of current portion	37,597,000	38,226,000
<b>Total capitalization</b>	<b>93,952,894</b>	<b>91,881,736</b>
<b>Current Liabilities</b>		
Current portion of long-term debt	520,000	1,051,241
Short-term borrowings	11,600,000	7,600,010
Accounts payable	11,070,642	16,397,691
Refunds payable to customers	636,153	357,041
Accrued interest	553,444	784,533
Dividends payable	1,273,446	1,092,168
Deferred income taxes	56,100	-
Other accrued liabilities	3,754,231	3,829,497
<b>Total current liabilities</b>	<b>29,464,016</b>	<b>31,112,181</b>
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	13,260,282	11,490,358
Deferred investment tax credits	766,802	821,617
Environmental liability	2,700,000	4,865,073
Accrued pension costs	1,536,304	2,338,201
Other liabilities	3,553,315	3,209,657
<b>Total deferred credits and other liabilities</b>	<b>21,816,703</b>	<b>22,724,906</b>
<b>Commitments and Contingencies</b>		
<i>(Notes L and M)</i>		
<b>Total Capitalization and Liabilities</b>	<b>\$ 145,233,613</b>	<b>\$ 145,718,823</b>

See accompanying notes

# Consolidated Statements of Cash Flows

For the Years Ended December 31,	1998	1997	1996
<b>Operating Activities</b>			
Net Income	\$ 5,302,586	\$ 5,867,612	\$ 7,781,933
Adjustments to reconcile net income to net operating cash:			
Depreciation and amortization	6,864,063	6,168,777	6,248,618
Investment tax credit adjustments	(54,815)	(54,815)	(54,815)
Deferred income taxes, net	1,711,510	1,437,206	1,794,146
Mark-to-market adjustments	(242,757)	1,144,966	(1,109,416)
Employee benefits	(801,898)	(238,826)	471,870
Employee compensation from lapsing of stock restrictions	119,845	173,643	334,745
Other, net	(171,616)	(286,147)	(32,133)
Changes in assets and liabilities:			
Accounts receivable, net	1,797,425	10,914,969	(8,597,772)
Other current assets	630,202	1,368,006	(2,766,414)
Other deferred charges	215,119	(623,138)	(977,257)
Accounts payable, net	(5,327,052)	(12,525,992)	12,048,169
Refunds payable to customers	279,112	3,307	(613,206)
Overrecovered (underrecovered) purchased gas costs	121,123	518,781	(2,245,544)
Other current liabilities	584,558	(2,193,548)	1,739,020
Net cash provided by operating activities	<b>11,027,405</b>	<b>11,674,801</b>	<b>14,021,944</b>
<b>Investing Activities</b>			
Property, plant and equipment expenditures, net	(12,021,735)	(12,370,932)	(14,025,373)
Purchases of investments	(500,000)	(36,167)	(129,406)
Net cash used by investing activities	<b>(12,521,735)</b>	<b>(12,407,099)</b>	<b>(14,154,779)</b>
<b>Financing Activities</b>			
Common stock dividends, net of amounts reinvested of \$463,231, \$382,932 and \$346,308 in 1998, 1997 and 1996, respectively	(4,298,837)	(3,846,264)	(3,368,545)
Issuance of stock — Dividend Reinvestment Plan optional cash	146,716	167,337	208,813
Issuance of stock — Retirement Savings Plan	466,759	404,297	349,031
Net borrowings (repayments) under line of credit agreements	3,999,990	(5,134,990)	7,334,990
Proceeds from issuance of long-term debt	-	9,929,711	-
Repayment of long-term debt	(1,051,390)	(3,098,455)	(881,467)
Net cash (used) provided by financing activities	<b>(736,762)</b>	<b>(1,578,364)</b>	<b>3,642,822</b>
<b>Net (Decrease) Increase in Cash and Cash Equivalents</b>	<b>(2,231,092)</b>	<b>(2,310,662)</b>	<b>3,509,987</b>
<b>Cash and Cash Equivalents at Beginning of Year</b>	<b>4,829,176</b>	<b>7,139,838</b>	<b>3,629,851</b>
<b>Cash and Cash Equivalents at End of Year</b>	<b>\$ 2,598,084</b>	<b>\$ 4,829,176</b>	<b>\$ 7,139,838</b>
<b>Supplemental Disclosure of Cash Flow Information</b>			
Cash paid for interest	\$ 3,490,993	\$ 3,243,981	\$ 2,872,973
Cash paid for income tax	\$ 2,670,580	\$ 3,500,160	\$ 2,059,441

See accompanying notes

## Consolidated Statements of Stockholders' Equity

For the Years Ended December 31,	1998	1997	1996
<b>Common Stock</b>			
Balance — beginning of year	\$ 2,435,142	\$ 2,403,978	\$ 2,365,562
Dividend Reinvestment Plan	16,240	15,398	16,514
Retirement Savings Plan	12,663	11,305	9,928
Conversion of debentures	3,115	4,461	429
USI restricted stock award agreements	-	-	10,639
Performance shares	11,859	-	-
Exercised stock options	-	-	906
Balance — end of year	2,479,019	2,435,142	2,403,978
<b>Additional Paid-in Capital</b>			
Balance — beginning of year	22,581,463	21,507,577	20,250,967
Dividend Reinvestment Plan	593,706	529,453	538,607
Retirement Savings Plan	454,096	392,992	328,465
Conversion of debentures	105,736	151,441	14,557
USI restricted stock award agreements	-	-	344,570
Performance shares	457,187	-	-
Exercised stock options	-	-	30,411
Balance — end of year	24,192,188	22,581,463	21,507,577
<b>Retained Earnings</b>			
Balance — beginning of year	28,533,145	27,113,764	23,458,776
Net income	5,302,586	5,867,612	7,781,933
Cash dividends — Chesapeake	(4,943,347)	(4,341,964)	(3,514,694)
Cash dividends — Pooled companies	-	(106,267)	(612,251)
Balance — end of year	28,892,384	28,533,145	27,113,764
<b>Unearned Compensation</b>			
Balance — beginning of year	(190,886)	(364,529)	(415,107)
Issuance of award	-	-	(284,167)
Amortization of prior years' awards	119,845	173,643	334,745
Balance — end of year	(71,041)	(190,886)	(364,529)
<b>Accumulated Other Comprehensive Income</b>			
Net of income tax expense of approximately \$552,000, \$190,000 and \$25,000 for the years 1998, 1997 and 1996, respectively	863,344	296,872	38,598
<b>Total Stockholders' Equity</b>	<b>\$ 56,355,894</b>	<b>\$ 53,655,736</b>	<b>\$ 50,699,388</b>

See accompanying notes

## Consolidated Statements of Income Taxes

For the Years Ended December 31,	1998	1997	1996
<b>Current Income Tax Expense</b>			
Federal	\$ 1,553,839	\$ 2,076,235	\$ 1,940,430
State	307,654	442,563	356,576
Investment tax credit adjustments, net	(54,815)	(54,815)	(54,815)
<b>Total current income tax expense</b>	<b>1,806,678</b>	<b>2,463,983</b>	<b>2,242,191</b>
<b>Deferred Income Tax Expense</b>			
Property, plant and equipment	887,175	1,335,802	581,373
Deferred gas costs	(111,416)	(204,170)	873,904
Pensions and other employee benefits	546,237	(19,508)	107,131
Unbilled revenue	(16,198)	(104,632)	54,320
Contributions in aid of construction	(104,003)	(33,028)	(6,979)
Environmental expenditures	415,845	249,417	108,578
Other	(198,574)	16,332	126,098
Total deferred income tax expense <sup>(1)</sup>	1,419,066	1,240,213	1,844,425
<b>Total Income Tax Expense</b>	<b>\$ 3,225,744</b>	<b>\$ 3,704,196</b>	<b>\$ 4,086,616</b>
<b>Reconciliation of Effective Income Tax Rates</b>			
Federal income tax expense at 34%	\$ 2,899,632	\$ 3,254,412	\$ 4,035,307
State income taxes, net of Federal benefit	363,041	399,213	537,566
Acquisition of subchapter S Corporation <sup>(2)</sup>	-	317,821	(268,211)
Other	(36,929)	(267,250)	(218,046)
<b>Total Income Tax Expense</b>	<b>\$ 3,225,744</b>	<b>\$ 3,704,196</b>	<b>\$ 4,086,616</b>
Effective income tax rate	37.8%	38.7%	34.4%

At December 31,	1998	1997
<b>Deferred Income Taxes</b>		
Deferred income tax liabilities:		
Property, plant and equipment	\$ 13,222,141	\$ 12,095,782
Deferred gas costs	546,391	649,681
Environmental costs	1,358,443	855,997
Other	1,077,008	704,991
<b>Total deferred income tax liabilities</b>	<b>16,203,983</b>	<b>14,306,451</b>
Deferred income tax assets:		
State operating loss carryforwards	72,041	57,303
Unbilled revenue	984,510	968,311
Pension and other employee benefits	884,286	831,735
Self insurance	625,602	585,995
Other	321,162	620,236
<b>Total deferred income tax assets</b>	<b>2,887,601</b>	<b>3,063,580</b>
<b>Deferred Income Taxes Per Consolidated Balance Sheet</b>	<b>\$ 13,316,382</b>	<b>\$ 11,242,871</b>

<sup>(1)</sup> Includes \$156,000, \$208,000 and \$392,000 of deferred state income taxes for the years 1998, 1997 and 1996, respectively.

<sup>(2)</sup> Accounted for as a pooling of interests (see Note B to the Consolidated Financial Statements).

See accompanying notes



## Notes to Consolidated Financial Statements

### A. Summary of Accounting Policies

#### Nature of Business

Chesapeake Utilities Corporation (the "Company") is engaged in natural gas distribution to approximately 37,100 customers located in southern Delaware, Maryland's Eastern Shore and Central Florida. The Company's natural gas transmission subsidiary operates a 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 Delaware and the Eastern Shore of Maryland. The Company's propane distribution and marketing segment provides distribution service to approximately 35,000 customers in southern Delaware, the Eastern Shore of Maryland and Virginia, and markets propane to a number of large independent oil and petrochemical companies, resellers, and propane distribution companies in the southeastern United States. The advanced information services segment provides consulting, custom programming, training and development tools for national and international clients.

#### Principles of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries. Investments in entities in which the Company owns more than 20 percent but 50 percent or less, are accounted for by the equity method. 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 the Delaware, Maryland and Florida Public Service Commissions with respect to their rates for service, maintenance of their accounting records and various other matters. Eastern Shore Natural Gas Company ("Eastern Shore") is an open access pipeline and is subject to regulation by the Federal Energy Regulatory Commission ("FERC"). The Company's financial statements are prepared on the basis of generally accepted accounting principles which give appropriate recognition to the ratemaking and accounting practices and policies of the various commissions. The propane distribution and marketing and advanced information services segments are not subject to regulation with respect to rates or maintenance of accounting records.

#### 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 are considered cash equivalents.

#### Property, Plant, Equipment and Depreciation

Utility property is stated at original cost while the assets of the propane segment are valued at cost. The costs of repairs and minor replacements are charged to income as incurred and the costs of major renewals and betterments are capitalized. Upon retirement or disposition of utility property, the recorded cost of removal, net of salvage value, is charged to accumulated depreciation. 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 which will amortize the unrecovered cost of depreciable property over the estimated useful life. Depreciation and amortization expense for financial statement purposes is provided at an annual rate for each segment. Average rates for 1998 were 5% and 3% for the natural gas distribution and transmission segments, respectively, 5% for propane distribution and marketing, 16% for advanced information services and 6% for general plant.

#### Environmental Regulatory Assets

Environmental regulatory assets represent amounts related to environmental liabilities for which cash expenditures have not been made. As expenditures are incurred, the environmental liability is reduced along with the environmental regulatory asset. These amounts, awaiting ratemaking treatment, are recorded to either environmental expenditures as an asset or accumulated depreciation as cost of removal. Environmental expenditures are amortized and/or recovered through a rider to base rates in accordance with the ratemaking treatment granted in each jurisdiction.

## Notes to Consolidated Financial Statements

### Other Deferred Charges and Intangible Assets

Other deferred charges include discount, premium and issuance costs associated with long-term debt and rate case expenses. The discount, premium and issuance costs are deferred, then amortized over the original lives of the respective debt issues. Gains and losses on the reacquisition of debt are amortized over the remaining lives of the original issuances. Rate case expenses are deferred, then amortized over periods approved by the applicable regulatory authorities. Intangible assets are associated with the acquisition of non-utility companies, and are amortized on a straight-line basis over a period of five to 40 years. A summary of intangible assets is as follows:

<b>At December 31,</b>	<b>1998</b>	<b>1997</b>
Gross intangibles	\$ 2,776,000	\$ 2,776,000
Accumulated amortization	(1,288,000)	(1,133,000)
Net unamortized balance	\$ 1,488,000	\$ 1,643,000

### 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 and tax bases of assets and liabilities, and are measured using current effective income tax rates. The portion of the Company's deferred tax liabilities applicable to utility operations which has not been reflected in current service rates represents 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.

The Company had state tax loss carryforwards of \$980,000 and \$818,000 at December 31, 1998 and 1997, respectively. The Company expects to use all of the loss carryforwards; therefore, no valuation allowance was recorded at December 31, 1998 or 1997. The loss carryforwards expire in 2006 through 2013.

### Financial Instruments

Xeron, the Company's wholesale propane 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. Changes in market price are recognized as gains or losses in the period of change. The resulting unrealized gains and losses are recorded as assets or liabilities.

### Operating Revenues

Revenues for the natural gas distribution divisions of the Company are based on rates approved by the various public service commissions. Customers' base rates may not be changed without formal approval by these commissions. With the exception of the Company's Florida division, the Company recognizes revenues from meters read on a monthly cycle basis. This practice results in unbilled and unrecorded revenue from the cycle date through month-end. The Florida division recognizes revenues based on services rendered and records an amount for gas delivered but not billed.

Chesapeake's natural gas distribution divisions 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 segment'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 customer is contractually obligated to deliver or receive natural gas.

The natural gas transmission segment became an open access pipeline on November 1, 1997 with revenues based on rates approved by FERC. Before open access, only portions of revenues were based on rates approved by FERC.

## Notes to Consolidated Financial Statements

The propane distribution operation records revenues on either an "as delivered" or on a "metered" basis depending on the customer type. The wholesale propane marketing operation calculates revenues daily on a mark-to-market basis for open contracts.

### Earnings Per Share

The calculations of both basic and diluted earnings per share are presented below.

For the Years Ended December 31,	1998	1997	1996
<b>Calculation of Basic Earnings Per Share:</b>			
Net Income	\$ 5,302,586	\$ 5,867,612	\$ 7,781,933
Weighted Average Shares Outstanding	5,060,328	4,972,089	4,912,136
<b>Basic Earnings Per Share</b>	<b>\$ 1.05</b>	<b>\$ 1.18</b>	<b>\$ 1.58</b>
<b>Calculation of Diluted Earnings Per Share:</b>			
<b>Reconciliation of Numerator:</b>			
Net Income — basic	\$ 5,302,586	\$ 5,867,612	\$ 7,781,933
Effect of 8.25% Convertible debentures	196,333	204,070	207,825
<b>Adjusted numerator — diluted</b>	<b>\$ 5,498,919</b>	<b>\$ 6,071,682</b>	<b>\$ 7,989,758</b>
<b>Reconciliation of Denominator:</b>			
Weighted Shares Outstanding — basic	5,060,328	4,972,089	4,912,136
Effect of 8.25% Convertible debentures	226,203	238,353	242,742
<b>Adjusted denominator — diluted</b>	<b>5,286,531</b>	<b>5,210,442</b>	<b>5,154,878</b>
<b>Diluted Earnings per Share</b>	<b>\$ 1.04</b>	<b>\$ 1.17</b>	<b>\$ 1.55</b>

### 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 revenue and expenses (see Note L to the Consolidated Financial Statements for significant estimates). These estimates involve judgements 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 Statement of Financial Accounting Standards ("SFAS") No. 71. If the Company were required to terminate application of SFAS No. 71 for regulated operations, all such deferred amounts would be recognized in the income statement at that time, resulting in a charge to earnings, net of applicable income taxes.

### FASB Statements and Other Authoritative Pronouncements Issued

#### *Derivative Instruments and Hedging Activities*

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, establishing accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities. This statement does not allow retroactive application to financial statements for prior periods. Chesapeake will adopt the requirements of this standard in the first quarter of 2000, as required. The Company believes that adoption of this statement will not have a material impact on the Company's financial position or results of operations.

The Emerging Issues Task Force released Issue 98-10, "Accounting for Energy Trading and Risk Management Activities." The Company records its use of derivatives in accordance with the standard by marking open positions to market value. The adoption of the pronouncement is not expected to have a material impact on the financial position or results of operations of the Company.

### Restatement and Reclassification of Prior Years' Amounts

Certain prior years' amounts have been reclassified to conform to current year presentation. Additionally, prior year amounts have been restated to reflect acquisitions accounted for as poolings of interests.

## Notes to Consolidated Financial Statements

### B. Business Combinations

In May 1998, Chesapeake acquired all of the outstanding common stock of Xeron, Inc, based in Houston, Texas for 475,000 shares of Chesapeake common stock. Xeron markets propane to a number of large independent oil and petrochemical companies, resellers, and southeastern retail propane companies. The transaction was accounted for as a pooling of interests.

In March 1998, the Company acquired Sam Shannahan Well Co., Inc., operating as Tolan Water Service in exchange for 25,000 shares of Chesapeake's common stock. Tolan provides water conditioning services to approximately 3,000 residential, commercial and industrial customers on the Delmarva Peninsula. This transaction was also accounted for as a pooling of interests.

The results of operations for the separate companies and the combined amounts are presented in the consolidated financial statements as follows.

	Five months ended May 31, 1998 *	Year Ended December 31, 1997	Year Ended December 31, 1996
<b>Operating Revenues</b>			
Chesapeake	\$ 54,750,771	\$ 122,774,593	\$ 130,213,409
Xeron	37,136,067	98,164,932	128,633,042
Tolan	719,523	1,549,739	1,255,749
<b>Combined</b>	<b>\$ 92,606,361</b>	<b>\$ 222,489,264</b>	<b>\$ 260,102,200</b>
<b>Net Income</b>			
Chesapeake	\$ 4,385,817	\$ 5,682,946	\$ 7,604,915
Xeron	21,704	128,910	158,991
Tolan	2,346	55,756	18,027
<b>Combined</b>	<b>\$ 4,409,867</b>	<b>\$ 5,867,612</b>	<b>\$ 7,781,933</b>

\* Statements for the five months ended May 31, 1998 are unaudited.

In March 1997, the Company acquired all of the outstanding common stock of Tri-County Gas Company, Inc. and associated properties. Tri-County's principal business was the distribution of propane to both retail and wholesale customers in southern Delaware, the Eastern Shore of Maryland and Virginia. Six hundred thirty-nine thousand shares of the Company's common stock were exchanged in the transaction, which was accounted for as a pooling of interests.

All prior period consolidated financial statements presented have been restated to include the combined results of operations, financial position and cash flows of each of the business combinations discussed above. All material intercompany transactions have been eliminated in consolidation.

### C. 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 every segment are regularly reviewed by the Company's chief operating decision maker in order to make decisions about resources and to assess performance.

## Notes to Consolidated Financial Statements

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

For the Years Ended December 31,	1998	1997	1996
<b>Operating Revenues, Unaffiliated Customers</b>			
Natural gas distribution	\$ 65,384,413	\$ 75,940,968	\$ 74,904,100
Natural gas transmission	3,199,032	12,164,369	15,188,752
Propane distribution and marketing	102,872,909	125,159,336	161,812,156
Advanced information services	10,330,703	7,636,407	6,903,246
Other	1,781,738	1,588,184	1,293,946
<b>Total operating revenues, unaffiliated customers</b>	<b>\$ 183,568,795</b>	<b>\$ 222,489,264</b>	<b>\$ 260,102,200</b>
<b>Intersegment Revenues *</b>			
Natural gas distribution	\$ 40,494	\$ 18,970	\$ 12,232
Natural gas transmission	7,269,620	19,282,359	21,543,352
Propane distribution and marketing	-	52,230	2,059
Advanced information services	-	149,602	326,913
Other	634,032	523,007	332,512
<b>Total intersegment revenues</b>	<b>\$ 7,944,146</b>	<b>\$ 20,026,168</b>	<b>\$ 22,217,068</b>
<b>Operating Income Before Income Taxes</b>			
Natural gas distribution	\$ 4,696,759	\$ 5,498,471	\$ 7,167,237
Natural gas transmission	4,117,366	3,721,148	2,458,442
Propane distribution and marketing	971,215	1,157,543	2,668,839
Advanced information services	1,316,158	1,045,912	1,056,201
Other	461,174	637,971	478,571
<b>Total</b>	<b>11,562,672</b>	<b>12,061,045</b>	<b>13,829,290</b>
Eliminations	60,009	32,727	153,591
<b>Total operating income before income taxes</b>	<b>\$ 11,622,681</b>	<b>\$ 12,093,772</b>	<b>\$ 13,982,881</b>
<b>Depreciation and Amortization</b>			
Natural gas distribution	\$ 3,330,624	\$ 3,076,654	\$ 2,907,831
Natural gas transmission	1,050,714	892,258	697,834
Propane distribution and marketing	1,334,414	1,214,918	1,720,631
Advanced information services	183,553	122,081	131,877
Other	209,897	169,506	147,757
<b>Total depreciation and amortization</b>	<b>\$ 6,109,202</b>	<b>\$ 5,475,417</b>	<b>\$ 5,605,930</b>
<b>Capital Expenditures</b>			
Natural gas distribution	\$ 8,512,661	\$ 6,569,865	\$ 6,961,652
Natural gas transmission	1,505,830	2,959,019	5,567,509
Propane distribution and marketing	1,544,992	2,820,166	2,189,368
Advanced information services	246,153	273,351	162,189
Other	840,186	848,680	517,997
<b>Total capital expenditures</b>	<b>\$ 12,649,822</b>	<b>\$ 13,471,081</b>	<b>\$ 15,398,715</b>
<b>Identifiable Assets, at December 31,</b>			
Natural gas distribution	\$ 77,756,422	\$ 78,732,860	\$ 77,426,232
Natural gas transmission	24,862,165	24,781,292	23,981,989
Propane distribution and marketing	27,526,019	31,831,616	44,073,080
Advanced information services	2,304,609	1,751,192	1,496,419
Other	12,784,398	8,621,863	8,808,724
<b>Total identifiable assets</b>	<b>\$ 145,233,613</b>	<b>\$ 145,718,823</b>	<b>\$ 155,786,444</b>

\* All significant intersegment revenues have been eliminated from consolidated revenues.

## Notes to Consolidated Financial Statements

### 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 fair value of the Company's open forward and futures contracts at December 31, 1998 and December 31, 1997 based on market rates were \$207,000 and \$36,000, respectively. The fair value of the Company's long-term debt is estimated using a discounted cash flow methodology. The estimated fair value of the Company's long-term debt at December 31, 1998, including current maturities, is approximately \$41.6 million as compared to a carrying value of \$38.1 million. At December 31, 1997, the estimated fair value was approximately \$40.7 million as compared to a carrying value of \$38.8 million. These estimates are based on published corporate borrowing rates for debt instruments with similar terms and average maturities.

### E. Investments

The investment balance at December 31, 1998 and 1997 consists primarily of a 7.3% ownership interest in the common stock of Florida Public Utilities Company ("FPU"). The Company has classified its investment in FPU as an "Available for Sale" security, which requires that all unrealized gains and losses be excluded from earnings and be reported net of income tax as a separate component of stockholders' equity. At December 31, 1998 and 1997, the market value exceeded the aggregate cost basis of the Company's portfolio by \$1,552,000 and \$487,000, respectively.

In August 1998, the Company entered into an agreement to sell its investment in FPU for \$16.50 per share to The Southern Company. The execution of the agreement is contingent on the approval of the Securities and Exchange Commission, which is expected to be obtained in 1999. Once regulatory approval is received, the Company will recognize a \$1,415,000 pre-tax gain or \$863,000, after taxes.

### F. Common Stock and Additional Paid-in Capital

The following is a schedule of changes in the Company's shares of common stock.

For the Years Ended December 31,	1998	1997	1996 <sup>(1)</sup>
<b>Common Stock: Shares issued and outstanding <sup>(2)</sup></b>			
Balance — beginning of year	5,004,078	4,939,515	4,860,588
Dividend Reinvestment Plan <sup>(3)</sup>	32,925	32,169	33,926
Sale of stock to Company's Retirement Savings Plan	26,018	23,228	20,398
Conversion of debentures	6,401	9,166	881
Performance shares	24,366	-	-
USI restricted stock award agreements	-	-	21,859
Exercised stock options	-	-	1,863
<b>Balance — end of year</b>	<b>5,093,788</b>	<b>5,004,078</b>	<b>4,939,515</b>

<sup>(1)</sup> The 1996 beginning balance has been restated to include 639,000, 25,000 and 475,000 shares of Common Stock that were issued to effect the business combinations with Tri-County Gas Company, Inc., Tolan Water Service and Xeron, Inc., respectively.

<sup>(2)</sup> 12,000,000 shares are authorized at a par value of \$.4867 per share.

<sup>(3)</sup> Includes dividends and reinvested optional cash payments.

### G. Long-term Debt

The outstanding long-term debt, net of current maturities, is as follows:

At December 31,	1998	1997
<b>First mortgage sinking fund bonds:</b>		
9.37% Series I, due December 15, 2004	\$ 3,780,000	\$ 4,300,000
8.25% Convertible debentures, due March 1, 2014	3,817,000	3,926,000
<b>Uncollateralized senior notes:</b>		
7.97% note, due February 1, 2008	10,000,000	10,000,000
6.91% note, due October 1, 2010	10,000,000	10,000,000
6.85% note, due January 1, 2012	10,000,000	10,000,000
<b>Total long-term debt</b>	<b>\$ 37,597,000</b>	<b>\$ 38,226,000</b>

Annual maturities of consolidated long-term debt for the next five years are as follows: \$1,520,000 for 1999, \$2,665,091 for the years 2000 through 2002 and \$3,665,091 for 2003.

## Notes to Consolidated Financial Statements

On December 15, 1997, the Company issued \$10 million of 6.85% senior notes due January 1, 2012. The Company used the proceeds to repay a portion of the Company's short-term borrowing.

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 1998, \$109,000 of debentures were converted. The debentures are redeemable at the option of the holder, subject to an annual non-cumulative maximum limitation of \$200,000 in the aggregate. At the Company's option, the debentures may be redeemed at the stated amounts.

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% of total capitalization, the times interest earned ratio must be at least 2.5 and the Company cannot, until the retirement of its Series I bonds, pay any dividends after December 31, 1988 which exceed the sum of \$2,135,188 plus consolidated net income recognized on or after January 1, 1989. As of December 31, 1998, the amounts available for future dividends permitted by the Series I covenant approximated \$14.7 million.

A portion of the natural gas distribution plant assets owned by the Company are subject to a lien under the mortgage pursuant to which the Company's first mortgage sinking fund bonds are issued.

### H. Short-term Borrowing

The Board of Directors has authorized the Company to borrow up to \$20.0 million from various banks and trust companies. As of December 31, 1998, the Company had three unsecured bank lines of credit totaling \$28.0 million, none of which required compensating balances. Under these lines of credit at December 31, 1998 and 1997, the Company had short-term debt outstanding of \$11.6 million and \$7.6 million, respectively, with a weighted average interest rate of 5.56% and 5.63%, respectively.

### I. Lease Obligations

The Company has entered several operating lease arrangements for office space at various locations. Rent expense related to these leases was \$309,000, \$343,000 and \$359,000 for 1998, 1997 and 1996, respectively. Future minimum payments under the Company's current lease agreements are \$309,000, \$297,000, \$261,000, \$187,000 and \$169,000 for the years of 1999 through 2003, respectively; and \$299,000 thereafter.

### J. Employee Benefits Plans

#### Pension Plan

Through December 31, 1998, the Company sponsored a defined benefit pension plan covering substantially all of its employees (see Enhanced Retirement Savings Plan). Benefits under the plan are based on each participant's years of service and highest average compensation. 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*.

In December 1998, the Company restructured the employee benefits plans to be competitive with employers in similar industries. Chesapeake offered current participants of the defined benefit plan the option to remain in the current plan or receive a one-time payout and enroll in an enhanced retirement savings plan. Chesapeake closed the defined benefit plan to new participants, effective December 31, 1998. Based on the election options selected by the employees, the Company reduced their accrued pension liability to \$1,283,088. Based on the change in the accrued liability, the Company was able to record a curtailment gain of \$1,224,298 in 1998.

## Notes to Consolidated Financial Statements

The following schedule sets forth the funded status of the pension plan at December 31, 1998 and 1997:

At December 31,	1998	1997
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of year	\$ 11,534,355	\$ 10,265,987
Service cost	838,177	680,192
Interest cost	803,727	732,188
Effect of curtailment	(1,224,298)	-
Change in discount rate	952,552	-
Actuarial (gain) loss	(384,492)	146,559
Benefits paid	(332,136)	(290,571)
<b>Benefit obligation at end of year</b>	<b>12,187,885</b>	<b>11,534,355</b>
<b>Change in plan assets:</b>		
Fair value of plan assets at beginning of year	13,592,699	10,720,514
Actual return on plan assets	1,324,606	2,427,768
Employer contribution	-	734,988
Benefits paid	(332,136)	(290,571)
<b>Fair value of plan assets at end of year</b>	<b>14,585,169</b>	<b>13,592,699</b>
<b>Funded Status</b>	<b>2,397,284</b>	<b>2,058,344</b>
<b>Unrecognized transition obligation</b>	<b>(111,371)</b>	<b>(126,475)</b>
<b>Unrecognized prior service cost</b>	<b>(67,152)</b>	<b>(71,851)</b>
<b>Unrecognized net gain</b>	<b>(3,501,849)</b>	<b>(4,038,679)</b>
<b>Accrued pension cost</b>	<b>\$ (1,283,088)</b>	<b>\$ (2,178,661)</b>
<b>Assumptions:</b>		
Discount rate	6.75%	7.25%
Rate of compensation increase	4.75%	4.75%
Expected return on plan assets	8.50%	8.50%

Net periodic pension costs for the defined pension benefit plan for 1998, 1997 and 1996 include the following components:

For the Years Ended December 31,	1998	1997	1996
<b>Components of net periodic pension cost:</b>			
Service cost	\$ 838,177	\$ 680,192	\$ 656,985
Interest cost	803,727	732,188	658,238
Expected return on assets	(1,149,754)	(898,037)	(784,924)
Amortization of:			
Transition assets	(15,104)	(15,104)	(15,104)
Prior service cost	(4,699)	(4,699)	(4,699)
Actuarial gain	(143,622)	(88,900)	(68,425)
<b>Net periodic pension cost</b>	<b>328,725</b>	<b>405,640</b>	<b>442,071</b>
<b>Curtailment gain</b>	<b>(1,224,298)</b>	<b>-</b>	<b>-</b>
<b>Amounts capitalized as construction costs</b>	<b>(31,107)</b>	<b>(33,942)</b>	<b>(38,860)</b>
<b>Total pension cost accruals</b>	<b>\$ (926,680)</b>	<b>\$ 371,698</b>	<b>\$ 403,211</b>

### Retirement Savings Plan

The Company sponsors a Retirement Savings Plan, a 401(k) plan, that provides participants a mechanism for making contributions for retirement savings. Each participant may make pre-tax contributions up to 15% of eligible base compensation subject to IRS limitations. Based on each participant's years of service, the Company makes a contribution matching 60% or 100% of each participant's pre-tax contributions, not to exceed 6% of the participant's eligible compensation for the plan year. The Company's contributions totaled \$495,000, \$404,000 and \$353,000 for the years ended December 31, 1998, 1997 and 1996, respectively. As of December 31, 1998, there are 30,356 shares reserved to fund future contributions to the Retirement Savings Plan.



## Notes to Consolidated Financial Statements

### Enhanced Retirement Savings Plan

Effective January 1, 1999, the Company will offer 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 will make a matching contribution of each employee's pre-tax contribution of up to 6% of the eligible compensation for the year. The match will be between 100% and 200% based on a combination of the employee's age and years of service. The first 100% of the funds will be matched with Chesapeake common stock. The remaining match will be invested in the Company's 401(k) plan according to each employee's election options.

### Other Post-retirement Benefits

The Company sponsors a defined benefit post-retirement health care and life insurance plan that covers substantially all natural gas and corporate employees. The Company had deferred approximately \$126,000, which represented the difference between the Maryland division's SFAS No. 106 expense and its actual pay-as-you-go cost. The amount is being amortized over five years starting in 1995. The unamortized balance was \$50,000 at December 31, 1998.

Net periodic post-retirement costs for 1998, 1997 and 1996 include the following components:

For the Years Ended December 31,	1998	1997	1996
<b>Components of net periodic post-retirement cost:</b>			
Service cost	\$ 3,361	\$ 3,287	\$ 2,820
Interest cost	59,321	60,221	54,651
Amortization of:			
Transition obligation	27,859	27,859	27,859
Actuarial loss	6,071	1,554	-
Net periodic post-retirement cost	96,612	92,921	85,330
Amounts capitalized as construction costs	(22,459)	(16,274)	(16,672)
Amounts amortized (deferred)	25,254	25,254	25,254
<b>Total post-retirement cost accruals</b>	<b>\$ 99,407</b>	<b>\$ 101,901</b>	<b>\$ 93,912</b>

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

At December 31,	1998	1997
<b>Change in benefit obligation:</b>		
Benefit obligation at beginning of year	\$ 868,899	\$ 791,871
Retirees	14,236	53,604
Fully-eligible active employees	674	7,978
Other active	3,251	15,446
Benefit obligation at end of year	\$ 887,060	\$ 868,899
<b>Funded Status</b>	<b>\$ (887,060)</b>	<b>\$ (868,899)</b>
Unrecognized transition obligation	217,295	245,154
Unrecognized net loss	165,160	147,422
<b>Accrued post-retirement cost</b>	<b>\$ (504,605)</b>	<b>\$ (476,323)</b>
<b>Assumptions:</b>		
Discount rate	6.75%	7.25%

The health care inflation rate for 1998 is assumed to be 9.0%. This rate is projected to gradually decrease to an ultimate rate of 5% by the year 2007. 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 \$105,000 as of January 1, 1999, and would increase the aggregate of the service cost and interest cost components of net periodic post-retirement benefit cost for 1999 by approximately \$8,000.

### K. Executive Incentive Plans

The Performance Incentive Plan ("the Plan") adopted in 1992, provides for the granting of stock options to certain officers of the Company over a 10-year period. The Plan provides participants an option to purchase shares of the Company's common stock, exercisable in cumulative installments of up to one-third on each anniversary of the

## Notes to Consolidated Financial Statements

commencement of the award period. The Plan also enables participants the right to earn performance shares upon the Company's achievement of certain performance goals as set forth in the specific agreements associated with particular options and/or performance shares.

The Company has executed Stock Option Agreements for a three-year performance period ending December 31, 2000 with certain executive officers. One-half of these options become exercisable over time and the other half become exercisable if certain performance targets are achieved. Chesapeake also executed Performance Share Agreements for the same period with certain other executive officers. Each year participants are eligible to earn a maximum number of performance shares equal to one-third of the total number of performance shares granted, based on the Company's achievement of certain performance goals. The Company recorded \$49,000 of compensation expense associated with these performance shares in 1998.

In November 1994, the Company executed Tandem Stock Option and Performance Share Agreements ("Agreements") with certain executive officers. During the three-year period ended December 31, 1997, the performance goals set forth in the Agreements were achieved. Following the approval of the Board of Directors on February 27, 1998, the Company issued 44,081 performance shares. At that time, 44,906 stock options expired. The Company recorded \$416,000 and \$227,000 to recognize the compensation expense associated with these performance shares in 1997 and 1996, respectively.

Changes in outstanding options were as follows:

	1998		1997		1996	
	Number of shares	Option Price	Number of shares	Option Price	Number of shares	Option Price
Balance — beginning of year	208,543	\$12.625 — \$20.50	113,051	\$12.625 — \$12.75	125,186	\$12.625 — \$12.75
Options granted			95,492	\$20.50		
Options expired	(44,906)	\$12.625				
Options exercised					(12,135)	\$12.75
Balance — end of year	163,637	\$12.75 — \$20.50	208,543	\$12.625 — \$20.50	113,051	\$12.625 — \$12.75
Exercisable	68,145	\$12.75	98,083	\$12.625 — \$12.75	83,114	\$12.625 — \$12.75

In December 1997, the Company granted stock options to certain executive officers of the Company. As required by SFAS No. 123, the pro forma information as if fair value based accounting had been used to account for the stock-based compensation costs is shown below.

For the Years Ended December 31,	1998	1997
Pro forma Net Income	\$ 5,262,468	\$ 5,864,269
<b>Pro forma Earnings Per Share:</b>		
Basic	\$ 1.04	\$ 1.18
Diluted	\$ 1.03	\$ 1.16
<b>Assumptions:</b>		
Dividend yield	4.73%	4.73%
Expected volatility	15.53%	15.53%
Risk-free interest rate	5.89%	5.89%
Expected lives	4 years	4 years

Certain key USI employees entered into restricted stock award agreements under which shares of Chesapeake common stock were issued over a five-year period beginning in 1992 as certain targets were met. Restrictions lapse over a five to ten-year period from the award date. At December 31, 1998 and 1997, respectively, 4,371 and 12,515 shares valued at \$71,041 and \$190,886 remain restricted.

### L. Environmental Commitments and Contingencies

The Company is currently participating in the investigation, assessment or remediation of three former gas manufacturing plant sites located in different jurisdictions, including the exploration of corrective action options to remove

## Notes to Consolidated Financial Statements

environmental contaminants. The Company has accrued liabilities for two of these sites, the Dover Gas Light and Salisbury Town Gas Light sites.

With respect to the Dover Gas Light site, the Company and General Public Utilities Corporation, Inc. ("GPU") have been ordered by the Environmental Protection Agency ("EPA") to fund or implement the EPA's Record of Decision ("ROD") on the appropriate remedial activities to be performed, which include both soil and ground-water remedies.

During the fourth quarter of 1998, the Company started the soil remediation process at that site at a cost of \$450,000. Over the next twelve to eighteen months, the Company will finalize the soil remediation and initiate the ground-water remedial activities.

The Company's independent consultants have prepared preliminary estimates of the costs of two potentially acceptable alternatives to complete the ground-water remediation activities at the site. The costs to remediate the ground-water range from a low of \$390,000 in capital and \$37,000 per year of operating costs; to a high of \$4.0 million in capital and \$500,000 per year in operating costs. In both cases, the operating costs are assumed to last for 30 years. A decision by the EPA as to the most appropriate ground-water remediation method is likely in 1999. The capital costs necessary to begin remediation are expected to be incurred over the next twelve to eighteen months.

Chesapeake cannot predict the ground-water remediation the EPA will select; therefore, the Company has accrued \$2.1 million at December 31, 1998 for the Dover site and has recorded a regulatory asset for an equivalent amount. Of this amount, \$1.5 million is for ground-water remediation and \$600,000 is for the remaining soil remediation. The \$1.5 million represents the low end of the ground-water remedy estimates described above.

The Company initiated litigation against one of the other potentially responsible parties for contribution to the remedial costs incurred by Chesapeake in connection with complying with the ROD. At this time, management cannot predict the outcome of the litigation or the amount of proceeds to be received, if any. Management believes that the Company will be equitably entitled to contribution from other responsible parties for a portion of the expenses to be incurred in connection with the remedies selected in the ROD. The Company expects that it will be able to recover actual costs incurred, which are not recovered from other responsible parties, exclusive of associated carrying costs, through the ratemaking process in accordance with environmental cost recovery rider provisions currently in effect.

In cooperation with the Maryland Department of the Environment ("MDE"), in 1996 the Company completed construction and began remediation procedures at the Salisbury site. In addition, the Company began quarterly reporting of the remediation and monitoring results to the MDE. The Company has established a liability with respect to the Salisbury site of \$600,000 as of December 31, 1998. This amount is based on the estimated operating costs of the remediation facilities over the next five years. A corresponding regulatory asset has been recorded, reflecting the Company's belief that costs incurred will be recoverable in base rates.

In addition, the Company has a site located in the state of Florida which is currently being evaluated. At this time, no estimate of liability can be made. It is management's opinion that any unrecovered current costs and any other future costs incurred will be recoverable through future rates or sharing arrangements with other responsible parties.

### ENVIRONMENTAL COSTS INCURRED

<b>At December 31,</b>	<b>1998</b>	<b>1997</b>
Delaware	\$ 6,846,722	\$ 5,317,380
Maryland	2,541,263	2,368,168
Florida	696,847	692,391
Total costs incurred	10,084,832	8,377,939
Less: Amounts, net of insurance proceeds, which have been approved for ratemaking treatment	(8,391,953)	(7,319,496)
Amounts pending ratemaking recovery	\$ 1,692,879	\$ 1,058,443

## Notes to Consolidated Financial Statements

### M. Other Commitments and Contingencies

#### Natural Gas Supply

The Company's natural gas distribution operations have entered into contractual commitments for daily entitlements of natural gas from various suppliers. The contracts have various expiration dates.

#### 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 of the Company.

### N. 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>1998</b>				
Operating Revenue	\$ 60,169,102	\$ 43,594,944	\$ 36,231,924	\$ 43,572,825
Operating Income	4,744,218	962,101	(459,965)	3,194,728
Net Income	4,000,602	263,751	(1,266,498)	2,304,731
Earnings per share:				
Basic	\$ 0.80	\$ 0.05	\$ (0.25)	\$ 0.45
Diluted	\$ 0.77	\$ 0.05	\$ (0.25)	\$ 0.44
<b>1997</b>				
Operating Revenue	\$ 76,302,285	\$ 44,918,820	\$ 41,680,719	\$ 59,587,440
Operating Income	4,148,755	1,392,667	(7,026)	3,132,068
Net Income	3,433,648	707,300	(762,784)	2,489,448
Earnings per share:				
Basic	\$ 0.69	\$ 0.14	\$ (0.15)	\$ 0.50
Diluted	\$ 0.67	\$ 0.14	\$ (0.15)	\$ 0.49

\* Results for the fourth quarter of 1998 reflect a one-time pension plan curtailment gain of approximately \$750,000, net of income tax expense. See Note J to the Consolidated Financial Statements.

## Operating Statistics

For the Years Ended December 31,	1998	1997	1996	1995	1994 <sup>(1)</sup>
<b>Revenues (in thousands)</b>					
Natural gas					
Residential	\$ 19,274	\$ 21,540	\$ 18,256	\$ 14,857	\$ 15,228
Commercial	15,243	16,557	14,339	11,383	11,594
Industrial	15,953	22,625	28,546	36,898	32,718
Sale for resale	11,683	23,010	24,481	12,459	9,586
Transportation	6,120	4,212	3,369	2,993	2,639
Other	310	162	1,102	515	(50)
<b>Total natural gas revenues</b>	<b>68,583</b>	<b>88,106</b>	<b>90,093</b>	<b>79,105</b>	<b>71,715</b>
Propane distribution and marketing <sup>(2)</sup>	102,873	125,159	161,812	147,596	17,789
Other	12,113	9,224	8,197	8,584	6,173
<b>Total revenues</b>	<b>\$ 183,569</b>	<b>\$ 222,489</b>	<b>\$ 260,102</b>	<b>\$ 235,285</b>	<b>\$ 95,677</b>

### Volumes

#### Natural gas deliveries (in MMCF)

Residential	1,636	1,753	1,987	1,686	1,665
Commercial	1,907	2,113	2,059	1,792	1,771
Industrial	3,115	5,975	7,553	13,622	10,752
Sale for resale	1,194	1,200	1,065	990	998
Transportation	13,548	12,231	12,138	11,131	7,542
<b>Total natural gas deliveries</b>	<b>21,400</b>	<b>23,272</b>	<b>24,802</b>	<b>29,221</b>	<b>22,728</b>
Propane distribution (in thousands of gallons) <sup>(2)</sup>	25,979	26,682	29,975	26,184	18,395

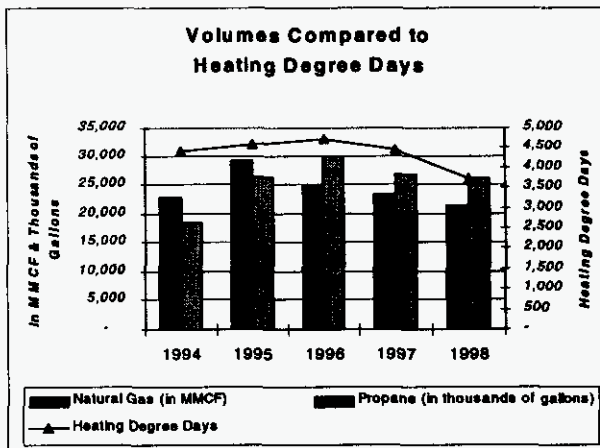
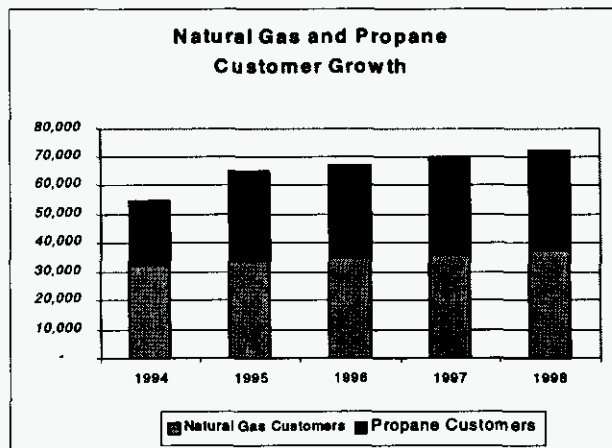
### Customers

Natural gas					
Residential	32,473	31,277	30,349	29,285	28,260
Commercial	4,416	4,288	4,151	4,030	3,879
Industrial <sup>(3)</sup>	236	229	210	212	204
Sale for resale <sup>(3)</sup>	3	3	3	3	3
<b>Total natural gas customers</b>	<b>37,128</b>	<b>35,797</b>	<b>34,713</b>	<b>33,530</b>	<b>32,346</b>
Propane distribution	34,988	33,998	32,218	31,372	22,180
<b>Total customers</b>	<b>72,116</b>	<b>69,795</b>	<b>66,931</b>	<b>64,902</b>	<b>54,526</b>

<sup>(1)</sup> 1994 has not been restated to include the business combinations with Tri-County Gas Company, Inc., Tolan Water Service or Xeron, Inc.

<sup>(2)</sup> 1994 amounts exclude \$2,895,000 in revenue and nine million gallons of propane sold to one large wholesale customer.

<sup>(3)</sup> Includes transportation customers.



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

None

**PART III**

**ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

Information pertaining to the Directors of the Company is incorporated herein by reference to the Proxy Statement, under "Information Regarding the Board of Directors and Nominees", dated and to be filed on or before March 30, 1999 in connection with the Company's Annual Meeting to be held on May 18, 1999.

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 Item 10 of Part I of this Form 10-K under "Executive Officers of the Registrant."

**ITEM 11. EXECUTIVE COMPENSATION**

This information is incorporated herein by reference to the Proxy Statement, under "Report on Executive Compensation", dated and to be filed on or before March 30, 1999 in connection with the Company's Annual Meeting to be held on May 18, 1999.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

This information is incorporated herein by reference to the Proxy Statement, under "Beneficial Ownership of the Company's Securities", dated and to be filed on or before March 30, 1999 in connection with the Company's Annual Meeting to be held on May 18, 1999.

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

This information is incorporated herein by reference to the Proxy Statement, under "Beneficial Ownership of the Company's Securities", dated and to be filed on or before March 30, 1999 in connection with the Company's Annual Meeting to be held on May 18, 1999.

**PART IV**

**ITEM 14. FINANCIAL STATEMENTS, FINANCIAL STATEMENT SCHEDULES, EXHIBITS AND REPORTS ON FORM 8-K**

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

1. Financial Statements:
  - Accountants' Report dated February 12, 1999 of PricewaterhouseCoopers LLP, Independent Accountants
  - Consolidated Statements of Income for each of the three years ended December 31, 1998, 1997 and 1996
  - Consolidated Balance Sheets at December 31, 1998 and December 31, 1997
  - Consolidated Statements of Cash Flows for each of the three years ended December 31, 1998, 1997 and 1996
  - Consolidated Statements of Common Stockholders' Equity for each of the three years ended December 31, 1998, 1997 and 1996
  - Consolidated Statements of Income Taxes for each of the three years ended December 31, 1998, 1997 and 1996
  - Notes to Consolidated Financial Statements

2. The following additional information for the years 1998, 1997 and 1996 is submitted herewith:
- 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:**

None.

**(c) Exhibits:**

- Exhibit 2(a) *Agreement and Plan of Merger* by and between Chesapeake Utilities Corporation and Tri-County Gas Company, Inc., filed on the Company's Form 8-K, File No. 001-11590 on January 13, 1997, is incorporated herein by reference.
- Exhibit 3(a) Amended Certificate of Incorporation of Chesapeake Utilities Corporation is incorporated herein by reference to Exhibit 3.1 of the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1998, File No. 001-11590.
- Exhibit 3(b) Amended Bylaws of Chesapeake Utilities Corporation, effective July 11, 1997, are incorporated herein by reference to Exhibit 3.2 of the Quarterly Report on Form 10-Q for the period ended June 30, 1998, 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) Directors Stock Compensation Plan adopted by Chesapeake Utilities Corporation in 1995 is incorporated herein by reference to the Company's Proxy Statement dated April 17, 1995 in connection with the Company's Annual Meeting held in May 1995.
- Exhibit 4(d) 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 Commission upon request.
- Exhibit 4(e) 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 Commission upon request.
- Exhibit 10(a) Service Agreement dated November 1, 1989, by and between Transcontinental Gas Pipe Line Corporation and Eastern Shore Natural Gas Company, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989, File No. 0-593.
- Exhibit 10(b) Service Agreement dated November 1, 1989, by and between Columbia Gas Transmission Corporation and Eastern Shore Natural Gas Company, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1989, File No. 0-593.
- Exhibit 10(c) Service Agreement for General Service dated November 1, 1989, by and between Florida Gas Transmission Company and Chesapeake Utilities Corporation, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990, File No. 0-593.

- Exhibit 10(d) Service Agreement for Preferred Service dated November 1, 1989, by and between Florida Gas Transmission Company and Chesapeake Utilities Corporation, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990, File No. 0-593.
- Exhibit 10(e) Service Agreement for Firm Transportation Service dated November 1, 1989, by and between Florida Gas Transmission Company and Chesapeake Utilities Corporation, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990, File No. 0-593.
- Exhibit 10(f) Form of Service Agreement for Interruptible Sales Services dated May 11, 1990, by and between Florida Gas Transmission Company and Chesapeake Utilities Corporation, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990, File No. 0-593.
- Exhibit 10(g) Interruptible Transportation Service Agreement dated February 23, 1990, by and between Florida Gas Transmission Company and Chesapeake Utilities Corporation, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990, File No. 0-593.
- Exhibit 10(h) Interruptible Transportation Service Agreement dated November 30, 1990, by and between Florida Gas Transmission Company and Chesapeake Utilities Corporation, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1990, File No. 0-593.
- Exhibit 10(i) Executive Employment Agreement dated March 26, 1997, by and between Chesapeake Utilities Corporation and each Ralph J. Adkins and John R. Schimkaitis is incorporated herein by reference to Exhibit 10 to the Company's Quarterly Report on Form 10-Q for the period ended June 30, 1997, File No. 001-11590.
- Exhibit 10(j) Form of Performance Share Agreement dated January 1, 1998, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and each of Ralph J. Adkins and John R. Schimkaitis is incorporated herein by reference to Exhibit 10 of the Company's Annual Report on Form 10-K for the year ended December 31, 1997, File No. 001-11590.
- Exhibit 10(k) Chesapeake Utilities Corporation Cash Bonus Incentive Plan dated January 1, 1992, is incorporated herein by reference to Exhibit 10 to the Company's Annual Report on Form 10-K for the year ended December 31, 1991, File No. 0-593.
- Exhibit 10(l) Chesapeake Utilities Corporation Performance Incentive Plan dated January 1, 1992, is incorporated herein by reference to the Company's Proxy Statement dated April 20, 1992, in connection with the Company's Annual Meeting held on May 19, 1992.
- Exhibit 10(m) Form of Stock Option Agreement dated January 1, 1998, pursuant to Chesapeake Utilities Corporation Performance Incentive Plan by and between Chesapeake Utilities Corporation and each of Michael P. McMasters, Stephen C. Thompson, William C. Boyles, Philip S. Barefoot, Jeremy D. West, William P. Schneider and James R. Schneider, is incorporated herein by reference to Exhibit 10 of the Company's Annual Report on Form 10-K for the year ended December 31, 1997, 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 Accountants, filed herewith.



## 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 16, 1999

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: March 16, 1999

/S/ JOHN R. SCHIMKAITIS  
John R. Schimkaitis, President,  
Chief Executive Officer and Director  
Date: March 16, 1999

/S/ MICHAEL P. MCMASTERS  
Michael P. McMasters, Vice President,  
Chief Financial Officer and Treasurer  
(Principal Financial Officer)  
Date: March 16, 1999

/S/ RICHARD BERNSTEIN  
Richard Bernstein, Director  
Date: March 16, 1999

/S/ WALTER J. COLEMAN  
Walter J. Coleman, Director  
Date: March 16, 1999

/S/ JOHN W. JARDINE, JR.  
John W. Jardine, Jr., Director  
Date: March 16, 1999

/S/ RUDOLPH M. PEINS, JR.  
Rudolph M. Peins, Jr., Director  
Date: March 16, 1999

/S/ ROBERT F. RIDER  
Robert F. Rider, Director  
Date: March 16, 1999

/S/ JEREMIAH P. SHEA  
Jeremiah P. Shea, Director  
Date: March 16, 1999

\_\_\_\_\_  
William G. Warden, III, Director  
Date: March 16, 1999

**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>					
1998	\$ 331,775	\$ 280,391	\$ 57,759	\$ (367,412)	\$ 302,513
1997	\$ 392,412	\$ 203,624	\$ 68,038	\$ (332,299)	\$ 331,775
1996	\$ 309,955	\$ 364,622	\$ 55,631	\$ (337,796)	\$ 392,412

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

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

**Chesapeake Utilities Corporation and Subsidiaries**  
**Exhibit 12**  
**Ratio of Earnings to Fixed Charges**

<b>For the Years Ended December 31,</b>	<b>1998</b>	<b>1997</b>	<b>1996</b>
<b>Income from continuing operations</b>	\$ 5,302,586	\$ 5,867,612	\$ 7,781,933
Add:			
Income taxes	3,225,744	3,704,196	4,086,616
Portion of rents representative of interest factor	130,717	167,029	155,916
Interest on indebtedness	3,256,415	3,224,606	2,884,858
Amortization of debt discount and expense	123,335	119,401	120,345
<b>Earnings as adjusted</b>	<b>\$ 12,038,797</b>	<b>\$ 13,082,844</b>	<b>\$ 15,029,668</b>
<b>Fixed Charges</b>			
Portion of rents representative of interest factor	\$ 130,717	\$ 167,029	\$ 155,916
Interest on indebtedness	3,256,415	3,224,606	2,884,858
Amortization of debt discount and expense	123,335	119,401	120,345
<b>Fixed Charges</b>	<b>\$ 3,510,467</b>	<b>\$ 3,511,036</b>	<b>\$ 3,161,119</b>
<b>Ratio of Earnings to Fixed Charges</b>	<b>3.43</b>	<b>3.73</b>	<b>4.75</b>

**Chesapeake Utilities Corporation**  
**Exhibit 21**  
**Subsidiaries of the Registrant**

<u>Subsidiaries</u>	<u>State Incorporated</u>
Eastern Shore Natural Gas Company	Delaware
Sharp Energy, Inc.	Delaware
Chesapeake Service Company	Delaware
United Systems, Inc.	Georgia
Tri-County Gas Company, Inc.	Maryland
Eastern Shore Real Estate	Maryland
Xeron, Inc.	Texas
Sam Shannaham Well Co.	Maryland
Sharp Water, Inc.	Delaware

<u>Subsidiary of Eastern Shore Natural Gas Company</u>	<u>State Incorporated</u>
Dover Exploration Company	Delaware

<u>Subsidiaries of Sharp Energy, Inc.</u>	<u>State Incorporated</u>
Sharpgas, Inc.	Delaware
Sharpoil, Inc.	Delaware

<u>Subsidiaries of Chesapeake Service Company</u>	<u>State Incorporated</u>
Skipjack, Inc.	Delaware
Capital Data Systems, Inc.	North Carolina
Currin and Associates, Inc.	North Carolina
Chesapeake Investment Company	Delaware

## CONSENT OF INDEPENDENT ACCOUNTANTS

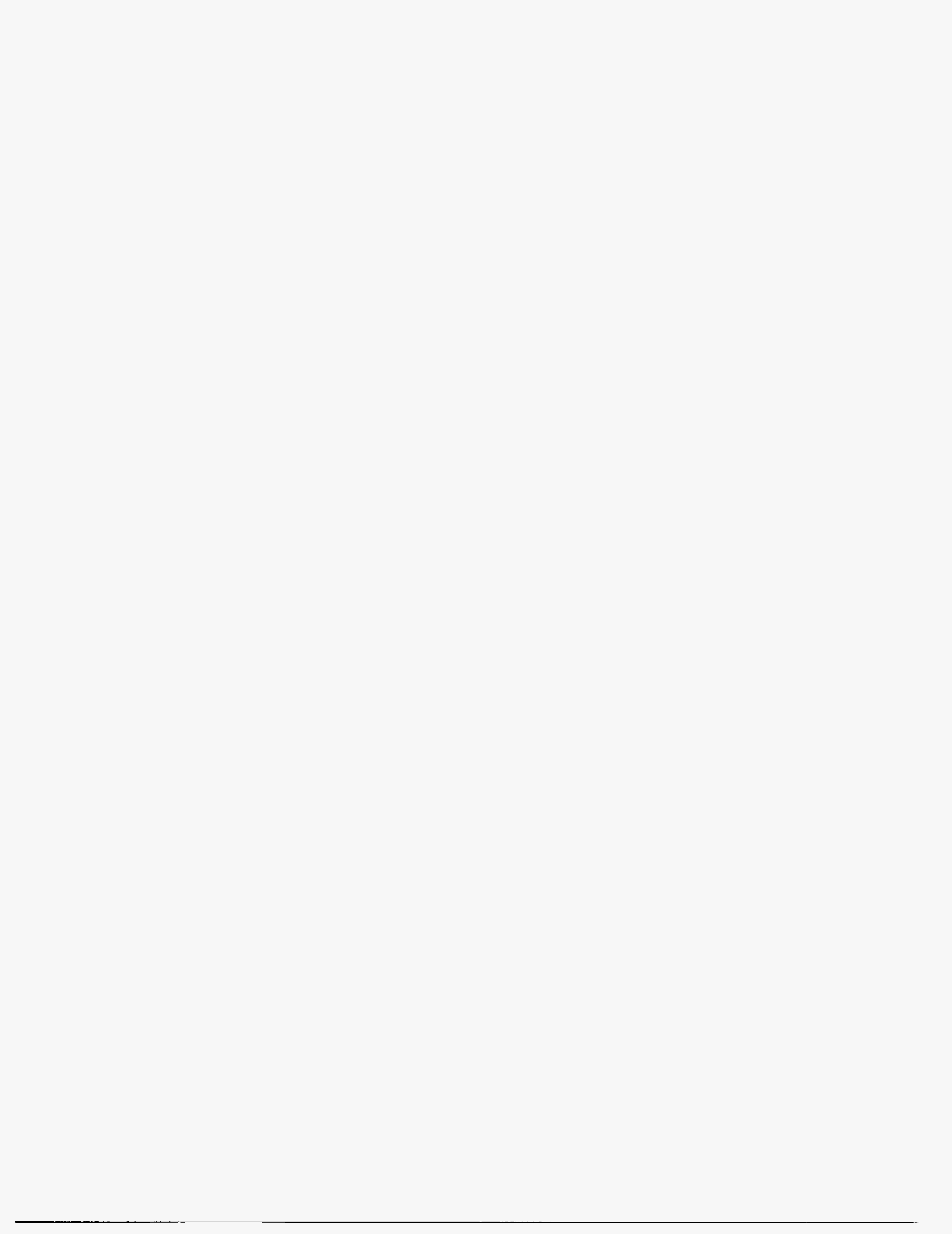
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We consent to the incorporation by reference in the Prospectuses of Chesapeake Utilities Corporation on Form S-2 (File No. 33-26582), Form S-3 (File Nos. 33-28391, 33-64671, 333-37165, 333-64757 and 333-63381) and Form S-8 (File No. 33-301175) of our report dated February 12, 1998 on our audits of the consolidated financial statements and the consolidated financial statement schedules of Chesapeake Utilities Corporation as of December 31, 1998 and 1997 and for each of the three years in the period ended December 31, 1998 included in this Annual Report on Form 10-K.

*PricewaterhouseCoopers LLP*

PRICEWATERHOUSECOOPERS LLP  
Washington, D.C.  
March 25, 1999





*Upon written request,  
Chesapeake will provide, free of  
charge, a copy of any exhibit to  
the 1998 Annual Report on  
Form 10-K not included  
in this document.*



**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, 1999

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 of 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

Common Stock, par value \$.4867 — 5,139,498 shares issued as of June 30, 1999.

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**PART I — FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**Chesapeake Utilities Corporation and Subsidiaries**

**Consolidated Statements of Income (Unaudited)**

For the Three Months Ended June 30,	1999	1998
<b>Operating Revenues</b>	\$ 46,851,305	\$ 43,594,944
<b>Cost of Sales</b>	35,221,923	33,309,758
<b>Gross Margin</b>	11,629,382	10,285,186
<b>Operating Expenses</b>		
Operations	6,548,966	6,203,139
Maintenance	428,183	532,539
Depreciation and amortization	1,658,836	1,521,802
Other taxes	1,008,566	963,097
Income taxes	430,320	102,507
<b>Total operating expenses</b>	10,074,871	9,323,084
<b>Operating Income</b>	1,554,511	962,102
<b>Other Income, net</b>	74,471	89,187
<b>Income Before Interest Charges</b>	1,628,982	1,051,289
<b>Interest Charges</b>	832,879	787,538
<b>Net Income</b>	\$ 796,103	\$ 263,751
<b>Earnings Per Share of Common Stock:</b>		
Basic	\$ 0.16	\$ 0.05
Diluted	\$ 0.15	\$ 0.05

**Consolidated Statements of Comprehensive Income (Unaudited)**

For the Three Months Ended June 30,	1999	1998
<b>Net Income</b>	\$ 796,103	\$ 263,751
<b>Unrealized gain on marketable securities, net of income taxes</b>	233,312	198,697
<b>Total Comprehensive Income</b>	\$ 1,029,415	\$ 462,448

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

# Chesapeake Utilities Corporation and Subsidiaries

## Consolidated Statements of Income (Unaudited)

For the Six Months Ended June 30,	1999	1998
Operating Revenues	\$ 102,497,377	\$ 103,764,046
Cost of Sales	72,315,133	77,175,201
Gross Margin	30,182,244	26,588,845
Operating Expenses		
Operations	13,076,947	12,173,257
Maintenance	847,335	1,011,651
Depreciation and amortization	3,296,832	3,034,375
Other taxes	2,180,176	2,133,944
Income taxes	3,458,068	2,529,298
Total operating expenses	22,859,358	20,882,525
Operating Income	7,322,886	5,706,320
Other Income, net	147,697	199,577
Income Before Interest Charges	7,470,583	5,905,897
Interest Charges	1,731,497	1,641,544
Net Income	\$ 5,739,086	\$ 4,264,353
Earnings Per Share of Common Stock:		
Basic	\$ 1.12	\$ 0.85
Diluted	\$ 1.09	\$ 0.83

## Consolidated Statements of Comprehensive Income (Unaudited)

For the Six Months Ended June 30,	1999	1998
Net Income	\$ 5,739,086	\$ 4,264,353
Unrealized gain on marketable securities, net of income taxes	-	383,084
Total Comprehensive Income	\$ 5,739,086	\$ 4,647,437

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

# Chesapeake Utilities Corporation and Subsidiaries

## Consolidated Statements of Cash Flows (Unaudited)

For the Six Months Ended June 30,	1999	1998
<b>Operating Activities</b>		
Net Income	\$ 5,739,086	\$ 4,264,353
Adjustments to reconcile net income to net operating cash:		
Depreciation and amortization	3,658,483	3,392,447
Deferred income taxes, net	(883,899)	(898,931)
Investment tax credit adjustments	(16,601)	(22,526)
Mark-to-market adjustments	33,855	(325,699)
Employee benefits	57,398	218,076
Employee compensation from lapsing stock restrictions	35,520	59,922
Other, net	41,635	26,160
Changes in assets and liabilities:		
Accounts receivable, net	222,951	3,492,595
Inventory, materials, supplies and storage gas	772,431	2,306,045
Other current assets	630,782	(31,838)
Other deferred charges	343,267	(327,659)
Accounts payable, net	1,867,404	(6,862,584)
Refunds payable to customers	(13,758)	(100,333)
Overrecovered purchased gas costs	2,239,032	1,861,725
Other current liabilities	3,861,696	3,577,168
<b>Net cash provided by operating activities</b>	<b>18,589,282</b>	<b>10,628,921</b>
<b>Investing Activities</b>		
Property, plant and equipment expenditures, net	(7,336,408)	(4,740,118)
<b>Net cash used by investing activities</b>	<b>(7,336,408)</b>	<b>(4,740,118)</b>
<b>Financing Activities</b>		
Common stock dividends net of amounts reinvested of \$219,808 and \$206,024, respectively	(2,332,631)	(2,022,068)
Issuance of stock:		
Dividend Reinvestment Plan optional cash	93,755	90,433
Retirement Savings Plan	420,236	207,949
Net repayment under line of credit agreements	(7,100,000)	(5,500,010)
Repayments of long-term debt	(1,268,025)	(791,326)
<b>Net cash used by financing activities</b>	<b>(10,186,665)</b>	<b>(8,015,022)</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>\$ 1,066,209</b>	<b>\$ (2,126,219)</b>
<b>Cash and Cash Equivalents at Beginning of Period</b>	<b>2,598,084</b>	<b>4,829,176</b>
<b>Cash and Cash Equivalents at End of Period</b>	<b>\$ 3,664,293</b>	<b>\$ 2,702,957</b>

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

# Chesapeake Utilities Corporation and Subsidiaries

## Consolidated Balance Sheets

	June 30, 1999 (Unaudited)	December 31, 1998 (Audited)
<b>Assets</b>		
<b>Property, Plant and Equipment</b>		
Natural gas distribution and transmission	\$ 122,724,609	\$ 117,232,506
Propane gas distribution and marketing	27,391,027	27,287,807
Advanced information services	1,309,744	1,087,910
Other plant	8,240,455	7,382,965
<b>Total property, plant and equipment</b>	<b>159,665,835</b>	<b>152,991,188</b>
<b>Less: Accumulated depreciation and amortization</b>	<b>(51,586,674)</b>	<b>(48,725,412)</b>
<b>Net property, plant and equipment</b>	<b>108,079,161</b>	<b>104,265,776</b>
<b>Investments</b>	<b>4,164,660</b>	<b>4,165,194</b>
<b>Current Assets</b>		
Cash and cash equivalents	3,664,293	2,598,084
Accounts receivable (less allowance for uncollectibles of \$239,204 and \$302,513 in 1999 and 1998, respectively)	14,604,449	14,861,255
Materials and supplies, at average cost	1,773,554	1,728,513
Propane inventory, at average cost	1,564,779	1,787,038
Storage gas prepayments	1,557,392	2,152,605
Underrecovered purchased gas costs	-	1,552,265
Income taxes receivable	-	344,311
Deferred income taxes	745,712	-
Prepaid expenses	965,813	1,596,595
<b>Total current assets</b>	<b>24,875,992</b>	<b>26,620,666</b>
<b>Deferred Charges and Other Assets</b>		
Environmental regulatory assets	2,653,980	2,700,000
Environmental expenditures	3,419,252	3,418,166
Other deferred charges and intangible assets	3,583,998	4,063,811
<b>Total deferred charges and other assets</b>	<b>9,657,230</b>	<b>10,181,977</b>
<b>Total Assets</b>	<b>\$ 146,777,043</b>	<b>\$ 145,233,613</b>

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

# Chesapeake Utilities Corporation and Subsidiaries

## Consolidated Balance Sheets

	June 30, 1999 (Unaudited)	December 31, 1998 (Audited)
<b>Capitalization and Liabilities</b>		
<b>Capitalization</b>		
Stockholders' equity		
Common Stock, par value \$.4867 per share; (authorized 12,000,000 shares; issued 5,140,486 and 5,093,788 shares, respectively)	\$ 2,501,748	\$ 2,479,019
Additional paid-in capital	24,967,433	24,192,188
Retained earnings	32,015,951	28,892,384
Accumulated other comprehensive income	863,344	863,344
Less: Unearned compensation related to restricted stock awards	(35,521)	(71,041)
<b>Total stockholders' equity</b>	<b>60,312,955</b>	<b>56,355,894</b>
Long-term debt, net of current portion	35,175,000	37,597,000
<b>Total capitalization</b>	<b>95,487,955</b>	<b>93,952,894</b>
<b>Current Liabilities</b>		
Current portion of long-term debt	1,638,000	520,000
Short-term borrowing	4,500,000	11,600,000
Accounts payable	12,938,046	11,070,642
Refunds payable to customers	622,395	636,153
Income taxes payable	2,079,672	-
Accrued interest	1,026,919	553,444
Dividends payable	1,336,526	1,273,446
Overrecovered purchased gas costs	686,767	-
Deferred income taxes	-	56,100
Other accrued liabilities	4,690,269	3,754,231
<b>Total current liabilities</b>	<b>29,518,594</b>	<b>29,464,016</b>
<b>Deferred Credits and Other Liabilities</b>		
Deferred income taxes	13,177,661	13,260,282
Deferred investment tax credits	750,201	766,802
Environmental liability	2,653,980	2,700,000
Accrued pension costs	1,593,702	1,536,304
Other liabilities	3,594,950	3,553,315
<b>Total deferred credits and other liabilities</b>	<b>21,770,494</b>	<b>21,816,703</b>
<b>Total Capitalization and Liabilities</b>	<b>\$ 146,777,043</b>	<b>\$ 145,233,613</b>

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. Quarterly Financial Data

The financial information of Chesapeake Utilities Corporation (the "Company") included herein is unaudited and should be read in conjunction with the Company's 1998 annual report on Form 10-K. In the opinion of management, the financial information reflects normal recurring adjustments, which are necessary for a fair presentation of the Company's interim results. Due to the seasonal nature of the Company's business, there are substantial variations in the results of operations reported on a quarterly basis; therefore, the results of operations for an interim period may not give a true indication of results for the year. Certain amounts in 1998 have been reclassified to conform with current year presentation.

### 2. Calculation of Earnings Per Share

For the Periods Ended June 30,	Three Months Ended		Six Months Ended	
	1999	1998	1999	1998
<b>Calculation of Basic Earnings Per Share:</b>				
Net Income	\$ 796,103	\$ 263,751	\$ 5,739,086	\$ 4,264,353
Weighted Average Shares Outstanding	5,134,178	5,055,237	5,121,189	5,040,043
<b>Basic Earnings Per Share</b>	<b>\$ 0.16</b>	<b>\$ 0.05</b>	<b>\$ 1.12</b>	<b>\$ 0.85</b>
<b>Calculation of Diluted Earnings Per Share:</b>				
<b>Reconciliation of Numerator:</b>				
Net Income — Basic	\$ 796,103	\$ 263,751	\$ 5,739,086	\$ 4,264,353
Effect of 8.25% Convertible debentures	-	-	94,602	96,412
<b>Adjusted numerator — Diluted</b>	<b>\$ 796,103</b>	<b>\$ 263,751</b>	<b>\$ 5,833,688</b>	<b>\$ 4,360,765</b>
<b>Reconciliation of Denominator:</b>				
Weighted Shares Outstanding — Basic	5,134,178	5,055,237	5,121,189	5,040,043
Effect of Dilutive Securities				
Stock options	10,368	11,860	11,026	13,034
8.25% Convertible debentures	-	-	222,822	227,087
<b>Adjusted denominator — Diluted</b>	<b>5,144,546</b>	<b>5,067,097</b>	<b>5,355,037</b>	<b>5,280,164</b>
<b>Diluted Earnings per Share</b>	<b>\$ 0.15</b>	<b>\$ 0.05</b>	<b>\$ 1.09</b>	<b>\$ 0.83</b>

No adjustments have been made to adjust basic earnings per share for the quarters ended June 30, 1999 and 1998 for the 8.25% convertible debentures due to their anti-dilutive effect for those periods.

### 3. Investments

The investment balance at June 30, 1999 and December 31, 1998 consists primarily of a 7.3% ownership interest in the common stock of Florida Public Utilities Company ("FPU"). The Company has classified its investment in FPU as an "Available for Sale" security, which requires that all unrealized gains and losses be excluded from earnings and be reported net of income tax as a separate component of stockholders' equity. As noted below, the Company has entered into an agreement to sell this investment.

In August 1998, the Company entered into an agreement to sell its investment in FPU for \$16.50 per share to The Southern Company. The execution of the agreement is contingent on the approval of the Securities and Exchange Commission for which the Company cannot predict the timing. If regulatory approval is received, the Company will recognize a \$1.4 million pre-tax gain or \$863,000, after taxes.

### 4. Commitments and Contingencies — Environmental Matters

The Company is currently participating in the investigation, assessment and remediation of three former gas manufacturing plant sites located in different jurisdictions, including the exploration of corrective action options to remove environmental contaminants. Chesapeake entered into settlement agreements with a number of insurance companies resulting in proceeds to fund actual environmental costs incurred for two



of the sites over three to seven-year periods beginning in 1990. The final insurance proceeds were requested and received in 1992. Chesapeake has received ratemaking treatment for costs incurred to date from the applicable regulatory commissions for the three sites listed below. It is management's opinion that any current or future costs that have not been recovered through insurance proceeds or rates at this time will be recoverable in future rates.

The Company has received and responded to an inquiry from the Maryland Department of the Environment regarding an investigation of hazardous substances at or about the location of a former manufactured gas plant ("MGP") in Cambridge. The Company never owned the property on which the MGP operated. After MGP operations ceased, Chesapeake acquired an adjoining property on which a gas storage tank was once operated. The successor to the MPG operator carried out a clean-up of that tank in the 1980's. The Company uses the adjoining property for other purposes and has not engaged in manufactured gas operations at Cambridge.

**(a) Dover Gas Light Site**

The Dover site has been listed by the Environmental Protection Agency Region III ("EPA") on the Superfund National Priorities List under the Comprehensive Environmental Response, Compensation and Liability Act. In 1994, the EPA issued a site Record of Decision ("ROD"), which selected a remedial plan and estimated the costs of the selected remediation at \$2.7 million for ground-water and \$3.3 million for soil. In 1995, the EPA issued an order ("Order") requiring both the Company and General Public Utilities Corporation, Inc. ("GPU") to fund or implement the ROD. Although notifying the EPA of its objections, the Company agreed to comply with the Order. GPU informed the EPA that it did not intend to comply; therefore, the EPA may seek judicial enforcement of its Order, as well as significant financial penalties for failure to comply. In June 1996, the Company initiated litigation against GPU for contribution to the remedial costs incurred by Chesapeake in connection with complying with the ROD. At this time, management cannot predict the outcome of the litigation or the amount of proceeds to be received, if any. Additional information pertaining to remediation costs, investigations related to additional parties who may be potentially responsible parties and/or litigation initiated by the Company can be found in the Company's annual report on Form 10-K for the year ended December 31, 1998 (see the "Environmental — Dover Gas Light Site" section, beginning on page 11).

In 1996, the Company began the design phase of the ROD, on-site pre-design and investigation. In January 1998, the EPA issued a ROD Amendment, which modified the soil remediation clean-up plan to include: (1) excavation and off-site thermal treatment of the contents of the former subsurface gas holders; (2) implementation of soil vaporization extraction; and (3) pavement of the parking lot. The overall estimated clean-up cost of the site under the EPA's ROD Amendment was \$4.2 million (\$1.5 million for soil remediation and \$2.7 million for ground-water remediation) as compared to the original ROD cleanup estimate of \$6.0 million (\$3.3 million for soil remediation and \$2.7 million for ground-water remediation).

During the fourth quarter of 1998 the Company completed the first element of the soil remediation. Over the next twelve to eighteen months the Company will finalize the remaining two elements of the soil remediation and initiate the ground-water remedial activities.

The Company's independent consultants have prepared preliminary cost estimates of two potentially acceptable alternatives to complete the ground-water remediation activities at the site. The costs range from a low of \$390,000 in capital and \$37,000 per year of operating costs for 30 years for natural attenuation to a high of \$4.0 million in capital and \$500,000 per year in operating costs for 30 years for a pump and treat system. A decision by the EPA as to the most appropriate ground-water remediation method is likely in 1999. The capital costs necessary to begin ground-water remediation are expected to be incurred over the next twelve to eighteen months. The Company cannot predict which ground-water

remediation method will be selected by the EPA and accordingly, adjusted its accrual to \$2.1 million at December 31, 1998 for the Dover site, and recorded a regulatory asset for an equivalent amount. Of this amount, \$1.5 million is for ground-water remediation and \$600,000 is for the remaining soil remediation. The \$1.5 million represents the low end of the ground-water remedy estimates described above. No changes have been made to these accrued amounts in 1999. The Company is currently engaged in investigations related to additional parties who may be potentially responsible parties ("PRPs"). Based upon these investigations, the Company will consider suit against other PRPs. The Company expects continued negotiations with PRPs in an attempt to resolve these matters.

As of June 30, 1999, the Company has incurred approximately \$7.0 million in costs relating to environmental testing and remedial action studies. Of this amount, \$1.1 million of incurred environmental costs have not received ratemaking treatment.

#### **(b) Salisbury Town Gas Light Site**

In cooperation with the Maryland Department of the Environment ("MDE"), the Company completed assessment of the Salisbury manufactured gas plant site, determining that there was localized ground-water contamination. During 1996, the Company completed construction and began Air Sparging and Soil-Vapor Extraction remediation procedures. Chesapeake has been reporting the remediation and monitoring results to the Maryland Department of the Environment on an ongoing basis since 1996.

The estimated cost of the remaining remediation is approximately \$136,000 per year for operating expenses for a period of five years. Based on these estimated costs, the Company adjusted both its liability and related regulatory asset to \$600,000 on December 31, 1998, to cover the Company's projected remediation costs for this site. As of June 30, 1999, the Company has incurred approximately \$2.6 million for remedial actions and environmental studies. Of this amount, approximately \$817,000 of incurred costs have not been recovered through insurance proceeds or received ratemaking treatment.

#### **(c) Winter Haven Coal Gas Site**

In May 1996, the company filed an Air Sparging and Soil Vapor Extraction Pilot Study Work Plan for the Winter Haven site with the Florida Department of Environmental Protection ("FDEP"). The Work Plan described the Company's proposal to undertake an Air Sparging and Soil Vapor Extraction ("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. The FDEP responded by requesting additional field investigation work, which was completed during the first quarter of 1999. In addition, the FDEP approved the AS/SVE Pilot Study Work Plan, which the Company began during June 1999. It is not possible to determine what remedial action will be required by FDEP and the cost of such remediation.

The Company has recovered all environmental costs incurred, approximately \$738,000, through rates charged to customers. Additionally, the Florida Public Service Commission has allowed the Company to continue to recover amounts for future environmental costs that might be incurred. At June 30, 1999, Chesapeake had received \$496,000 related to future costs, which might be incurred.

### **5. Recent Accounting Pronouncements**

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

##### ***Derivative Instruments and Hedging Activities***

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, establishing accounting and reporting standards for derivative instruments, including certain derivative instruments

embedded in other contracts, and hedging activities. This statement does not allow retroactive application to financial statements for prior periods. Chesapeake will adopt the requirements of this standard in the first quarter of 2001, as required. Originally applicable to all fiscal quarters of fiscal years beginning after June 15, 1999, the FASB has deferred application of this standard to all fiscal quarters of fiscal years beginning after June 15, 2000. The Company believes that adoption of this statement will not have a material impact on the Company's financial position or results of operations.

The Emerging Issues Task Force released Issue 98-10, "Accounting for Energy Trading and Risk Management Activities", effective January 1, 1999. The Company records its use of derivatives in accordance with the standard by marking open positions to market value.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### RESULTS OF OPERATIONS FOR THE QUARTER ENDED JUNE 30, 1999

#### Consolidated Overview

The Company recognized net income of \$796,000 — \$.16 per share — for the second quarter of 1999, representing an increase in income of \$532,000, or \$.11 per share, as compared to the corresponding period in 1998. As indicated in the following table, the increase in the Company's Earnings Before Interest and Taxes ("EBIT") is primarily due to increased contributions from the natural gas propane gas and advanced information services segments.

For the Three Months Ended June 30,	1999	1998	Change
Earnings Before Interest & Taxes			
Natural Gas Distribution & Transmission	\$ 1,954,213	\$ 1,311,362	\$ 642,851
Propane Gas Distribution & Marketing	(443,730)	(781,021)	337,291
Advanced Information Services	418,751	337,016	81,735
Other & Eliminations	55,597	197,252	(141,655)
Earnings Before Interest & Taxes	1,984,831	1,064,609	920,222
Operating Income Taxes	430,320	102,507	327,813
Interest	832,879	787,538	45,341
Non-Operating Income, net	74,471	89,187	(14,716)
Net Income	\$ 796,103	\$ 263,751	\$ 532,352

#### Natural Gas Distribution and Transmission

The natural gas distribution and transmission segment reported EBIT of \$1,954,000 for the second quarter of 1999 as compared to \$1,311,000 for the corresponding period last year — an increase of \$643,000. The rise in EBIT is primarily due an increase in gross margin.

For the Three Months Ended June 30,	1999	1998	Change
Revenue	\$ 15,974,554	\$ 14,789,163	\$ 1,185,391
Cost of Gas	8,534,536	7,972,686	561,850
Gross Margin	7,440,018	6,816,477	623,541
Operations & Maintenance	3,548,637	3,678,032	(129,395)
Depreciation & Amortization	1,206,328	1,117,157	89,171
Other Taxes	730,840	709,926	20,914
Total Operating Expenses	5,485,805	5,505,115	(19,310)
Earnings Before Interest & Taxes	\$ 1,954,213	\$ 1,311,362	\$ 642,851

Gross margin increased due to transportation revenue combined with increased deliveries to residential and commercial customers in Chesapeake's northern service territory. Higher transportation revenue is primarily attributable to a single industrial customer contracting services on a monthly basis. Deliveries to the residential and commercial customers increased 6.6%, contributing approximately \$292,000 in additional margin, due to cooler temperatures and the increased number of residential and commercial customers. The reduction in operating expenses was primarily the result of lower operations and maintenance expenses offset by depreciation, marketing programs designed to continue building customer growth and billable service work.

#### Propane Gas Distribution and Marketing

For the second quarter of 1999, the propane gas segment reported a loss before interest and taxes of \$444,000, as compared to \$781,000 for the same period last year. The \$337,000 improvement is primarily the result of increased gross margin.

For the Three Months Ended June 30,	1999	1998	Change
Revenue	\$ 26,764,392	\$ 25,774,384	\$ 990,008
Cost of Sales	24,503,285	23,825,736	677,549
Gross Margin	2,261,107	1,948,648	312,459
Operations & Maintenance	2,254,518	2,269,042	(14,524)
Depreciation & Amortization	324,646	322,038	2,608
Other Taxes	125,673	138,589	(12,916)
Total Operating Expenses	2,704,837	2,729,669	(24,832)
Loss Before Interest & Taxes	\$ (443,730)	\$ (781,021)	\$ 337,291

The increase in gross margin is due primarily to a \$239,000 increase in distribution sales margins and a \$133,000 increase in propane marketing margins, offset by a \$60,000 reduction in other margins. Distribution gross margin increased primarily due to cooler temperatures during the second quarter of 1999 when compared to the same period last year. The change in temperatures resulted in a 15% increase in propane gallons distributed. Lower wholesale propane supply costs helped to increase the distribution margins earned per gallon sold, accounting for approximately 25% of the \$239,000 increase. Operating expenses for the quarter decreased slightly due to lower maintenance, service and selling expenses offset by increased marketing, employee benefits and delivery expenses.

#### Advanced Information Services

The advanced information services segment recognized EBIT of \$419,000 and \$337,000 for the quarters ended June 30, 1999 and 1998, respectively. The \$82,000 increase in EBIT is attributable to an increase in margin, reduced by higher operating expenses.

For the Three Months Ended June 30,	1999	1998	Change
Revenue	\$ 3,573,799	\$ 2,470,655	\$ 1,103,144
Cost of Sales	1,771,201	1,191,276	579,925
Gross Margin	1,802,598	1,279,379	523,219
Operations & Maintenance	1,184,984	804,839	380,145
Depreciation & Amortization	66,448	42,116	24,332
Other Taxes	132,415	95,408	37,007
Total Operating Expenses	1,383,847	942,363	441,484
Earnings Before Interest & Taxes	\$ 418,751	\$ 337,016	\$ 81,735

Higher revenues are primarily due to increased consulting services and software sales. Operating expenses increased primarily in the areas of compensation, both earnings-driven and staff-related, employee benefits

and consulting services. Depreciation is also higher primarily due to computer equipment purchases to support increased attendance in training classes and increased staffing.

### Operating Income Taxes

Operating income taxes increased due to the increase in operating income.

### Comprehensive Income

The Company has disclosed an unrealized gain on the sale of marketable securities of \$233,000 for the three months ended June 30, 1999, reflecting the change from a market price of \$14.75 per share at March 31, 1999 to the agreed upon sale price of \$16.50 per share at June 30, 1999. The investment is classified as "Available for Sale" (see Note 3 to the Consolidated Financial Statements). As previously discussed, in August 1998, the Company entered into an agreement with The Southern Company to sell its investment in FPU for \$16.50 per share. If the sale is consummated, the Company will recognize a non-recurring, after tax gain of approximately \$863,000, which represents the difference between the sale price and Chesapeake's cost basis.

## RESULTS OF OPERATIONS FOR THE SIX MONTHS ENDED JUNE 30, 1999

### Consolidated Overview

The Company recognized net income of \$5,739,000 — \$1.12 per share — for the six months ended 1999, representing an increase of \$1,475,000, or \$.27 per share, as compared to net income for the first half of 1998. As indicated in the following table, the increase in the Company's Earnings Before Interest and Taxes ("EBIT") is primarily due to increased contributions from Chesapeake's three primary business units — natural gas, propane gas and advanced information services.

For the Six Months Ended June 30,	1999	1998	Change
Earnings Before Interest & Taxes			
Natural Gas Distribution & Transmission	\$ 7,144,726	\$ 5,992,142	\$ 1,152,584
Propane Gas Distribution & Marketing	2,771,734	1,325,144	1,446,590
Advanced Information Services	681,600	604,930	76,670
Other & Eliminations	182,894	313,402	(130,508)
Earnings Before Interest & Taxes	10,780,954	8,235,618	2,545,336
Operating Income Taxes	3,458,068	2,529,298	928,770
Interest	1,731,497	1,641,544	89,953
Non-Operating Income, net	147,697	199,577	(51,880)
Net Income	\$ 5,739,086	\$ 4,264,353	\$ 1,474,733

### Natural Gas Distribution and Transmission

The natural gas distribution and transmission segment reported EBIT of \$7,145,000 for the first six months of 1999 as compared to \$5,992,000 for the corresponding period last year — an increase of \$1,153,000. The increase in EBIT is due an increase in gross margin.

<b>For the Six Months Ended June 30,</b>	<b>1999</b>	<b>1998</b>	<b>Change</b>
Revenue	\$ 40,576,451	\$ 41,859,811	\$ (1,283,360)
Cost of Gas	22,265,077	24,949,956	(2,684,879)
Gross Margin	18,311,374	16,909,855	1,401,519
Operations & Maintenance	7,190,209	7,131,794	58,415
Depreciation & Amortization	2,410,168	2,229,602	180,566
Other Taxes	1,566,271	1,556,317	9,954
Total Operating Expenses	11,166,648	10,917,713	248,935
Earnings Before Interest & Taxes	\$ 7,144,726	\$ 5,992,142	\$ 1,152,584

Gross margin increased due to colder temperatures combined with a 5.6% growth in residential and commercial customers. Deliveries to these customers increased 6.3% due to the colder weather and the increased number of residential and commercial customers. The colder temperatures and increases in customers served contributed to a rise in margin of approximately \$818,000. Also contributing to the rise in margin were increases in transportation revenue earned from the system expansion and industrial customers. Although gross margin increased from \$16.9 million to \$18.3 million from 1998 to 1999, revenue and the associated cost of gas declined due to a reduction in the price of gas. Changes in the cost of gas are passed on to customers through the purchased gas adjustment clauses in the Company's tariffs. Increases in operating expenses were driven by depreciation, employee benefits, marketing programs designed to continue building customer growth and billable service work. These are partially offset by decreased consulting, legal and data processing costs.

In an effort to reduce the impact of warmer temperatures in the future, Chesapeake filed and received approval in the state of Delaware to implement a weather normalization clause. The new margin sharing mechanism was approved May 25, 1999. It will increase the margins contributed by weather-sensitive customers during periods when the weather is significantly warmer and decrease margins contributed by them when the weather is significantly cooler. The Company intends to make a similar filing in its Maryland jurisdiction in the third quarter.

#### **Propane Gas Distribution and Marketing**

For the first six months of 1999, the propane gas segment reported earnings before interest and taxes of \$2,772,000, as compared to \$1,325,000 for the same period last year. The \$1,447,000 increase is primarily the result of increased gross margin.

<b>For the Six Months Ended June 30,</b>	<b>1999</b>	<b>1998</b>	<b>Change</b>
Revenue	\$ 54,351,087	\$ 56,270,628	\$ (1,919,541)
Cost of Sales	46,077,755	49,438,683	(3,360,928)
Gross Margin	8,273,332	6,831,945	1,441,387
Operations & Maintenance	4,554,912	4,532,201	22,711
Depreciation & Amortization	649,365	649,681	(316)
Other Taxes	297,321	324,919	(27,598)
Total Operating Expenses	5,501,598	5,506,801	(5,203)
Earnings Before Interest & Taxes	\$ 2,771,734	\$ 1,325,144	\$ 1,446,590

The increase in gross margin is due primarily to a \$1.4 million increase in distribution sales margins and a \$66,000 increase in propane marketing margins, offset by a \$46,000 reduction in other margins. Distribution gross margin increased primarily due to colder temperatures during the first six months of 1999 when compared to the same period last year. The change in temperatures resulted in a 15.9% increase in propane gallons distributed. Lower wholesale propane supply costs helped to increase the distribution margins earned

per gallon sold — approximately 36% of the \$1.4 million — resulting in a margin per gallon increase of approximately 7.5%.

### Advanced Information Services

The advanced information services segment recognized an EBIT of \$682,000 and \$605,000 for the six months ended June 30, 1999 and 1998, respectively. The \$77,000 increase in EBIT is attributable to increased gross margin partially offset by increased expenses.

For the Six Months Ended June 30,	1999	1998	Change
Revenue	\$ 6,582,149	\$ 4,748,914	\$ 1,833,235
Cost of Sales	3,285,583	2,308,662	976,921
Gross Margin	3,296,566	2,440,252	856,314
Operations & Maintenance	2,215,283	1,538,056	677,227
Depreciation & Amortization	124,925	83,773	41,152
Other Taxes	274,758	213,493	61,265
Total Operating Expenses	2,614,966	1,835,322	779,644
Earnings Before Interest & Taxes	\$ 681,600	\$ 604,930	\$ 76,670

Higher revenues are primarily due to increased consulting and training services and software sales. These are partially offset by a reduction in placement service revenues. Operating expenses increased primarily in the areas of compensation, due to both increased staffing and earnings-driven compensation, employee benefits and consulting services. Depreciation is also higher primarily due to computer equipment purchases to support increased attendance in training classes and increased staffing.

### Operating Income Taxes

Operating income taxes increased due to the increase in operating income.

### Environmental Matters

The Company continues to work with federal and state environmental agencies to assess the environmental impacts and explore corrective action at several former gas manufacturing plant sites (see Note 4 to the Consolidated Financial Statements). The Company believes that any future costs associated with these sites will be recoverable in future rates.

### FINANCIAL POSITION, LIQUIDITY AND CAPITAL RESOURCES

The Company's capital requirements reflect the capital-intensive nature of its business and are attributable principally to its construction program and the retirement of its outstanding debt. The Company relies on funds provided by operations and short-term borrowing to meet normal working capital requirements and temporarily finance capital expenditures. During the first six months of 1999, the Company's net cash provided by operating activities, net cash used by investing activities and net cash used by financing activities were approximately \$18.6 million, \$7.3 million and \$10.2 million, respectively. Due to the seasonal nature of the Company's business, there are substantial variations in the results of operations reported on a quarterly basis.

The Company has three unsecured bank lines of credit, totaling \$28 million. Under these lines of credit, the Board of Directors has authorized the Company to borrow up to \$20 million from various banks and trust companies. Funds provided from these lines of credit are used for short-term cash needs to meet seasonal working capital requirements and to fund portions of its capital expenditures. The outstanding balances of short-term borrowing at June 30, 1999 and December 31, 1998 were \$4.5 and \$11.6 million, respectively.

During the six months ended June 30, 1999 and June 30, 1998, net property, plant and equipment expenditures were approximately \$7.3 and \$4.7 million, respectively. Chesapeake has budgeted \$25.0 million for capital expenditures during 1999. This amount includes \$21.2 million for natural gas distribution and transmission; \$2.1 million for propane distribution and marketing; \$336,000 for advanced information services; and \$1.4 million for general plant. The natural gas expenditures are for expansion and improvement of facilities in existing service territories and improvement and expansion of the pipeline system, specifically, the construction of eight miles of pipeline to provide additional firm transportation capacity to two existing customers. The propane expenditures are to support customer growth and the replacement of older equipment. The advanced information services expenditures are for computer hardware, software and related equipment to support customer growth and increased staffing. General expenditures are for building improvements, computer software and hardware. Financing for the 1999 construction program is expected to be provided from short-term borrowing and cash from operations. The construction program is subject to continuous review and modification. Actual construction expenditures may vary from the above estimates due to a number of factors including inflation, changing economic conditions, regulation, sales growth and the cost and availability of capital.

Chesapeake has budgeted \$2.2 million for environmental related expenditures during 1999 and expects to incur additional expenditures in future years (see Note 4 to the Consolidated Financial Statements), a portion of which may need to be financed through external sources. Management does not expect such financing to have a material adverse effect on the financial position or capital resources of the Company.

The Company is continually evaluating new business opportunities and acquisitions, some of which may require the Company to obtain financing. Management will consider the impact of any such financing on the Company's financial position in its evaluation of the business opportunity or acquisition. Any such financing activities are not expected to have a material adverse effect on the financial position or capital resources of the Company.

As of June 30, 1999, common equity represented 63.2% of permanent capitalization, compared to 60.0% as of December 31, 1998. The Company remains committed to maintaining a sound capital structure and strong credit ratings in order 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, helps to ensure that the Company will be able to attract capital from outside sources at a reasonable cost.

## **OTHER MATTERS**

### **The Year 2000**

Chesapeake is dependent upon a variety of information systems to operate efficiently and effectively. In order to address the impact of the Year 2000 ("Y2K") on its information systems, the Company has been preparing for Y2K since 1996 by engaging in a strategic initiative to assess, correct and test all of our information systems and date-sensitive equipment. Since that time, Chesapeake has been evaluating and remediating any deficiencies. The Company's evaluation of its readiness and the potential impact of Y2K on its systems have been separated into five components: primary internal applications, embedded systems, vendors/suppliers, end-user computing systems and customers.

- Chesapeake's primary internal applications include company maintained software systems for its financial information; natural gas customer information and billing; and propane customer information, billing and delivery. The Company completed testing of these three applications in 1998 and deems them Y2K ready.



- Embedded systems include the supervisory control and data acquisition ("SCADA") system for the natural gas segment, telecommunications, metering and other facilities related systems. The Company has prioritized the vendors of these systems into three potential impact classifications: high impact vendors, supporting items such as the SCADA system; medium impact vendors, supporting systems such as telecommunications; and low impact vendors, supporting items such as copiers and postage meters. The Company has been testing these systems and has either worked with vendors to reach a state of readiness with the applicable systems or has changed to vendors or systems that are Y2K ready.
- Chesapeake has identified vendors/suppliers that supply the Company with products and services that impact various elements of the Company's business. The Company has classified these vendors into three impact classifications — high impact vendors such as suppliers of natural gas or propane; medium impact vendors such as regional communication vendors; and low impact vendors. The Company has requested a Y2K status statement from each of these vendors. The Company will continue to follow up with vendors that are not Y2K ready and has considered alternate providers as necessary to the extent available.
- End-user computing systems are upgraded periodically through the Company's ongoing replacement program. Chesapeake's personal computers and local area network are Y2K ready. The Company's PC-based and network-based software is also Y2K ready.
- Customers, primarily industrial interruptible natural gas customers, must ensure that their plant controls are Y2K ready for their alternative fuel. The Company has contacted these interruptible customers and has taken into account the results of the survey in developing the natural gas contingency plan. Four of Chesapeake's service territories have filed contingency plans with their respective regulatory agencies.

The Company believes the most significant potential risks with respect to its internal operations, those over which it has direct control, are its ability to: (1) use electronic devices to control and operate its natural gas delivery systems; (2) maintain continuous operation of its computer systems; (3) render timely bills to its customers; and (4) enforce tariffs and contracts applicable to interruptible customers.

The Company relies on the producers of natural gas and suppliers of interstate transportation capacity to deliver natural gas to the Company's natural gas delivery systems. The Company is also dependent on propane producers, suppliers and railroad facilities to receive propane supply. Chesapeake is also dependent on various suppliers of communication services. Should any of these critical vendors fail, the impact of any such failure could become a significant challenge to the Company's ability to meet the demands of its customers, to operate its delivery systems and to communicate with its customers. It could also have a material adverse financial impact, including but not limited to, lost sales revenues, increased operating costs and claims from customers related to business interruptions. The Company's Y2K evaluation process has addressed each of these risks and the required remediation. The Company has developed contingency plans for its various service areas, addressing various alternatives and assessing a variety of scenarios that could emerge and require the Company to react. Plans include preemptive measures for interruption of interruptible customers, loss of electrical power and communications, communicating with emergency services and employing multiple shifts during the period. Alternate methods of communicating with employees scheduled to handle potential service calls, stationing crews in pre-determined locations in the event of telephone system failure and having food and water on hand for Chesapeake employees to be able to continue to function throughout any possible emergency have also been incorporated into the plans. The contingency plans could be modified as warranted by changing events.

The costs Chesapeake has incurred as of June 30, 1999 to address Y2K issues have been immaterial. The Company has completed its Y2K evaluation, remediation and contingency planning process and deems the Company to be Y2K ready.

### **Cautionary Statement**

Statements in this report and elsewhere are considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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. These statements relate to such topics as customer growth, increases in revenues or margins, Y2K readiness, regulatory approvals, market risk associated with the Company's propane marketing operation, 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. These factors include, among other things:

- the seasonality and temperature sensitivity of Chesapeake's natural gas and propane gas businesses (that is, the Company's earnings vary depending on the season and, in the winter months, how cold the weather is);
- consumption patterns of the Company's existing and expected customers in these businesses;
- the wholesale price of propane and market movements in these prices, which affect both the margins in the Company's propane gas distribution business and the profitability of the propane gas marketing operation;
- the relative price of alternative energy sources, to which some of Chesapeake's customers have access;
- the effects of competition on both unregulated and regulated businesses;
- the ability of the natural gas segment to attract new customers in an open access environment;
- the ability of the Company's existing, new and planned facilities to generate expected revenues;
- the Company's ability to obtain the rate relief requested from utility regulators and the timing of that rate relief; and
- the Company's ability to identify and address Y2K issues successfully, in a timely manner and at a reasonable cost, as well as the ability of the Company's vendors, suppliers, and other service providers and customers to successfully address their own Y2K issues in a timely manner.

### **Recent Accounting Pronouncements**

Derivatives — SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and hedging activities. It requires that entities recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. This statement, originally effective for all fiscal quarters of fiscal years beginning after June 15, 1999 has been deferred by FASB and is now effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The Company believes that adoption of this statement will not have a material impact on the Company's financial position or results of operations.

### **Item 3. Quantitative and Qualitative Disclosures about Market Risk**

Market risk represents the potential loss arising from adverse changes in market rates and prices. The Company's long-term debt consists of first mortgage bonds, senior notes and convertible debentures. All of Chesapeake's long-term debt is fixed rate debt and was not entered into for trading purposes. The carrying value of Chesapeake's long-term debt at June 30, 1999 was \$36.8 million. The fair value was \$37.9 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 is exposed to changes in interest rates as a result of financing through its issuance of fixed rate long-term debt. The Company evaluates whether to refinance existing debt or permanently finance existing short-term borrowing based on the fluctuation in interest rates.

At June 30, 1999, the wholesale propane marketing operation was a party to natural gas liquids ("NGL") forward contracts, primarily propane contracts, with various third parties. These contracts require that the wholesale propane 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 respective party. The wholesale propane 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 wholesale propane marketing operation is subject to commodity price risk on their open positions to the extent that NGL market prices deviate from fixed contract settlement amounts. Market risks 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. In order to manage exposures to changing market prices, open positions are marked to market 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. Listed below is quantitative information on the forward and futures contracts at June 30, 1999. All of the contracts mature during 1999.

At June 30, 1999	Quantity in gallons	Estimated Market Prices	Weighted Average Contract Prices
<b>Forward Contracts</b>			
Sale	17,383,800	\$0.3450 — \$0.3525	\$0.3197
Purchase	18,051,600	\$0.3450 — \$0.3525	\$0.3169
<b>Futures Contracts</b>			
Sale	2,856,000	\$0.3450 — \$0.3525	\$0.3098
Purchase	4,998,000	\$0.3450 — \$0.3525	\$0.3243
Estimated market prices and weighted average contract prices are in dollars per gallon.			

## PART II — OTHER INFORMATION

- Item 1. Legal Proceedings**  
See Note 4 to the Consolidated Financial Statements
- Item 2. Changes in Securities and Use of Proceeds**  
None
- Item 3. Defaults upon Senior Securities**  
None
- Item 4. Submission of Matters to a Vote of Security Holders**  
The annual Meeting of Stockholders was held on May 18, 1999. Proposals as submitted in the proxy statement were voted on as follows:
1. All nominees to the Board of Directors were elected to the class indicated in the proxy statement.
  2. Ratification of the selection of the Company's independent auditors through the fiscal year ending December 31, 1999 was approved.
- Item 5. Other Information**  
None
- Item 6. Exhibits and Reports on Form 8-K**  
None

**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*

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Michael P. McMasters  
Vice President, Treasurer and Chief Financial Officer

Date: August 12, 1999

CHESAPEAKE UTILITIES CORPORATION  
 2000 SUMMARY OF ESTIMATED CAPITAL EXPENDITURES  
 DISTRIBUTION UTILITY PLANT  
 UNAUDITED

EXHIBIT B

<u>PLANT ACCOUNT NUMBER</u>	<u>DESCRIPTION</u>	<u>TOTAL 2000 CAPITAL ESTIMATED</u>
301	ORGANIZATION	\$0
302	FRANCHISE AND CONSENTS	\$0
303	INTANGIBLE PLANT	\$0
304	LAND AND LAND RIGHTS	\$16,000
305	STRUCTURES AND IMPROVEMENTS	\$9,000
311	PROPANE PLANT	\$160,000
374	LAND AND LAND RIGHTS	\$0
375	STRUCTURES AND IMPROVEMENTS	\$0
376	MAINS	\$6,350,000
378	M & R EQUIPMENT - GENERAL	\$161,000
379	M & R EQUIPMENT - CITY GATE	\$424,000
380	SERVICES	\$1,493,000
381	METERS	\$811,000
382	METER INSTALLATIONS	\$426,000
383	HOUSE REGULATORS	\$194,000
384	REGULATOR INSTALLATIONS	\$0
385	INDUSTRIAL M & R STATION	\$275,000
387	OTHER EQUIPMENT	\$85,000
389	LAND AND LAND RIGHTS	\$0
390	STRUCTURES AND IMPROVEMENTS	\$60,000
391	OFFICE FURNITURE AND EQUIPMENT	\$57,000
392	TRANSPORTATION	\$430,000
393	STORES EQUIPMENT	\$0
394	TOOLS, SHOP, AND GARAGE EQUIP	\$29,000
395	LABORATORY EQUIPMENT	\$0
396	POWER OPERATED EQUIPMENT	\$152,000
397	COMMUNICATIONS EQUIPMENT	\$52,000
398	MISCELLANEOUS EQUIPMENT	\$95,000
399	OTHER TANGIBLE PROPERTY	\$0
TOTAL CAPITAL EXPENDITURES		\$11,279,000

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 and Convertible Debentures, as well as for other corporate purposes including, but not limited to, working capital, retirement of short-term debt, retirement of long-term debt, capital improvements and/or acquisitions.

## STATE OF DELAWARE

## BEFORE THE PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION )  
 OF CHESAPEAKE UTILITIES CORPORATION )  
 FOR APPROVAL OF THE ISSUANCE OF ) PSC DOCKET NO. 99-291  
 COMMON STOCK (FILED JUNE 23, 1999) )

ORDER NO. 5165

AND NOW, to-wit, on this 13th day of July, 1999, the Applicant, Chesapeake Utilities Corporation ("Chesapeake" or the "Company"), having sought Commission approval to issue: (1) up to 100,000 shares of Chesapeake common stock to be used for investing the employer's matching contributions under the Company's Retirement Savings Plan; and (2) up to 200,000 shares of Chesapeake common stock for the purpose of providing stock incentives to Company executives under the Company's Performance Incentive Plan;

AND, the Commission having examined the Company's application and made such investigation in connection with said matters as the Commission deemed necessary, and having heard the presentation of the Company and the Commission Staff at the Commission meeting of July 13, 1999;

AND, the Commission being limited in its authority with respect to utility financing applications pursuant to 26 Del. C. § 215 under the holding of Diamond State Tel. Co. v. Public Service Commission, Del. Supr., 367 A.2d 644 (1976), to the extent that, among other things, the future rate impact of the proposed financing is not deemed an

appropriate consideration in making a determination concerning such applications;

AND, the Commission having been advised, and having determined, that the proposed issuance of up to 300,000 shares of Chesapeake common stock for the purposes set forth in the application is in accordance with law, for a proper purpose, and consistent with the public interest; now, therefore,

IT IS ORDERED THAT:

1. The application filed by Chesapeake Utilities Corporation in this matter on or about June 23, 1999, is hereby approved and Chesapeake Utilities Corporation is hereby authorized to issue up to 300,000 shares of its common stock for the purposes of administering its Retirement Savings Plan and Performance Incentive Plan.

2. Approval of Chesapeake Utilities Corporation's application by the Commission shall not be construed as approving any capitalization ratios that result for any purposes or procedures involving ratemaking; that approval shall not be construed as approving any of the Retirement Savings Plan or Performance Incentive Plan for the purposes of any future rate-making proceeding; nor are the Commission's rules regarding the burden of proving the merits of any related issue waived hereby. The Commission's approval of Chesapeake Utilities Corporation's application is limited to that which is necessary under 26 Del. C. § 215.



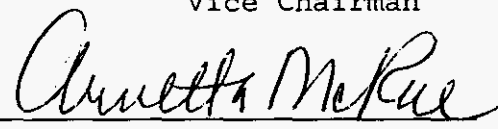
3. Nothing in this Order shall be construed as a guarantee, warranty, or representation by the State of Delaware or by any agency, commission, or department hereof, with respect to the Shares to be issued pursuant to the application and this Order.

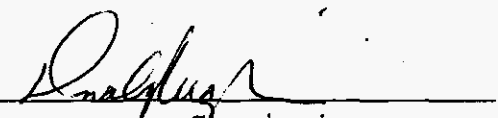
4. Chesapeake Utilities Corporation shall, five years from the date of this Order, file with the Commission a written report indicating the number of shares of common stock issued pursuant to this authorization and setting forth the capitalization ratios arising from the issuance of the common stock approved herein.

5. That the Commission reserves the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

  
Chairman

Vice Chairman  
  
Commissioner

  
Commissioner

  
Commissioner

ATTEST:

  
Secretary

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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

**CHESAPEAKE UTILITIES CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation)

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

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

Title of each class  
to be so registered  
Rights to Purchase Series A  
Participating Cumulative  
Preferred Stock

Name of each exchange on which  
each class is to be registered  
New York Stock Exchange

If this form relates to the registration of a class of securities pursuant to Section 12(b) of the Exchange Act and is effective pursuant to General Instruction A.(c), check the following box. [X]

If this form relates to the registration of a class of securities pursuant to Section 12(g) of the Exchange Act and is effective pursuant to General Instruction A.(d), check the following box. [ ]

Securities Act registration statement file number to which this form relates: \_\_\_\_\_ (if applicable)

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

\_\_\_\_\_  
(Title of Class)

\_\_\_\_\_  
(Title of Class)

## Item 1. Description of Registrant's Securities to be Registered.

On August 20, 1999, the Board of Directors of Chesapeake Utilities Corporation (the "*Corporation*") declared a dividend distribution of one preferred share purchase right (a "*Right*") for each outstanding share of Common Stock, par value \$0.48 2/3 per share (a "*Common Share*"), of the Corporation. The dividend is payable to the stockholders of record on September 3, 1999 (the "*Record Date*"). One Right also will be issued with each Common Share issued thereafter until the Distribution Date (as defined below) and, in certain circumstances, with each Common Share issued after the Distribution Date. Except as set forth below, each Right, when it becomes exercisable, entitles the registered holder to purchase from the Corporation one-fiftieth of a share of Series A Participating Cumulative Preferred Stock, par value \$.01 per share (the "*Preferred Shares*"), of the Corporation at a price of \$54.56 per one-fiftieth of a Preferred Share (the "*Purchase Price*"), subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "*Rights Agreement*") between the Corporation and BankBoston, N.A., as Rights Agent (the "*Rights Agent*"), dated as of August 20, 1999.

The following summary of the material terms of the Rights Agreement is a general description only and is subject to the detailed terms and conditions set forth in the Rights Agreement. A copy of the Rights Agreement is attached as Exhibit 1 to this Form 8-A, and is hereby incorporated herein by reference.

### Rights Are Evidenced by Common Share Certificates until Distribution Date

Initially, the Rights will be attached to all certificates representing Common Shares then outstanding; and no separate Right Certificates will be distributed. The Rights will separate from the Common Shares upon the earliest to occur of (i) the date of a public announcement that a person or group of affiliated or associated persons have acquired beneficial ownership of 15% or more of the outstanding Common Shares (except pursuant to a tender or exchange offer that is for all outstanding Common Shares at a price and on terms which a majority of the members of the Board of Directors who are not employees of the Corporation and who are not affiliated with the Acquiring Person (as defined below) determines to be adequate and in the best interests of the Corporation and its stockholders other than such Acquiring Person and its affiliates and associates (a "*Permitted Offer*") or (ii) 10 days (or such later date as the Board may determine) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer the consummation of which would result in a person or group becoming an Acquiring Person (as hereinafter defined) (the earliest of such dates being called the "*Distribution Date*"). A person or group whose acquisition of Common Shares causes a Distribution Date pursuant to clause (i) above is an "*Acquiring Person*." The date that a person or group becomes an Acquiring Person is the "*Shares Acquisition Date*."

The Rights Agreement provides that, until the Distribution Date, the Rights will be transferred with and only with the Common Shares. Until the Distribution Date (or earlier redemption or expiration of the Rights), new Common Share certificates issued after the Record Date upon transfer or new issuance of Common Shares will contain a notation incorporating the Rights Agreement by reference. Until the Distribution Date (or earlier redemption or expiration of the Rights), the surrender for transfer of any certificates for Common Shares outstanding as of the Record Date, with or without such notation or a copy of this Summary of Rights being attached thereto, will also constitute the transfer of the Rights associated with the Common Shares represented by such certificate. As soon as practicable following the Distribution Date, separate certificates evidencing the Rights ("*Right Certificates*") will be mailed to holders of record of the Common Shares as of the close of business on the Distribution Date (and to each initial record holder of certain Common Shares issued after the Distribution Date), and such separate Right Certificates alone will evidence the Rights.

### Expiration of Rights

The Rights are not exercisable until the Distribution Date and will expire at the close of business on August 20, 2009, unless earlier redeemed by the Corporation as described below.

### Flip-In Events

In the event that any person becomes an Acquiring Person (the "Flip-In Event"), each holder of a Right will thereafter have the right to receive, upon exercise, the number of Common Shares (or, in certain circumstances, other securities of the Corporation) having a value (immediately prior to such triggering event) equal to two times the exercise price of the Right. Notwithstanding the foregoing, following the occurrence of such an event, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by any Acquiring Person or any affiliate or associate thereof will be null and void.

### Flip-Over Events

A Flip-Over Event will occur in the event that, at any time following the Shares Acquisition Date, (i) the Corporation is involved in a merger or other business combination transaction (whether or not the Corporation is the surviving entity) with, or (ii) more than 50% of the Corporation's assets or earning power is sold or transferred to, in either case an Acquiring Person or any of its affiliates or associates or, if the holders of the outstanding Common Shares are not treated alike, any other entity. Upon the occurrence of a Flip-Over Event, each holder of a Right (except for the Rights of an Acquiring Person or any of its affiliates and associates which, as described above, shall have become null and void) generally shall have the right to receive, upon exercise, common shares of the acquiring company having a value equal to two times the exercise price of the Right.

### Exchange Provision

At any time after an Acquiring Person obtains 15% or more of the Common Shares and prior to the acquisition by an Acquiring Person of 50% or more of the outstanding Common Shares, the Board of Directors may elect to exchange the Rights (other than the Rights owned by the Acquiring Person and any of its affiliates and associates), in whole or in part, for Common Shares at an exchange ratio of one Common Share per Right (subject to adjustment).

### Adjustment of the Purchase Price and Securities Issuable upon Exercise of Rights.

The Purchase Price payable, and the number of Preferred Shares, Common Shares or other securities issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Shares, (ii) upon the grant to holders of the Preferred Shares of certain rights or warrants to subscribe for or purchase Preferred Shares at a price, or securities convertible into Preferred Shares with a conversion price, less than the then current market price of the Preferred Shares, or (iii) upon the distribution to holders of the Preferred Shares of evidences of indebtedness or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above). With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments require an adjustment of at least 1% in the Purchase Price.

### Terms of the Preferred Stock

The Preferred Shares purchasable upon exercise of the Rights will not be redeemable. Each Preferred Share will be entitled to a minimum preferential quarterly dividend payment equal to the greater of (i) \$13.00 per share (or \$.26 per 1/50th of a Preferred Share) and (ii) an aggregate dividend per share of 50 times (subject to adjustment) the dividend declared per Common Share. In the event of liquidation, the holders of the Preferred Shares will be entitled to a minimum preferential liquidation payment of \$ 900.00 per share (or \$18.00 per 1/50th of a Preferred Share); thereafter, and after the holders of the Common Shares receive a liquidation payment of \$18.00 per share, the holders of the Preferred Shares and the holders of the Common Shares will share the remaining assets in the ratio of 50 (subject to adjustment) to one for each Preferred Share and Common Share so held, respectively. In the event of any merger, consolidation or other transaction in which Common Shares are exchanged, each Preferred Share will be entitled to receive 50 times (subject to adjustment) the amount received per Common Share. The holders of Preferred Shares will be entitled to

vote on all matters submitted to a vote of the Common Shares (with the Preferred Shares being entitled to 50 votes per share). In the event that the amount of accrued and unpaid dividends on the Preferred Shares is equivalent to six full quarterly dividends or more, the holders of the Preferred Shares shall have the right, voting as a class, to elect two directors in addition to the directors elected by the holders of the Common Shares until all cumulative dividends on the Preferred Shares have been paid through the last quarterly dividend payment date. These rights are protected by customary antidilution provisions.

Because of the nature of the dividend, liquidation and voting rights of the Preferred Shares, the value of a one-fiftieth interest in a Preferred Share purchasable upon the exercise of a Right should approximate the value of one Common Share.

No fractional Preferred Shares will be issued (other than fractions which are one-fiftieth or integral multiples of one-fiftieth of a Preferred Share, which may, at the election of the Corporation, be evidenced by depository receipts) and in lieu thereof, an adjustment in cash will be made based on the market price of the Preferred Shares.

#### Redemption of Rights

At any time prior to the earlier to occur of (i) a person becoming an Acquiring Person or (ii) the expiration of the Rights, the Corporation may redeem the Rights in whole, but not in part, at a price of \$.01 per Right (the "Redemption Price"), which redemption shall be effective upon the action of the Board of Directors. Additionally, following a Flip-In Event and prior to a Flip-Over Event, the Corporation may redeem the then outstanding Rights in whole, but not in part, at the Redemption Price, *provided* that such redemption is in connection with a merger or other business combination transaction or series of transactions involving the Corporation in which all holders of Common Shares are treated alike but not involving an Acquiring Person or any of its affiliates or associates.

#### Amendment of Rights Agreement

All of the provisions of the Rights Agreement may be amended by the Board of Directors of the Corporation at any time prior to the Distribution Date without the approval of the holders of the Rights. After the Distribution Date, the provisions of the Rights Agreement may be amended by the Board of Directors without the approval of the holders of the Rights to cure any ambiguity, defect or inconsistency or to make changes which do not adversely affect the interests of holders of Rights (excluding the interests of any Acquiring Person or its affiliates or associates).

#### Certain Anti-takeover Effects

The Rights approved by the Board of Directors of the Company are designed to protect the value of the outstanding Common Shares 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 are not intended to prevent a takeover of the Company at a fair price and should not interfere with any merger or business combination approved by the Board of Directors. The issuance of the Rights will have no dilutive effect, nor will it affect reported earnings per share or change the way in which the Common Shares are currently traded.

The Rights may have the effect of rendering more difficult or discouraging an acquisition of the Company deemed undesirable by the Board of Directors. The Rights may cause substantial dilution to a person or group that attempts to acquire the Company on terms or in a manner not approved by the Company's Board of Directors, except pursuant to an offer conditioned upon the negotiation, purchase, or redemption of the Rights. However, the Board of Directors believes that the Rights represent a sound and reasonable means of addressing the complex issues of corporate policy created by the current takeover environment.

**Item 2. Exhibits.**

1. Rights Agreement, dated as of August 20, 1999, between Chesapeake Utilities Corporation and BankBoston, N.A., as Rights Agent, including (i) the form of Certificate of Voting Powers, Designations, Preferences and Rights of Series A Participating Cumulative Preferred Stock attached thereto as Exhibit A, (ii) the form of Rights Certificate attached thereto as Exhibit B, and (iii) the Summary of Rights to Purchase Preferred Shares attached thereto as Exhibit C (incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K dated August 24, 1999, File No. 001-11590).
2. Restated Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 1998, File No. 001-11590).
3. Amended Bylaws of the Registrant, dated August 20, 1999.

**SIGNATURE**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant has duly caused this registration statement to be signed on its behalf by the undersigned, thereto duly authorized.

CHESAPEAKE UTILITIES CORPORATION

By: /s/ MICHAEL P. McMASTERS  
Name: Michael P. McMasters  
Title: Vice President, CFO and Treasurer

Date: August 24, 1999

## RIGHTS AGREEMENT

RIGHTS AGREEMENT, dated as of August 20, 1999 (the "*Agreement*"), between Chesapeake Utilities Corporation, a Delaware corporation (the "*Corporation*"), and BankBoston, N.A., a national banking association (the "*Rights Agent*").

The Board of Directors of the Corporation has authorized and declared a dividend of one preferred share purchase right (a "*Right*") for each Common Share (as hereinafter defined) of the Corporation outstanding at the close of business on September 3, 1999 (the "*Record Date*"), each Right representing the right to purchase one-fiftieth (1/50) of a Preferred Share (as hereinafter defined), upon the terms and subject to the conditions herein set forth, and has further authorized and directed the issuance of one Right with respect to each Common Share that shall become outstanding between the Record Date and the earliest of the Distribution Date, the Redemption Date or the Final Expiration Date (as each such term is hereinafter defined); *provided, however*, that Rights may be issued with respect to Common Shares that shall become outstanding after the Distribution Date and prior to the earlier of the Redemption Date and the Final Expiration Date in accordance with the provisions of Section 22 of this Agreement.

Accordingly, in consideration of the premises and the mutual agreements herein set forth, the parties hereby agree as follows:

Section 1. *Certain Definitions.* For purposes of this Agreement, the following terms have the meanings indicated:

(a) "*Acquiring Person*" shall mean any Person who or which, together with all Affiliates and Associates of such Person, shall be the Beneficial Owner of 15% or more of the then outstanding Common Shares (other than as a result of a Permitted Offer (as hereinafter defined)) or was such a Beneficial Owner at any time after the date hereof, whether or not such Person continues to be the Beneficial Owner of 15% or more of the then outstanding Common Shares. Notwithstanding the foregoing, (A) the term "Acquiring Person" shall not include (i) the Corporation, (ii) any Subsidiary of the Corporation, (iii) any employee benefit plan of the Corporation or of any Subsidiary of the Corporation, (iv) any Person or entity organized, appointed or established by the Corporation for or pursuant to the terms of any such plan, or (v) any Person, who or which together with all Affiliates and Associates of such Person becomes the Beneficial Owner of 15% or more of the then outstanding Common Shares as a result of the acquisition of Common Shares directly from the Corporation, and (B) no Person shall be deemed to be an "Acquiring Person" either (x) as a result of the acquisition of Common Shares by the Corporation which, by reducing the number of Common Shares outstanding, increases the proportional number of shares beneficially owned by such Person together with all Affiliates and Associates of such Person; except that if (i) a Person would become an Acquiring Person (but for the operation of this subclause (x) as a result of the acquisition of Common Shares by the Corporation, and (ii) after such share acquisition by the Corporation, such Person, or an Affiliate or Associate of such Person, becomes the Beneficial Owner of any additional Common Shares,



then such Person shall be deemed an Acquiring Person, or (y) if (i) within eight (8) days after such Person would otherwise have become an Acquiring Person (but for the operation of this subclause Y), such Person notifies the Board of Directors that such Person did so inadvertently and (ii) within two (2) days after such notification, such Person is the Beneficial Owner of less than of the outstanding Common Shares.

(b) "*Act*" shall mean the Securities Act of 1933, as amended and as in effect on the date of this Agreement.

(c) "*Affiliate*" and "*Associate*" shall have the respective meanings ascribed to such terms in Rule 12b-2 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended and in effect on the date of this Agreement (the "*Exchange Act*")

(d) A Person shall be deemed the "*Beneficial Owner*" of and shall be deemed to "*beneficially own*" any securities:

(i) which such Person or any of such Person's Affiliates or Associates beneficially owns, directly or indirectly;

(ii) which such Person or any of such Person's Affiliates or Associates has (A) the right to acquire (whether such right is exercisable immediately or only after the passage of time) pursuant to any agreement, arrangement or understanding, or upon the exercise of conversion rights, exchange rights, rights (other than the Rights), warrants or options, or otherwise; *provided, however*, that a Person shall not be deemed the Beneficial Owner of, or to beneficially own, securities tendered pursuant to a tender or exchange offer made by or on behalf of such Person or any of such Person's Affiliates or Associates until such tendered securities are accepted for purchase or exchange; or (B) the right to vote pursuant to any agreement, arrangement or understanding; *provided, however*, that a Person shall not be deemed the Beneficial Owner of, or to beneficially own, any security if the agreement, arrangement or understanding to vote such security (1) arises solely from a revocable proxy or consent given to such Person in response to a public proxy or consent solicitation made pursuant to, and in accordance with, the applicable rules and regulations promulgated under the Exchange Act and (2) is not also then reportable on Schedule 13D under the Exchange Act (or any comparable or successor report); or

(iii) which are beneficially owned, directly or indirectly, by any other Person (or any Affiliate or Associate thereof) with which such Person (or any of such Person's Affiliates or Associates) has any agreement, arrangement or understanding (other than customary agreements with and between underwriters and selling group members with respect to a bona fide public offering of securities) relating to the acquisition, holding, voting (except to the extent contemplated by the proviso to Section 1(d)(ii)(B)) or disposing of any securities of the Corporation.

Notwithstanding anything in this definition of Beneficial Ownership to the contrary, the phrase "*then outstanding*," when used with reference to a Person's Beneficial Ownership of securities of the Corporation, shall mean the number of such securities then issued and outstanding together with the number of such securities not then actually issued and outstanding which such Person would be deemed to own beneficially hereunder.

(e) "*Business Day*" shall mean any day other than a Saturday, Sunday or a day on which banking institutions in the Commonwealth of Massachusetts are authorized or obligated by law or executive order to close.

(f) "*Close of business*" on any given date shall mean 5:00 P.M., New York time, on such date; *provided, however*, that if such date is not a Business Day it shall mean 5:00 P.M., New York time, on the next succeeding Business Day.

(g) "*Common Shares*" when used with reference to the Corporation shall mean the shares of Common Stock, par value \$0.48  $\frac{2}{3}$  per share, of the Corporation or, in the event of a subdivision, combination or consolidation with respect to such shares of Common Stock, the shares of Common Stock resulting from such subdivision, combination or consolidation. "*Common Shares*" when used with reference to any Person other than the Corporation shall mean the capital stock (or equity interest) with the greatest voting power of such other Person or, if such other Person is a Subsidiary of another Person, the Person or Persons which ultimately control such first-mentioned Person.

(h) "*Distribution Date*" shall have the meaning set forth in Section 3 hereof.

(i) "*Final Expiration Date*" shall have the meaning set forth in Section 7 hereof.

(j) "*Interested Stockholder*" shall mean any Acquiring Person or any Affiliate or Associate of an Acquiring Person or any other Person in which any such Acquiring Person, Affiliate or Associate has an interest, or any other Person acting directly or indirectly on behalf of or in concert with any such Acquiring Person, Affiliate or Associate.

(k) "*Permitted Offer*" shall mean a tender or exchange offer which is for all outstanding Common Shares at a price and on terms determined, prior to the purchase of shares under such tender or exchange offer, by at least a majority of the members of the Board of Directors who are not officers of the Corporation and who are not Acquiring Persons or Affiliates, Associates, nominees or representatives of an Acquiring Person, to be adequate (taking into account all factors that such directors deem relevant including, without limitation, prices that could reasonably be achieved if the Corporation or its assets were sold on an orderly basis designed to realize maximum value) and otherwise in the best interests of the Corporation and its stockholders (other than the Person or any Affiliate or Associate thereof on whose basis the offer is being made) taking into account all factors that such directors may deem relevant.

(l) "*Person*" shall mean any individual, firm, partnership, corporation, trust, association, joint venture or other entity, and shall include any successor (by merger or otherwise) of such entity.

(m) "*Preferred Shares*" shall mean shares of Participating Cumulative Preferred Stock, par value \$0.01 per share, of the Corporation having the relative rights, preferences and limitations set forth in the Form of Certificate of Amendment attached to this Agreement as Exhibit A.

(n) "*Redemption Date*" shall have the meaning set forth in Section 7 hereof.

(o) "*Section 11(a)(ii) Event*" shall mean any event described in Section 11(a)(ii) hereof.

(p) "*Section 13 Event*" shall mean any event described in clause (x), (y) or (z) of Section 13(a) hereof.

(q) "*Shares Acquisition Date*" shall mean the first date of public announcement (which, for purposes of this definition, shall include, without limitation, a report filed pursuant to the Exchange Act) by the Corporation or an Acquiring Person that an Acquiring Person has become such, *provided, that*, if such Person is determined not to have become an Acquiring Person pursuant to Section 1(b)(y) hereof, then no Shares Acquisition Date shall be deemed to have occurred.

(r) "*Subsidiary*" of any Person shall mean any corporation or other Person of which a majority of the voting power of the voting equity securities or equity interest is owned, directly or indirectly, by such Person.

(s) "*Triggering Event*" shall mean any Section 11(a)(ii) Event or any Section 13 Event.

*Section 2. Appointment of Rights Agent.* The Corporation hereby appoints the Rights Agent to act as agent for the Corporation and the holders of the Rights (who, in accordance with Section 3 hereof, shall prior to the Distribution Date also be the holders of Common Shares) in accordance with the terms and conditions hereof, and the Rights Agent hereby accepts such appointment. The Corporation may from time to time appoint such co-Rights Agents as it may deem necessary or desirable, upon ten days' prior written notice to the Rights Agent. The Rights Agent shall have no duty to supervise, and shall in no event be liable for, the acts or omissions of any such co-Rights Agent.

*Section 3. Issuance of Right Certificates.*

(a) Until the earlier of (i) the Shares Acquisition Date or (ii) the close of business on the tenth day (or such later date as may be determined by action of the Corporation's Board of Directors) after the date of the commencement by any Person (other than the Corporation, any Subsidiary of the Corporation, any employee benefit plan of the Corporation or of any Subsidiary of the Corporation or any Person or entity organized, appointed or established by the Corporation for or pursuant to the terms of any such plan) of, or of the first public announcement of the intention of any Person (other than the Corporation, any Subsidiary of the Corporation, any employee benefit plan of the Corporation or of any Subsidiary of the Corporation or any Person or entity organized, appointed or established by the Corporation for or pursuant to the terms of any such plan) to commence (which intention to commence remains in effect for five Business Days after such announcement), a tender or exchange offer the consummation of which would result in any Person becoming an Acquiring Person (including, in the case of both (i) and (ii), any such date which is after the date of this Agreement and prior to the issuance of the Rights), the

earlier of such dates being herein referred to as the "*Distribution Date*," (x) the Rights will be evidenced (subject to the provisions of Section 3(b) hereof) by the certificates for Common Shares registered in the names of the holders thereof (which certificates shall also be deemed to be Right Certificates) and not by separate Right Certificates, and (y) the right to receive Right Certificates will be transferable only in connection with the transfer of the underlying Common Shares (including a transfer to the Corporation); *provided, however*, that if a tender offer is terminated prior to the occurrence of a Distribution Date, then no Distribution Date shall occur as a result of such tender offer. As soon as practicable after the Distribution Date, the Corporation will prepare and execute, the Rights Agent will countersign, and the Corporation will send or cause to be sent by first-class, postage-prepaid mail, to each record holder of Common Shares as of the close of business on the Distribution Date, at the address of such holder shown on the records of the Corporation, a Right Certificate, substantially in the form of Exhibit B hereto (a "*Right Certificate*"), evidencing one Right for each Common Share so held. As of and after the Distribution Date, the Rights will be evidenced solely by such Right Certificates.

(b) As promptly as practicable following the Record Date, the Corporation will send a copy of a Summary of Rights to Purchase Preferred Shares, in substantially the form of Exhibit C hereto (the "*Summary of Rights*"), by first-class, postage-prepaid mail, to each record holder of Common Shares as of the close of business on the Record Date, at the address of such holder shown on the records of the Corporation. With respect to certificates for Common Shares outstanding as of the Record Date, until the Distribution Date, the Rights will be evidenced by such certificates registered in the names of the holders thereof together with a copy of the Summary of Rights attached thereto. Until the Distribution Date (or the earlier of the Redemption Date or the Final Expiration Date), the surrender for transfer of any certificate for Common Shares outstanding on the Record Date, with or without a copy of the Summary of Rights attached thereto, shall also constitute the transfer of the Rights associated with such Common Shares.

(c) Certificates for Common Shares which become outstanding (including, without limitation, reacquired Common Shares referred to in the last sentence of this paragraph (c)) after the Record Date but prior to the earliest of the Distribution Date, the Redemption Date or the Final Expiration Date, shall be deemed also to be certificates for Rights, and shall bear the following legend:

This certificate also evidences and entitles the holder hereof to certain rights as set forth in a Rights Agreement between Chesapeake Utilities Corporation (the "Corporation") and BankBoston, N.A., dated as of August 20, 1999 (the "Rights Agreement"), the terms of which are hereby incorporated herein by reference and a copy of which is on file at the principal executive offices of the Corporation. Under certain circumstances, as set forth in the Rights Agreement, such Rights will be evidenced by separate certificates and will no longer be evidenced by this certificate. The Corporation will mail to the holder of this certificate a copy of the Rights Agreement without charge after receipt of a written request therefor. Under certain circumstances set forth in the Rights Agreement, Rights issued to, or held by, any Person who is, was or becomes an Acquiring Person or an Affiliate or Associate thereof (as defined in the Rights Agreement) and certain related

persons, whether currently held by or on behalf of such Person or by any subsequent holder, may become null and void.

With respect to such certificates containing the foregoing legend, until the Distribution Date, the Rights associated with the Common Shares represented by such certificates shall be evidenced by such certificates alone, and the surrender for transfer of any such certificate shall also constitute the transfer of the Rights associated with the Common Shares represented thereby. In the event that the Corporation purchases or acquires any Common Shares after the Record Date but prior to the Distribution Date, any Rights associated with such Common Shares shall be deemed cancelled and retired so that the Corporation shall not be entitled to exercise any Rights associated with the Common Shares which are no longer outstanding.

**Section 4. *Form of Right Certificate.*** (a) The Right Certificates (and the forms of election to purchase and of assignment to be printed on the reverse thereof) shall be substantially in the form set forth in Exhibit B hereto and may have such marks of identification or designation and such legends, summaries or endorsements printed thereon as the Corporation may deem appropriate and as are not inconsistent with the provisions of this Agreement, or as may be required to comply with any applicable law or with any rule or regulation made pursuant thereto or with any rule or regulation of any stock exchange on which the Rights may from time to time be listed, or to conform to usage. Subject to the provisions of Section 11 and Section 22 hereof, the Right Certificates shall entitle the holders thereof to purchase such number of one-fiftieths of a Preferred Share as shall be set forth therein at the price per one-fiftieth of a Preferred Share set forth therein (the "*Purchase Price*"), but the amount and type of securities purchasable upon the exercise of each Right and the Purchase Price thereof shall be subject to adjustment as provided herein.

(b) Any Right Certificate issued pursuant to Section 3(a) or Section 22 hereof that represents Rights which are null and void pursuant to Section 7(e) of this Agreement and any Right Certificate issued pursuant to Section 6 or Section 11 hereof upon transfer, exchange, replacement or adjustment of any other Right Certificate referred to in this sentence, shall contain (to the extent feasible) the following legend:

The Rights represented by this Right Certificate are or were beneficially owned by a Person who was or became an Acquiring Person or an Affiliate or Associate of an Acquiring Person (as such terms are defined in the Rights Agreement). Accordingly, this Right Certificate and the Rights represented hereby are null and void.

Provisions of Section 7(e) of this Rights Agreement shall be operative whether or not the foregoing legend is contained on any such Right Certificate.

**Section 5. *Countersignature and Registration.*** The Right Certificates shall be executed on behalf of the Corporation by its Chairman of the Board, its Chief Executive Officer, its President, any of its Vice Presidents, or its Treasurer, either manually or by facsimile signature, shall have affixed thereto the Corporation's seal or a facsimile thereof, and shall be attested by the Secretary or an Assistant Secretary of the Corporation, either manually or by facsimile signature. The Right

Certificates shall be countersigned by the Rights Agent and shall not be valid for any purpose unless so countersigned. In case any officer of the Corporation who shall have signed any of the Right Certificates shall cease to be such officer of the Corporation before countersignature by the Rights Agent and issuance and delivery by the Corporation, such Right Certificates may nevertheless be countersigned by the Rights Agent and issued and delivered by the Corporation with the same force and effect as though the person who signed such Right Certificates had not ceased to be such officer of the Corporation; and any Right Certificate may be signed on behalf of the Corporation by any person who, at the actual date of the execution of such Right Certificate, shall be a proper officer of the Corporation to sign such Right Certificate, although at the date of the execution of this Rights Agreement any such person was not such an officer.

Following the Distribution Date, the Rights Agent will keep or cause to be kept, at its principal office or offices designated as the appropriate place for surrender of such Right Certificate or transfer, books for registration and transfer of the Right Certificates issued hereunder. Such books shall show the names and addresses of the respective holders of the Right Certificates, the number of Rights evidenced on its face by each of the Right Certificates and the certificate number and the date of each of the Right Certificates.

Section 6. *Transfer, Split-Up, Combination and Exchange of Right Certificates; Mutilated, Destroyed, Lost or Stolen Right Certificate.* Subject to the provisions of Section 4(b), Section 7(e) and Section 14 hereof, at any time after the close of business on the Distribution Date, and at or prior to the close of business on the earlier of the Redemption Date or the Final Expiration Date, any Right Certificate or Right Certificates may be transferred, split up, combined or exchanged for another Right Certificate or Right Certificates, entitling the registered holder to purchase a like number of one-fiftieths of a Preferred Share (or, following a Triggering Event, other securities, as the case may be) as the Right Certificate or Right Certificates surrendered then entitled such holder (or former holder in the case of a transfer) to purchase. Any registered holder desiring to transfer, split up, combine or exchange any Right Certificate or Right Certificates shall make such request in writing delivered to the Rights Agent, and shall surrender the Right Certificate or Right Certificates to be transferred, split up, combined or exchanged at the principal office or offices of the Rights Agent designated for such purpose. Neither the Rights Agent nor the Corporation shall be obligated to take any action whatsoever with respect to the transfer of any such surrendered Right Certificate until the registered holder shall have completed and signed the certificate contained in the form of assignment on the reverse side of such Right Certificate and shall have provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Corporation shall reasonably request. Thereupon the Rights Agent shall, subject to Section 4(b), Section 7(e) and Section 14 hereof, countersign and deliver to the Person entitled thereto a Right Certificate or Right Certificates, as the case may be, as so requested. The Corporation may require payment of a sum sufficient to cover any tax or governmental charge that may be imposed in connection with any transfer, split up, combination or exchange of Right Certificates.

Upon receipt by the Corporation and the Rights Agent of evidence reasonably satisfactory to them of the loss, theft, destruction or mutilation of a Right Certificate, and, in case of loss, theft or destruction, of indemnity or security reasonably satisfactory to them, and, at the

Corporation's request, reimbursement to the Corporation and the Rights Agent of all reasonable expenses incidental thereto, and upon surrender to the Rights Agent and cancellation of the Right Certificate if mutilated, the Corporation will make and deliver a new Right Certificate of like tenor to the Rights Agent for countersignature and delivery to the registered holder in lieu of the Right Certificate so lost, stolen, destroyed or mutilated.

**Section 7. *Exercise of Rights; Purchase Price; Expiration Date of Rights.*** (a) Subject to Section 7(e) hereof, the registered holder of any Right Certificate may exercise the Rights evidenced thereby (except as otherwise provided herein) in whole or in part at any time after the Distribution Date upon surrender of the Right Certificate, with the form of election to purchase and the certificate on the reverse side thereof duly executed, to the Rights Agent at the principal office or offices of the Rights Agent designated for such purpose, together with payment of the aggregate Purchase Price for the total number of one-fiftieths of a Preferred Share (or other securities, as the case may be) as to which such surrendered Rights are exercised, at or prior to the earliest of (i) the close of business on the tenth anniversary of the date of this Agreement (the "*Final Expiration Date*"), or (ii) the time at which the Rights are redeemed as provided in Section 23 hereof (the "*Redemption Date*").

(b) The Purchase Price for each one-fiftieth of a Preferred Share pursuant to the exercise of a Right shall initially be \$54.56 shall be subject to adjustment from time to time as provided in the next sentence and in Sections 11 and 13(a) hereof and shall be payable in accordance with paragraph (c) below. Anything in this Agreement to the contrary notwithstanding, in the event that at any time after the date of this Agreement and prior to the Distribution Date, the Corporation shall (i) declare or pay any dividend on the Common Shares payable in Common Shares or (ii) effect a subdivision, combination or consolidation of the Common Shares (by reclassification or otherwise than by payment of dividends in Common Shares) into a greater or lesser number of Common Shares, then in any such case, each Common Share outstanding following such subdivision, combination or consolidation shall continue to have a Right associated therewith and the Purchase Price following any such event shall be proportionately adjusted to equal the result obtained by multiplying the Purchase Price immediately prior to such event by a fraction the numerator of which shall be the total number of Common Shares outstanding immediately prior to the occurrence of the event and the denominator of which shall be the total number of Common Shares outstanding immediately following the occurrence of such event. The adjustment provided for in the preceding sentence shall be made successively whenever such a dividend is declared or paid or such a subdivision, combination or consolidation is effected.

(c) Upon receipt of a Right Certificate representing exercisable Rights, with the form of election to purchase and the certificate duly executed, accompanied by payment of the Purchase Price for the Preferred Shares (or other securities, as the case may be) to be purchased and an amount equal to any applicable transfer tax required to be paid by the holder of such Right Certificate in accordance with Section 6 hereof by certified check, cashier's check or money order payable to the order of the Corporation, the Rights Agent shall thereupon promptly (i) (A) requisition from any transfer agent of the Preferred Shares certificates for the number of Preferred Shares to be purchased and the Corporation hereby irrevocably authorizes its transfer agent to comply with all such requests, or (B) if the Corporation, in its sole discretion, shall have elected to

deposit the Preferred Shares issuable upon exercise of the Rights hereunder into a depository, requisition from the depository agent depository receipts representing such number of one-fiftieths of a Preferred Share as are to be purchased (in which case certificates for the Preferred Shares represented by such receipts shall be deposited by the transfer agent with the depository agent) and the Corporation will direct the depository agent to comply with such requests, (ii) when appropriate, requisition from the Corporation the amount of cash to be paid in lieu of issuance of fractional shares in accordance with Section 14 hereof, (iii) after receipt of such certificates or depository receipts, cause the same to be delivered to or upon the order of the registered holder of such Right Certificate, registered in such name or names as may be designated by such holder, and (iv) when appropriate, after receipt thereof, deliver such cash to or upon the order of the registered holder of such Right Certificate. In the event that the Corporation is obligated to issue other securities (including Common Shares) of the Corporation pursuant to Section 11(a) hereof, the Corporation will make all arrangements necessary so that such other securities are available for distribution by the Rights Agent, if and when appropriate.

In addition, in the case of an exercise of the Rights by a holder pursuant to Section 11 (a)(ii), the Rights Agent shall return such Right Certificate to the registered holder thereof after imprinting, stamping or otherwise indicating thereon that the rights represented by such Right Certificate no longer include the rights provided by Section 11(a)(ii) of the Rights Agreement and if less than all the Rights represented by such Right Certificate were so exercised, the Rights Agent shall indicate on the Right Certificate the number of Rights represented thereby which continue to include the rights provided by Section 11(a)(ii).

(d) In case the registered holder of any Right Certificate shall exercise less than all the Rights evidenced thereby, a new Right Certificate evidencing Rights equivalent to the Rights remaining unexercised shall be issued by the Rights Agent to the registered holder of such Right Certificate or to his duly authorized assigns, subject to the provisions of Section 14 hereof, or the Rights Agent shall place an appropriate notation on the Right Certificate with respect to those Rights exercised.

(e) Notwithstanding anything in this Agreement to the contrary, from and after the first occurrence of a Section 11 (a)(ii) Event, any Rights beneficially owned by (i) an Acquiring Person or an Affiliate or Associate of an Acquiring Person, (ii) a transferee of an Acquiring Person (or of any Affiliate or Associate thereof) who becomes a transferee after the Acquiring Person becomes such, or (iii) a transferee of an Acquiring Person (or of any Affiliate or Associate thereof) who becomes a transferee prior to or concurrently with the Acquiring Person becoming such and receives such Rights pursuant to either (A) a transfer (whether or not for consideration) from the Acquiring Person to holders of equity interests in such Acquiring Person or to any Person with whom the Acquiring Person has a continuing agreement, arrangement or understanding regarding the transferred Rights or (B) a transfer which the Board of Directors of the Corporation has determined is part of a plan, arrangement or understanding which has as a primary purpose or effect the avoidance of this Section 7(e), shall become null and void without any further action and no holder of such Rights shall have any rights whatsoever with respect to such Rights, whether under any provision of this Agreement or otherwise. The Corporation shall use all reasonable efforts to insure that the provisions of this Section 7(e) and Section 4(b) hereof are



complied with, but shall have no liability to any holder of Right Certificates or other Person as a result of its failure to make any determinations with respect to an Acquiring Person or its Affiliates, Associates or transferees hereunder.

(f) Notwithstanding anything in this Agreement to the contrary, neither the Rights Agent nor the Corporation shall be obligated to undertake any action with respect to a registered holder upon the occurrence of any purported exercise as set forth in this Section 7 unless such registered holder shall have (i) completed and signed the certificate contained in the form of election to purchase set forth on the reverse side of the Right Certificate surrendered for such exercise, and (ii) provided such additional evidence of the identity of the Beneficial Owner (or former Beneficial Owner) or Affiliates or Associates thereof as the Corporation shall reasonably request.

**Section 8. *Cancellation and Destruction of Right Certificates.*** All Right Certificates surrendered for the purpose of exercise, transfer, split up, combination or exchange shall, if surrendered to the Corporation or to any of its agents, be delivered to the Rights Agent for cancellation or in cancelled form, or, if surrendered to the Rights Agent, shall be cancelled by it, and no Right Certificates shall be issued in lieu thereof except as expressly permitted by any of the provisions of this Rights Agreement. The Corporation shall deliver to the Rights Agent for cancellation and retirement, and the Rights Agent shall so cancel and retire, any other Right Certificate purchased or acquired by the Corporation otherwise than upon the exercise thereof. The Rights Agent shall deliver all cancelled Right Certificates to the Corporation, or shall, at the written request of the Corporation, destroy such cancelled Right Certificates, and in such case shall deliver a certificate of destruction thereof to the Corporation.

**Section 9. *Reservation and Availability of Preferred Shares.*** The Corporation covenants and agrees that at all times prior to the occurrence of a Section 11(a)(ii) Event it will cause to be reserved and kept available out of its authorized and unissued Preferred Shares, or any authorized and issued Preferred Shares held in its treasury, the number of Preferred Shares that will be sufficient to permit the exercise in full of all outstanding Rights and, after the Occurrence of a Section 11(a)(ii) Event, shall, to the extent reasonably practicable, so reserve and keep available a sufficient number of Common Shares (and/or other securities) which may be required to permit the exercise in full of the Rights pursuant to this Agreement.

So long as the Preferred Shares (and, after the occurrence of a Section 11(a)(ii) Event, Common Shares or any other securities) issuable upon the exercise of the Rights may be listed on any national securities exchange, the Corporation shall use its best efforts to cause, from and after such time as the Rights become exercisable, all shares reserved for such issuance to be listed on such exchange upon official notice of issuance upon such exercise.

The Corporation covenants and agrees that it will take all such action as may be necessary to ensure that all Preferred Shares (or Common Shares and/or other securities, as the case may be) delivered upon exercise of Rights shall, at the time of delivery of the certificates for such shares or other securities (subject to payment of the Purchase Price), be duly and validly authorized and issued and fully paid and non-assessable shares or securities.

The Corporation further covenants and agrees that it will pay when due and payable any and all U.S. federal and state transfer taxes and charges which may be payable in respect of the issuance or delivery of the Right Certificates or of any Preferred Shares (or Common Shares and/or other securities, as the case may be) upon the exercise of Rights. The Corporation shall not, however, be required to pay any transfer tax which may be payable in respect of any transfer or delivery of Right Certificates to a person other than, or the issuance or delivery of certificates or depository receipts for the Preferred Shares (or Common Shares and/or other securities, as the case may be) in a name other than that of, the registered holder of the Right Certificate evidencing Rights surrendered for exercise, or to issue or to deliver any certificates or depository receipts for Preferred Shares (or Common Shares and/or other securities, as the case may be) upon the exercise of any Rights, until any such tax shall have been paid (any such tax being payable by the holder of such Right Certificate at the time of surrender) or until it has been established to the Corporation's reasonable satisfaction that no such tax is due.

The Corporation shall use its best efforts to (i) file, as soon as practicable following the Shares Acquisition Date, a registration statement under the Act, with respect to the securities purchasable upon exercise of the Rights on an appropriate form, (ii) cause such registration statement to become effective as soon as practicable after such filing, and (iii) cause such registration statement to remain effective (with a prospectus at all times meeting the requirements of the Act and the rules and regulations thereunder) until the date of the expiration of the rights provided by Section 11(a)(ii). The Corporation will also take such action as may be appropriate under the blue sky laws of the various states.

Section 10. *Preferred Shares Record Date.* Each person in whose name any certificate for Preferred Shares (or Common Shares and/or other securities, as the case may be) is issued upon the exercise of Rights shall for all purposes be deemed to have become the holder of record of the Preferred Shares (or Common Shares and/or other securities, as the case may be) represented thereby on, and such certificate shall be dated, the date upon which the Right Certificate evidencing such Rights was duly surrendered and payment of the Purchase Price (and any applicable transfer taxes) was made: *provided, however,* that, if the date of such surrender and payment is a date upon which the Preferred Shares (or Common Shares and/or other securities, as the case may be) transfer books of the Corporation are closed, such person shall be deemed to have become the record holder of such shares on, and such certificate shall be dated, the next succeeding Business Day on which the Preferred Shares (or Common Shares and/or other securities, as the case may be) transfer books of the Corporation are open.

Section 11. *Adjustment of Purchase Price, Number and Kind of Shares or Number of Rights.* The Purchase Price, the number and kind of shares covered by each Right and the number of Rights outstanding are subject to adjustment from time to time as provided in this Section 11.

(a) (i) In the event the Corporation shall at any time after the date of this Agreement (A) declare a dividend on the Preferred Shares payable in Preferred Shares, (B) subdivide the outstanding Preferred Shares, (C) combine the outstanding Preferred Shares into a smaller number of Preferred Shares, or (D) issue any shares of its capital stock in a reclassification of the Preferred Shares (including any such reclassification in connection with a consolidation or merger

in which the Corporation is the continuing or surviving corporation), except as otherwise provided in this Section 11(a) and Section 7(e) hereof, the Purchase Price in effect at the time of the record date for such dividend or of the effective date of such subdivision, combination or reclassification, and the number and kind of shares of capital stock issuable on such date, shall be proportionately adjusted so that the holder of any Right exercised after such time shall be entitled to receive the aggregate number and kind of shares of capital stock which, if such Right had been exercised immediately prior to such date and at a time when the Preferred Shares transfer books of the Corporation were open, such holder would have owned upon such exercise and been entitled to receive by virtue of such dividend, subdivision, combination or reclassification; *provided, however*, that in no event shall the consideration to be paid upon the exercise of one Right be less than the aggregate par value of the shares of capital stock of the Corporation issuable upon exercise of one Right. If an event occurs which would require an adjustment under both Section 11(a)(i) and Section 11(a)(ii), the adjustment provided for in this Section 11(a)(i) shall be in addition to, and shall be made prior to, any adjustment required pursuant to Section 11(a)(ii).

(ii) In the event any Person, alone or together with its Affiliates and Associates, shall become an Acquiring Person, then proper provision shall be made so that each holder of a Right (except as provided below and in Section 7(e) hereof) shall have a right to receive, upon exercise thereof at a price equal to the then current Purchase Price, in accordance with the terms of this Agreement, such number of Common Shares (or, in the discretion of the Board of Directors, one-fiftieths of a Preferred Share) as shall equal the result obtained by (x) multiplying the then current Purchase Price by the then number of one-fiftieths of a Preferred Share for which a Right was exercisable immediately prior to the first occurrence of a Section 11(a)(ii) Event, and dividing that product by (y) 50% of the then current per share market price of the Corporation's Common Shares (determined pursuant to Section 11(d) hereof) on the date of such first occurrence (such number of shares being referred to as the "*Adjustment Shares*"); *provided, however*, that if the transaction that would otherwise give rise to the foregoing adjustment is also subject to the provisions of Section 13 hereof, then only the provisions of Section 13 hereof shall apply and no adjustment shall be made pursuant to this Section 11(a)(ii);

(iii) In the event that there shall not be sufficient treasury shares or authorized but unissued (and unreserved) Common Shares to permit the exercise in full of the Rights in accordance with the foregoing subparagraph (ii) and the Rights become so exercisable (and the Board has determined to make the Rights exercisable into fractions of a Preferred Share), notwithstanding any other provision of this Agreement, to the extent necessary and permitted by applicable law, each Right shall thereafter represent the right to receive, upon exercise thereof at the then current Purchase Price in accordance with the terms of this Agreement, (x) a number of (or fractions of) Common Shares (up to the maximum number of Common Shares which may permissibly be issued) and (y) one-fiftieths of a Preferred Share or a number of, or fractions of other equity securities of the Corporation (or, in the discretion of the Board of Directors, debt) which the Board of Directors of the Corporation has determined to have the same aggregate current market value (determined pursuant to Section 11(d)(i) and (ii) hereof, to the extent applicable) as one Common Share (such number of, or fractions of, Preferred Shares, debt, or other equity securities or debt of the Corporation being referred to as a "*capital stock*");

*equivalent*"), equal in the aggregate to the number of Adjustment Shares; *provided, however*, if sufficient Common Shares and/or capital stock equivalents are unavailable, then the Corporation shall, to the extent permitted by applicable law, take all such action as may be necessary to authorize additional Common Shares or capital stock equivalents for issuance upon exercise of the Rights, including the calling of a meeting of stockholders; and *provided, further*, that if the Corporation is unable to cause sufficient Common Shares and/or capital stock equivalents to be available for issuance upon exercise in full of the Rights, then each Right shall thereafter represent the right to receive the Adjusted Number of Shares upon exercise at the Adjusted Purchase Price (as such terms are hereinafter defined). As used herein, the term "*Adjusted Number of Shares*" shall be equal to that number of (or fractions of) Common Shares (and/or capital stock equivalents) equal to the product of (x) the number of Adjustment Shares and (y) a fraction, the numerator of which is the number of Common Shares (and/or capital stock equivalents) available for issuance upon exercise of the Rights and the denominator of which is the aggregate number of Adjustment Shares otherwise issuable upon exercise in full of all Rights (assuming there were a sufficient number of Common Shares available) (such fraction being referred to as the "*Proration Factor*"). The "*Adjusted Purchase Price*" shall mean the product of the Purchase Price and the Proration Factor. The Board of Directors may, but shall not be required to, establish procedures to allocate the right to receive Common Shares and capital stock equivalents upon exercise of the Rights among holders of Rights.

(b) In case the Corporation shall fix a record date for the issuance of rights (other than the Rights), options or warrants to all holders of Preferred Shares entitling them (for a period expiring within 45 calendar days after such record date) to subscribe for or purchase Preferred Shares (or shares having the same rights, privileges and preferences as the Preferred Shares ("*equivalent preferred shares*")) or securities convertible into Preferred Shares or equivalent preferred shares at a price per Preferred Share or equivalent preferred share (or having a conversion price per share, if a security convertible into Preferred Shares or equivalent preferred shares) less than the then current per share market price of the Preferred Shares (as determined pursuant to Section 11(d) hereof) on such record date, the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the number of Preferred Shares outstanding on such record date plus the number of Preferred Shares which the aggregate offering price of the total number of Preferred Shares and/or equivalent preferred shares so to be offered (and/or the aggregate initial conversion price of the convertible securities so to be offered) would purchase at such current per share market price, and the denominator of which shall be the number of Preferred Shares outstanding on such record date plus the number of additional Preferred Shares and/or equivalent preferred shares to be offered for subscription or purchase (or into which the convertible securities so to be offered are initially convertible), *provided, however*, that in no event shall the consideration to be paid upon the exercise of one Right be less than the aggregate par value of the shares of capital stock of the Corporation issuable upon exercise of one Right. In case such subscription price may be paid in a consideration part or all of which shall be in a form other than cash, the value of such consideration shall be determined in good faith by the Board of Directors of the Corporation, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent. Preferred Shares owned by or held for the account of the Corporation shall not be deemed outstanding for the purpose of any such

computation. Such adjustment shall be made successively whenever such a record date is fixed, and in the event that such rights, options or warrants are not so issued, the Purchase Price shall be adjusted to be the Purchase Price which would then be in effect if such record date had not been fixed.

(c) In case the Corporation shall fix a record date for the making of a distribution to all holders of the Preferred Shares (including any such distribution made in connection with a consolidation or merger in which the Corporation is the continuing or surviving corporation) of evidences of indebtedness or assets (other than a regular quarterly cash dividend or a dividend payable in Preferred Shares) or subscription rights or warrants (excluding those referred to in Section 11(b) hereof), the Purchase Price to be in effect after such record date shall be determined by multiplying the Purchase Price in effect immediately prior to such record date by a fraction, the numerator of which shall be the then current per share market price (as determined pursuant to Section 11(d) hereof) of the Preferred Shares on such record date, less the fair market value (as determined in good faith by the Board of Directors of the Corporation, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent) of the portion of the assets or evidences of indebtedness so to be distributed or of such subscription rights or warrants applicable to one Preferred Share and the denominator of which shall be such current per share market price of the Preferred Shares; *provided, however*, that in no event shall the consideration to be paid upon the exercise of one Right be less than the aggregate par value of the shares of capital stock of the Corporation to be issued upon exercise of one Right. Such adjustments shall be made successively whenever such a record date is fixed; and in the event that such distribution is not so made, the Purchase Price shall again be adjusted to be the Purchase Price which would then be in effect if such record date had not been fixed.

(d)(i) For the purpose of any computation hereunder, the "*current per share market price*" of any security (a "*Security*" for the purpose of this Section 11 (d)(i)) on any date shall be deemed to be the average of the daily closing prices per share of such Security for the thirty (30) consecutive Trading Days (as such term is hereinafter defined) immediately prior to such date; *provided, however*, that in the event that the current per share market price of the Security is determined during a period following the announcement by the issuer of such Security of (A) a dividend or distribution on such Security payable in shares of such Security or securities convertible into such shares, or (B) any subdivision, combination or reclassification of such Security and prior to the expiration of thirty (30) Trading Days after the ex-dividend date for such dividend or distribution, or the record date for such subdivision, combination or reclassification, then, and in each such case, the current per share market price shall be appropriately adjusted to reflect the current market price per share equivalent of such Security. The closing price for each day shall be the last sale price, regular way, or, in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on the New York Stock Exchange or, if the Security is not listed or admitted to trading on the New York Stock Exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on principal national securities exchange on which the Security is listed or admitted to trading or, if the Security is not listed or admitted to trading on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low

asked prices in the over-the-counter market, as reported by the National Association of Securities Dealers, Inc. Automated Quotations System ("*NASDAQ*") or such other system then in use, or, if on any such date the Security is not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Security selected by the Board of Directors of the Corporation. If on any such date no such market maker is making market in the Security, the fair value of the Security on such date as determined in good faith by the Board of Directors of the Corporation shall be used. The term "*Trading Day*" shall mean a day on which the principal national securities exchange on which the Security is listed or admitted to trading is open for the transaction of business or, if the Security is not listed or admitted to trading on any national securities exchange, a Business Day.

(ii) For the purpose of any computation hereunder, the "*current per share market price*" of the Preferred Shares shall be determined in accordance with the method set forth in Section 11(d)(i). If the Preferred Shares are not publicly traded, the "*current per share market price*" of the Preferred Shares shall be conclusively deemed to be the current per share market price of the Common Shares as determined pursuant to Section 11(d)(i), (appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof), multiplied by 50. If neither the Common Shares nor the Preferred Shares are publicly held or so listed or traded, "*current per share market price*" shall mean the fair value per share as determined in good faith by the Board of Directors of the Corporation, whose determination shall be described in a statement filed with the Rights Agent and shall be binding on the Rights Agent.

(e) Anything herein to the contrary notwithstanding, no adjustment in the Purchase Price shall be required unless such adjustment would require an increase or decrease of at least 1% in the Purchase Price; *provided, however*, that any adjustments which by reason of this Section 11 (e) are not required to be made shall be carried forward and taken into account in any subsequent adjustment. All calculations under this Section 11 shall be made to the nearest cent or to the nearest one-fiftieth of a Preferred Share or one ten-thousandth of any other share or security as the case may be. Notwithstanding the first sentence of this Section 11(e), any adjustment required by this Section 11 shall be made no later than the earlier of (i) three (3) years from the date of the transaction which mandates such adjustment or (ii) the Final Expiration Date.

(f) If as a result of an adjustment made pursuant to Section 11(a)(ii) or Section 13(a) hereof, the holder of any Right thereafter exercised shall become entitled to receive any shares of capital stock of the Corporation other than Preferred Shares, thereafter the number of other shares so receivable upon exercise of any Right shall be subject to adjustment from time to time in a manner and on terms as nearly equivalent as practicable to the provisions with respect to the Preferred Shares contained in Section 11(a) through (c), inclusive, and the provisions of Sections 7, 9, 10, 13 and 14 with respect to the Preferred Shares shall apply on like terms to any such other shares.

(g) All Rights originally issued by the Corporation subsequent to any adjustment made to the Purchase Price hereunder shall evidence the right to purchase, at the adjusted Purchase Price, the number of one-fiftieths of a Preferred Share purchasable from time to time hereunder upon exercise of the Rights, all subject to further adjustment as provided herein.

(h) The Corporation may elect on or after the date of any adjustment of the Purchase Price to adjust the number of Rights, in lieu of any adjustment in the number of one-fiftieths of a Preferred Share purchasable upon the exercise of a Right. Each of the Rights outstanding after such adjustment of the number of Rights shall be exercisable for the number of one-fiftieths of a Preferred Share for which a Right was exercisable immediately prior to such adjustment. Each Right held of record prior to such adjustment of the number of Rights shall become that number of Rights (calculated to the nearest one ten-thousandth) obtained by dividing the Purchase Price in effect immediately prior to adjustment of the Purchase Price by the Purchase Price in effect immediately after adjustment of the Purchase Price. The Corporation shall make a public announcement of its election to adjust the number of Rights, indicating the record date for the adjustment, and, if known at the time, the amount of the adjustment to be made. This record date may be the date on which the Purchase Price is adjusted or any day thereafter, but, if the Right Certificates have been issued, shall be at least ten (10) days later than the date of the public announcement. If Right Certificates have been issued, upon each adjustment of the number of Rights pursuant to this Section 11(h), the Corporation shall, as promptly as practicable, cause to be distributed to holders of record of Right Certificates on such record date Right Certificates evidencing, subject to Section 14 hereof, the additional Rights to which such holders shall be entitled as a result of such adjustment, or, at the option of the Corporation, shall cause to be distributed to such holders of record in substitution and replacement for the Right Certificates held by such holders prior to the date of adjustment, and upon surrender thereof, if required by the Corporation, new Right Certificates evidencing all the Rights to which such holders shall be entitled after such adjustment. Right Certificates so to be distributed shall be issued, executed and countersigned in the manner provided for herein and shall be registered in the names of the holders of record of Right Certificates on the record date specified in the public announcement.

(i) Irrespective of any adjustment or change in the Purchase Price or the number of one-fiftieths of a Preferred Share issuable upon the exercise of the Rights, the Right Certificates theretofore and thereafter issued may continue to express the Purchase Price and the number of one-fiftieths of a Preferred Share which were expressed in the initial Right Certificates issued hereunder.

(j) Before taking any action that would cause an adjustment reducing the Purchase Price below the then par value, if any, of the number of one-fiftieths of a Preferred Share, Common Shares or other securities issuable upon exercise of the Rights, the Corporation shall take any corporate action which may, in the opinion of its counsel, be necessary in order that the Corporation may validly and legally issue such number of fully paid and non-assessable one-fiftieths of a Preferred Share, Common Shares or other securities at such adjusted Purchase Price.

(k) In any case in which this Section 11 shall require that an adjustment in the Purchase Price be made effective as of a record date for a specified event, the Corporation may elect to defer until the occurrence of such event the issuance to the holder of any Right exercised after such record date the Preferred Shares, Common Shares or other securities of the Corporation, if any, issuable upon such exercise over and above the Preferred Shares, Common Shares or other securities of the Corporation, if any, issuable upon exercise on the basis of the Purchase Price in

effect prior to such adjustment; *provided, however*, that the Corporation shall deliver to such holder a due bill or other appropriate instrument evidencing such holder's right to receive such additional shares upon the occurrence of the event requiring such adjustment.

(l) Anything in this Section 11 to the contrary notwithstanding, the Corporation shall be entitled to make such reductions in the Purchase Price, in addition to those adjustments expressly required by this Section 11, as and to the extent that it in its sole discretion shall determine to be advisable in order that (i) any consolidation or subdivision of the Preferred Shares, (ii) issuance wholly for cash of Preferred Shares at less than the current market price, (iii) issuance wholly for cash of Preferred Shares or securities which by their terms are convertible into or exchangeable for Preferred Shares, (iv) stock dividends or (v) issuance of rights, options or warrants referred to in this Section 11 hereafter made by the Corporation to holders of its Preferred Shares shall not be taxable to such stockholders.

(m) The Corporation covenants and agrees that it shall not, at any time after the Distribution Date, (i) consolidate with any other Person (other than a Subsidiary of the Corporation in a transaction which does not violate Section 11 (n) hereof), (ii) merge with or into any other Person (other than a Subsidiary of the Corporation in a transaction which does not violate Section 11(n) hereof), or (iii) sell or transfer (or permit any Subsidiary to sell or transfer), in one transaction, or a series of related transactions, assets or earning power aggregating more than 50% of the assets or earning power of the Corporation and its Subsidiaries (taken as a whole) to any other Person or Persons (other than the Corporation and/or any of its Subsidiaries in one or more transactions each of which does not violate Section 11(n) hereof), if (x) at the time of or immediately after such consolidation, merger, sale or transfer there are any charter or by-law provisions or any rights, warrants or other instruments or securities outstanding or agreements in effect or other actions taken, which would materially diminish or otherwise eliminate the benefits intended to be afforded by the Rights or (y) prior to, simultaneously with or immediately after such consolidation, merger or sale, the stockholders of the Person who constitutes, or would constitute, the "Principal Party" for purposes of Section 13(a) hereof shall have received a distribution of Rights previously owned by such Person or any of its Affiliates and Associates. The Corporation shall not consummate any such consolidation, merger, sale or transfer unless prior thereto the Corporation and such other Person shall have executed and delivered to the Rights Agent a supplemental agreement evidencing compliance with this Section 11(m).

(n) The Corporation covenants and agrees that, after the Distribution Date, it will not, except as permitted by Section 23 or Section 27 hereof, take (or permit any Subsidiary to take) any action the purpose of which is to, or if at the time such action is taken it is reasonably foreseeable that the effect of such action is to, materially diminish or otherwise eliminate the benefits intended to be afforded by the Rights.

(o) The exercise of Rights under Section 11(a)(ii) shall only result in the loss of rights under Section 11(a)(ii) to the extent so exercised and shall not otherwise affect the rights represented by the Rights under this Rights Agreement, including the rights represented, by Section 13.



**Section 12. *Certificate of Adjusted Purchase Price or Number of Shares.*** Whenever an adjustment is made as provided in Sections 11 or 13 hereof, the Corporation shall promptly (a) prepare a certificate setting forth such adjustment, and a brief statement of the facts accounting for such adjustment, (b) file with the Rights Agent and with each transfer agent for the Common Shares and the Preferred Shares a copy of such certificate, and (c) mail a brief summary thereof to each holder of a Right Certificate in accordance with Section 26 hereof. The Rights Agent shall be fully protected in relying on any such certificate and on any adjustment therein contained and shall not be deemed to have knowledge of such adjustment unless and until it shall have received such certificate.

**Section 13. *Consolidation, Merger or Sale or Transfer of Assets or Earning Power.*** (a) In the event that, on or following the Shares Acquisition Date, directly or indirectly, (x) the Corporation shall consolidate with, or merge with and into, any Interested Stockholder or, if in such merger or consolidation all holders of Common Shares are not treated alike, any other Person, (y) the Corporation shall consolidate with, or merge with, any Interested Stockholder or, if in such merger or consolidation all holders of Common Shares are not treated alike, any other Person, and the Corporation shall be the continuing or surviving corporation of such consolidation or merger (other than, in the case of any transaction described in (x) or (y), a merger or consolidation which would result in all of the securities generally entitled to vote in the election of directors ("*voting securities*") of the Corporation outstanding immediately prior thereto continuing to represent (either by remaining outstanding or by being converted into securities of the surviving entity) all of the voting securities of the Corporation or such surviving entity outstanding immediately after such merger or consolidation and the holders of such securities not having changed as a result of such merger or consolidation), or (z) the Corporation shall sell or otherwise transfer (or one or more of its Subsidiaries shall sell or otherwise transfer), in one transaction or a series of related transactions, assets or earning power aggregating more than 50% of the assets or earning power of the Corporation and its Subsidiaries (taken as a whole) to any Interested Stockholder or Stockholders or, if in such transaction all holders of Common Stock are not treated alike, any other Person (other than the Corporation or any Subsidiary of the Corporation in one or more transactions each of which does not violate Section 11(n) hereof), then, and in each such case (except as provided in Section 13(d) hereof), proper provision shall be made so that (i) each holder of a Right, except as provided in Section 7(e) hereof, shall thereafter have the right to receive, upon the exercise thereof at a price equal to the then current Purchase Price, in accordance with the terms of this Agreement and in lieu of Preferred Shares, such number of freely tradable Common Shares of the Principal Party (as hereinafter defined), not subject to any liens, encumbrances, rights of first refusal or other adverse claims, as shall equal the result obtained by (A) multiplying the then current Purchase Price by the number of one-fiftieths of a Preferred Share for which a Right is then exercisable (without taking into account any adjustment previously made pursuant to Section 11(a)(ii)) and dividing that product by (B) 50% of the then current per share market price of the Common Shares of such Principal Party (determined pursuant to Section 11(d) hereof) on the date of consummation of such Section 13 Event; (ii) such Principal Party shall thereafter be liable for, and shall assume, by virtue of such Section 13 Event, all the obligations and duties of the Corporation pursuant to this Agreement; (iii) the term "Corporation" shall thereafter be deemed to refer to such Principal Party, it being specifically intended that the provisions of Section 11 hereof shall apply only to

such Principal Party following the first occurrence of a Section 13 Event; and (iv) such Principal Party shall take such steps (including, but not limited to, the reservation of a sufficient number of its Common Shares) in connection with the consummation of any such transaction as may be necessary to assure that the provisions hereof shall thereafter be applicable, as nearly as reasonably may be, in relation to the Common Shares thereafter deliverable upon the exercise of the Rights.

(b) "Principal Party" shall mean

(i) in the case of any transaction described in clause (x) or (y) of the first sentence of Section 13(a), the Person that is the issuer of any securities into which Common Shares of the Corporation are converted in such merger or consolidation, and if no securities are so issued, the Person that is the other party to such merger or consolidation (including, if applicable, the Corporation if it is the surviving corporation); and

(ii) in the case of any transaction described in clause (z) of the first sentence of Section 13(a), the Person that is the party receiving the greatest portion of the assets or earning power transferred pursuant to such transaction or transactions;

*provided, however,* that in any of the foregoing cases, (1) if the Common Shares of such Person are not at such time and have not been continuously over the preceding twelve (12) month period registered under Section 12 of the Exchange Act, and such Person is a direct or indirect Subsidiary of another Person the Common Shares of which are and have been so registered, "Principal Party" shall refer to such other Person; (2) in case such Person is a Subsidiary, directly or indirectly, of more than one Person, the Common Shares of two or more of which are and have been so registered, "Principal Party" shall refer to whichever of such Persons is the issuer of the Common Shares having the greatest aggregate market value; and (3) in case such Person is owned, directly or indirectly, by a joint venture formed by two or more Persons that are not owned, directly or indirectly, by the same Person, the rules set forth in (1) and (2) above shall apply to each of the chains of ownership having an interest in such joint venture as if such party were a "Subsidiary" of both or all of such joint venturers and the Principal Parties in each such chain shall bear the obligations set forth in this Section 13 in the same ratio as their direct or indirect interests in such Person bear to the total of such interests.

(c) The Corporation shall not consummate any such consolidation, merger, sale or transfer unless the Principal Party shall have a sufficient number of its authorized Common Shares which have not been issued or reserved for issuance to permit the exercise in full of the Rights in accordance with this Section 13 and unless prior thereto the Corporation and such Principal Party shall have executed and delivered to the Rights Agent a supplemental agreement providing for the terms set forth in paragraphs (a) and (b) of this Section 13 and further providing that, as soon as practicable after the date of any consolidation, merger, sale or transfer mentioned in paragraph (a) of this Section 13, the Principal Party at its own expense shall:

(i) prepare and file a registration statement under the Act with respect to the Rights and the securities purchasable upon exercise of the Rights on an appropriate form and will use its best

efforts to cause such registration statement to (A) become effective as soon as practicable after such filing and (B) remain effective (with a prospectus at all times meeting the requirements of the Act) until the Final Expiration Date;

(ii) use its best efforts to qualify or register the Rights and the securities purchasable upon exercise of the Rights under the blue sky laws of such jurisdictions as may be necessary or appropriate; and

(iii) deliver to holders of the Rights historical financial statements for the Principal Party which comply in all respects with the requirements for registration on Form 10 under the Exchange Act.

The provisions of this Section 13 shall similarly apply to successive mergers or consolidations or sales or other transfers. The rights under this Section 13 shall be in addition to the rights to exercise Rights and adjustments under Section 11(a)(ii) and shall survive any exercise thereof.

(d) Notwithstanding anything in this Agreement to the contrary, Section 13 shall not be applicable to a transaction described in subparagraphs (x) and (y) of Section 13(a) if: (i) such transaction is consummated with a Person or Persons who acquired Common Shares pursuant to a Permitted Offer (or with a wholly owned Subsidiary of any such Person or Persons); (ii) the price per Common Share offered in such transaction is not less than the price per Common Share paid to all holders of Common Shares whose shares were purchased pursuant to such Permitted Offer; and (iii) the form of consideration offered in such transaction is the same as the form of consideration paid pursuant to such Permitted Offer. Upon consummation of any such transaction contemplated by this Section 13(d), all Rights hereunder shall expire.

Section 14. *Fractional Rights and Fractional Shares.* (a) The Corporation shall not be required to issue fractions of Rights or to distribute Right Certificates which evidence fractional Rights. In lieu of such fractional Rights, there shall be paid to the registered holders of the Right Certificates with regard to which such fractional Rights would otherwise be issuable, an amount in cash equal to the same fraction of the current market value of a whole Right. For the purposes of this Section 14(a), the current market value of a whole Right shall be the closing price of the Rights for the Trading Day immediately prior to the date on which such fractional Rights would have been otherwise issuable. The closing price for any day shall be the last sale price, regular way, or, in case no such sale takes place on such day, the average of the closing bid and asked prices, regular way, in either case as reported in the principal consolidated transaction reporting system with respect to securities listed or admitted to trading on the New York Stock Exchange or, if the Rights are not listed or admitted to trading on the New York Stock Exchange, as reported in the principal consolidated transaction reporting system with respect to securities listed on the principal national securities exchange on which the Rights are listed or admitted to trading or, if the Rights are not listed or admitted to trading on any national securities exchange, the last quoted price or, if not so quoted, the average of the high bid and low asked prices in the over-the-counter market, as reported by NASDAQ or such other system then in use or, if on any such date the Rights are not quoted by any such organization, the average of the closing bid and asked prices as furnished by a professional market maker making a market in the Rights selected

by the Board of Directors of the Corporation. If on any such date no such market maker is making a market in the Rights, the fair value of the Rights on such date as determined in good faith by the Board of Directors of the Corporation shall be used.

(b) The Corporation shall not be required to issue fractions of Preferred Shares (other than fractions which are one-fiftieth or integral multiples of one-fiftieth of a Preferred Share) upon exercise of the Rights or to distribute certificates which evidence fractional Preferred Shares (other than fractions which are one-fiftieth or integral multiples of one-fiftieth of a Preferred Share). Fractions of Preferred Shares in integral multiples of one-fiftieth of a Preferred Share may, at the election of the Corporation, be evidenced by depositary receipts, pursuant to an appropriate agreement between the Corporation and a depositary selected by it; *provided* that such agreement shall provide that the holders of such depositary receipts shall have the rights, privileges and preferences to which they are entitled as beneficial owners of the Preferred Shares represented by such depositary receipts. In lieu of fractional Preferred Shares that are not one-fiftieth or integral multiples of one-fiftieth of a Preferred Share, the Corporation shall pay to the registered holders of Right Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the current market value of one Preferred Share. For the purposes of this Section 14(b), the current market value of a Preferred Share shall be the closing price of a Preferred Share (as determined pursuant to Section 11(d)(ii) hereof) for the Trading Day immediately prior to the date of such exercise.

(c) Following the occurrence of one of the transactions or events specified in Section 11 giving rise to the right to receive Common Shares, capital stock equivalents (other than Preferred Shares) or other securities upon the exercise of a Right, the Corporation shall not be required to issue fractions of shares or units of such Common Shares, capital stock equivalents or other securities upon exercise of the Rights or to distribute certificates which evidence fractions of such Common Shares, capital stock equivalents or other securities. In lieu of fractional shares or units of such Common Shares, capital stock equivalents or other securities, the Corporation may pay to the registered holders of Right Certificates at the time such Rights are exercised as herein provided an amount in cash equal to the same fraction of the current market value of a share or unit of such Common Shares, capital stock equivalents or other securities. For purposes of this Section 14(c), the current market value shall be determined in the manner set forth in Section 11(d) hereof for the Trading Day immediately prior to the date of such exercise and, if such capital stock equivalent is not traded, each such capital stock equivalent shall have the value of fiftieth of a Preferred Share.

(d) The holder of a Right by the acceptance of the Right expressly waives his right to receive any fractional Rights or any fractional share upon exercise of a Right (except as provided above).

**Section 15. *Rights of Action.*** All rights of action in respect of this Agreement, excepting the rights of action given to the Rights Agent under Section 18 hereof, are vested in the respective registered holders of the Right Certificates (and, prior to the Distribution Date, the registered holders of the Common Shares); and any registered holder of any Right Certificate (or, prior to the Distribution Date, of the Common Shares), without the consent of the Rights Agent or of the

holder of any other Right Certificate (or, prior to the Distribution Date, of the Common Shares), may, in his own behalf and for his own benefit, enforce, and may institute and maintain any suit, action or proceeding against the Corporation to enforce, or otherwise act in respect of, his right to exercise the Rights evidenced by such Right Certificate in the manner provided in such Right Certificate and in this Agreement. Without limiting the foregoing or any remedies available to the holders of Rights, it is specifically acknowledged that the holders of Rights would not have an adequate remedy at law for any breach of this Agreement and will be entitled to specific performance of the obligations under, and injunctive relief against actual or threatened violations of the obligations of any Person subject to, this Agreement.

Section 16. *Agreement of Right Holders.* Every holder of a Right, by accepting the same, consents and agrees with the Corporation and the Rights Agent and with every other holder of a Right that:

(a) prior to the Distribution Date, the Rights will be transferable only in connection with the transfer of the Common Shares;

(b) after the Distribution Date, the Right Certificates are transferable only on the registry books of the Rights Agent if surrendered at the principal office or offices of the Rights Agent designated for such purpose, duly endorsed or accompanied by a proper instrument of transfer and with the appropriate form fully executed;

(c) subject to Section 6 and Section 7(f) hereof, the Corporation and the Rights Agent may deem and treat the person in whose name the Right Certificate (or, prior to the Distribution Date, the associated Common Shares certificate) is registered as the absolute owner thereof and of the Rights evidenced thereby (notwithstanding any notations of ownership or writing on the Right Certificate or the associated Common Shares certificate made by anyone other than the Corporation or the Rights Agent) for all purposes whatsoever, and neither the Corporation nor the Rights Agent, subject to the last sentence of Section 7(e) hereof, shall be required to be affected by any notice to the contrary; and

(d) notwithstanding anything in this Agreement to the contrary, neither the Corporation nor the Rights Agent shall have any liability to any holder of a Right or a beneficial interest in a Right or other Person as a result of its inability to perform any of its obligations under this Agreement by reason of any preliminary or permanent injunction or other order, decree or ruling issued by a court of competent jurisdiction or by a governmental, regulatory or administrative agency or commission, or any statute, rule, regulation or executive order promulgated or enacted by any governmental authority, prohibiting or otherwise restraining performance of such obligation; *provided, however*, the Corporation must use its best efforts to have any such order, decree or ruling lifted or otherwise overturned as soon as possible.

Section 17. *Right Certificate Holder Not Deemed a Stockholder.* No holder, as such, of any Right Certificate shall be entitled to vote, receive dividends or be deemed for any purpose the holder of the Preferred Shares or any other securities of the Corporation which may at any time be issuable on the exercise of the Rights represented thereby, nor shall anything contained herein or

in any Right Certificate be construed to confer upon the holder of any Right Certificate, as such, any of the rights of a stockholder of the Corporation or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting stockholders (except as provided in Section 25 hereof), or to receive dividends or other distributions or to exercise any preemptive or subscription rights, or otherwise, until the Right or Rights evidenced by such Right Certificate shall have been exercised in accordance with the provisions hereof.

*Section 18. Concerning the Rights Agent.* The Corporation agrees to pay to the Rights Agent reasonable compensation for all services rendered by it hereunder and, from time to time, on demand of the Rights Agent, its reasonable expenses and counsel fees and other disbursements incurred in the administration and execution of this Agreement and the exercise and performance of its duties hereunder. The Corporation also agrees to indemnify the Rights Agent for, and to hold it harmless against, any loss, liability, or expense, incurred without gross negligence, bad faith or willful misconduct on the part of the Rights Agent, for anything done or omitted by the Rights Agent in connection with the acceptance and administration of this Agreement, including the costs and expenses of defending against any claim of liability in the premises. The indemnity provided for herein shall survive the expiration of the Rights and the termination of this Agreement.

The Rights Agent shall be protected and shall incur no liability for, or in respect of, any action taken, suffered or omitted by it in connection with, its administration of this Agreement in reliance upon any Right Certificate or certificate for Common Shares or for other securities of the Corporation, instrument of assignment or transfer, power of attorney, endorsement, affidavit, letter, notice, direction, consent, certificate, statement, or other paper or document believed by it to be genuine and to be signed, executed and, where necessary, verified or acknowledged, by the proper Person or Persons.

*Section 19. Merger or Consolidation or Change of Name of Rights Agent.* Any corporation into which the Rights Agent or any successor Rights Agent may be merged or with which it may be consolidated, or any corporation resulting from any merger or consolidation to which the Rights Agent or any successor Rights Agent shall be a party, or any corporation succeeding to the stock transfer or all or substantially all of the corporate trust business of the Rights Agent or any successor Rights Agent, shall be the successor to the Rights Agent under this Agreement without the execution or filing of any paper or any further act on the part of any of the parties hereto, provided that such corporation would be eligible for appointment as a successor Rights Agent under the provisions of Section 21 hereof. In case at the time such successor Rights Agent shall succeed to the agency created by this Agreement, any of the Right Certificates shall have been countersigned but not delivered, any such successor Rights Agent may adopt the countersignature of a predecessor Rights Agent and deliver such Right Certificates so countersigned; and in case at that time any of the Right Certificates shall not have been countersigned, any successor Rights Agent may countersign such Right Certificates either in the name of the predecessor or in the name of the successor Rights Agent; and in all such cases such Right Certificates shall have the full force provided in the Right Certificates and in this Agreement.

In case at any time the name of the Rights Agent shall be changed and at such time any of the Right Certificates shall have been countersigned but not delivered, the Rights Agent may adopt the countersignature under its prior name and deliver Right Certificates so countersigned; and in case at that time any of the Right Certificates shall not have been countersigned, the Rights Agent may countersign such Right Certificates either in its prior name or in its changed name; and in all such cases such Right Certificates shall have the full force provided in the Right Certificates and in this Agreement.

**Section 20. *Duties of Rights Agent.*** The Rights Agent undertakes only those duties and obligations imposed by this Agreement upon the following terms and conditions, by all of which the Corporation and the holders of Right Certificates, by their acceptance thereof, shall be bound:

(a) The Rights Agent may consult with legal counsel (who may be legal counsel for the Corporation), and the opinion of such counsel shall be full and complete authorization and protection to the Rights Agent as to any action taken or omitted by it in good faith and in accordance with such opinion.

(b) Whenever in the performance of its duties under this Agreement the Rights Agent shall deem it necessary or desirable that any fact or matter (including, without limitation, the identity of an Acquiring Person and the determination of the current market price of any security) be proved or established by the Corporation prior to taking or suffering any action hereunder, such fact or matter (unless other evidence in respect thereof be herein specifically prescribed) may be deemed to be conclusively proved and established by a certificate signed by any one of the Chairman of the Board, the Chief Executive Officer, the President, any Vice President, the Treasurer or the Secretary of the Corporation and delivered to the Rights Agent; and such certificate shall be full authorization to the Rights Agent for any action taken or suffered in good faith by it under the provisions of this Agreement in reliance upon such certificate.

(c) The Rights Agent shall be liable hereunder only for its own gross negligence, bad faith or willful misconduct.

(d) The Rights Agent shall not be liable for or by reason of any of the statements of fact or recitals contained in this Agreement or in the Right Certificates (except its countersignature on such Right Certificates) or be required to verify the same, but all such statements and recitals are and shall be deemed to have been made by the Corporation only.

(e) The Rights Agent shall not be under any responsibility in respect of the validity of this Agreement or the execution and delivery hereof (except the due execution hereof by the Rights Agent) or in respect of the validity or execution of any Right Certificate (except its countersignature thereof), nor shall it be responsible for any breach by the Corporation of any covenant or condition contained in this Agreement or in any Rights Certificate; nor shall it be responsible for any change in the exercisability of the Rights (including the Rights becoming void pursuant to Section 7(e) hereof) or any adjustment required under the provisions of Section 11 or Section 13 hereof or responsible for the manner, method or amount of any such adjustment or the ascertaining of the existence of facts that would require any such adjustment (except with respect

to the exercise of Rights evidenced by Right Certificates after receipt of the certificate described in Section 12 hereof); nor shall it by any act hereunder be deemed to make any representation or warranty as to the authorization or reservation of any Preferred Shares or Common Shares to be issued pursuant to this Agreement or any Right Certificate or as to whether any Preferred Shares or Common Shares will, when issued, be validly authorized and issued, fully paid and non-assessable.

(f) The Corporation agrees that it will perform, execute, acknowledge and deliver or cause to be performed, executed, acknowledged and delivered all such further and other acts, instruments and assurances as may reasonably be required by the Rights Agent for the carrying out or performing by the Rights Agent of the provisions of this Agreement.

(g) The Rights Agent is hereby authorized and directed to accept instructions with respect to the performance of its duties hereunder from any one of the Chairman of the Board, the Chief Executive Officer, the President, any Vice President, the Treasurer or the Secretary of the Corporation, and to apply to such officers for advice or instructions in connection with its duties, and shall not be liable for any, action taken or suffered by it in good faith or lack of action in accordance with instructions of any such officer or for any delay in acting while waiting for those instructions. Any application by the Rights Agent for written instructions from the Corporation may, at the option of the Rights Agent, set forth in writing any action proposed to be taken or omitted by the Rights Agent under this Rights Agreement and the date on or after which such action shall be taken or such omission shall be effective. The Rights Agent shall not be liable for any action taken by, or omission of, the Rights Agent in accordance with a proposal included in any such application on or after the date specified in such application (which date shall not be less than five Business Days after the date any officer of the Corporation actually receives such application, unless any such officer shall have consented in writing to an earlier date) unless, prior to taking any such action (or the effective date in the case of an omission), the Rights Agent shall have received written instruction in response to such application specifying the action to be taken or omitted.

(h) The Rights Agent and any stockholder, director, officer or employee of the Rights Agent may buy, sell or deal in any of the Rights or other securities of the Corporation or become pecuniarily interested in any transaction in which the Corporation may be interested, or contract with or lend money to the Corporation or otherwise act as fully and freely as though it were not Rights Agent under this Agreement. Nothing herein shall preclude the Rights Agent from acting in any other capacity for the Corporation or for any other legal entity.

(i) The Rights Agent may execute and exercise any of the rights or powers hereby vested in it or perform any duty hereunder either itself or by or through its attorneys or agents, and the Rights Agent shall not be answerable or accountable for any act, default, neglect or misconduct of any such attorneys or agents or for any loss to the Corporation resulting from any such act, default, neglect or misconduct, provided reasonable care was exercised in the selection and continued employment thereof.



(j) No provision of this Agreement shall require the Rights Agent to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder or in the exercise of its rights if there shall be reasonable grounds for believing that repayment of such funds or adequate indemnification against such risk or liability is not reasonably assured to it.

(k) If with respect to any Rights Certificate surrendered to the Rights Agent for exercise or transfer, the certificate attached to the form of assignment or form of election to purchase, as the case may be, has not been completed, the Rights Agent shall not take any further action with respect to such requested exercise of transfer without first consulting with the Corporation.

Section 21. *Change of Rights Agent.* The Rights Agent or any successor Rights Agent may resign and be discharged from its duties under this Agreement upon thirty (30) days' notice in writing mailed to the Corporation and to each transfer agent of the Common Shares or Preferred Shares by registered or certified mail, and to the holders of the Right Certificates by first-class mail. The Corporation may remove the Rights Agent or any successor Rights Agent upon sixty (60) days' notice in writing, mailed to the Rights Agent or successor Rights Agent, as the case may be, and to each transfer agent of the Common Shares or Preferred Shares by registered or certified mail, and to holders of the Right Certificates by first-class mail. If the Rights Agent shall resign or be removed or shall otherwise become incapable of acting, the Corporation shall appoint a successor to the Rights Agent. If the Corporation shall fail to make such appointment within a period of sixty (60) days after giving notice of such removal or after it has been notified in writing of such resignation or incapacity by the resigning or incapacitated Rights Agent or by the holder of a Right Certificate (who shall, with such notice, submit his Right Certificate for inspection by the Corporation), then the registered holder of any Right Certificate may apply to any court of competent jurisdiction for the appointment of a new Rights Agent. Any successor Rights Agent, whether appointed by the Corporation or by such a court, shall be a corporation organized and doing business under the laws of the United States or of the State of New York (or of any other state of the United States so long as such corporation is authorized to do business as a banking institution in the State of New York), in good standing, having an office in the State of New York which is authorized under such laws to exercise corporate trust or stock transfer powers and is subject to supervision or examination by federal or state authority and which has at the time of its appointment as Rights Agent a combined capital and surplus of at least \$100,000,000. After appointment, the successor Rights Agent shall be vested with the same powers, rights, duties and responsibilities as if it had been originally named as Rights Agent without further act or deed; but the predecessor Rights Agent shall deliver and transfer to the successor Rights Agent any property at the time held by it hereunder, and execute and deliver any further assurance, conveyance, act or deed necessary for the purpose. Not later than the effective date of any such appointment the Corporation shall file notice thereof in writing with the predecessor Rights Agent and each transfer agent of the Common Shares or Preferred Shares, and mail a notice thereof in writing to the registered holders of the Right Certificates. Failure to give any notice provided for in this Section 21, however, or any defect therein, shall not affect the legality or validity of the resignation or removal of the Rights Agent or the appointment of the successor Rights Agent, as the case may be.

**Section 22. Issuance of New Right Certificates.** Notwithstanding any of the provisions of this Agreement or of the Rights to the contrary, the Corporation may, at its option, issue new *Right Certificates evidencing Rights* in such form as may be approved by its Board of Directors to reflect any adjustment or change in the Purchase Price and the number or kind or class of shares or other securities or property purchasable under the *Right Certificates* made in accordance with the provisions of this Agreement. In addition, in connection with the issuance or sale of Common Shares following the Distribution Date and prior to the earlier of the Redemption Date and the Final Expiration Date, the Corporation (a) shall with respect to Common Shares so issued or sold pursuant to the exercise of stock options or under any employee plan or arrangement, or upon the exercise, conversion or exchange of securities, notes or debentures issued by the Corporation, and (b) may, in any other case, if deemed necessary or appropriate by the Board of Directors of the Corporation, issue *Right Certificates* representing the appropriate number of Rights in connection with such issuance or sale; *provided, however*, that (i) the Corporation shall not be obligated to issue any such *Right Certificates* if, and to the extent that, the Corporation shall be advised by counsel that such issuance would create a significant risk of material adverse tax consequences to the Corporation or the Person to whom such *Right Certificate* would be issued, and (ii) no *Right Certificate* shall be issued if, and to the extent that, appropriate adjustment shall otherwise have been made in lieu of the issuance thereof.

**Section 23. Redemption and Termination.**

(a)(i) The Board of Directors of the Corporation may, at its option, redeem all but not less than all the then outstanding Rights at a redemption price of \$0.01 (one cent) per Right, as such amount may be appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such redemption price being hereinafter referred to as the "*Redemption Price*"), at any time prior to the earlier of (x) a Person becoming an Acquiring Person or (y) the Final Expiration Date. The Corporation may, at its option, pay the Redemption Price either in Common Shares (based on the "current per share market price," as defined in Section 11(d) hereof, of the Common Share at the time of redemption) or cash; *provided* that if the Corporation elects to pay the Redemption Price in Common Shares, the Corporation shall not be required to issue any fractional Common Shares and the number of Common Shares issuable to each holder of Rights shall be rounded down to the next whole share.

(ii) The Board of Directors of the Corporation may, at its option, at any time following the occurrence of a Section 11(a)(ii) Event and prior to any Section 13 Event, redeem all but not less than all of the then outstanding Rights at the Redemption Price in connection with any merger, consolidation or sale or other transfer (in one transaction or in a series of related transactions) of assets or earning power aggregating 50% or more of the earning power of the Corporation and its subsidiaries (taken as a whole) in which all holders of Common Shares are treated alike and not involving (other than as a holder of Common Shares being treated like all other such holders) an Interested Stockholder.

(b) In the case of a redemption permitted under Section 23(a)(i), immediately upon the date for redemption set forth (or determined in the manner specified in) in a resolution of the

Board of Directors of the Corporation ordering the redemption of the Rights, evidence of which shall have been filed with the Rights Agent, and without any further action and without any notice, the right to exercise the Rights will terminate and the only right thereafter of the holders of Rights shall be to receive the Redemption Price for each Right so held. In the case of a redemption permitted only under Section 23(a)(ii), evidence of which shall have been filed with the Rights Agent, the right to exercise the Rights will terminate and represent only the right to receive the Redemption Price upon the later of ten Business Days following the giving of such notice or the expiration of any period during which the rights under Section 11(a)(ii) may be exercised. The Corporation shall promptly give public notice of any such redemption; *provided, however*, that the failure to give, or any defect in, any such notice shall not affect the validity of such redemption. Within ten (10) days after such date for redemption set forth in a resolution of the Board of Directors ordering the redemption of the Rights, the Corporation shall mail a notice of redemption to all the holders of the then outstanding Rights at their last addresses as they appear upon the registry books of the Rights Agent or, prior to the Distribution Date, on the registry books of the transfer agent for the Common Shares. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of redemption will state the method by which the payment of the Redemption Price will be made. Neither the Corporation nor any of its Affiliates or Associates may redeem, acquire or purchase for value any Rights at any time in any manner other than that specifically set forth in this Section 23 and other than in connection with the purchase of Common Shares prior to the Distribution Date.

(c) The Corporation may, at its option, discharge all of its obligations with respect to the Rights by (i) issuing a press release announcing the manner of redemption of the Rights in accordance with this Agreement and (ii) mailing payment of the Redemption Price to the registered holders of the Rights at their last addresses as they appear on the registry books of the Rights Agent or, prior to the Distribution Date, on the registry books of the transfer agent of the Common Shares, and upon such action, all outstanding Rights and Right Certificates shall be null and void without any further action by the Corporation.

#### *Section 24. Exchange.*

(a) The Board of Directors of the Corporation may, at its option, at any time after any Person becomes an Acquiring Person, exchange all or part of the then outstanding and exercisable Rights (which shall not include Rights that have become void pursuant to the provisions of Section 11(a)(ii) hereof) for Common Shares of the Corporation at an exchange ratio of one Common Share per Right, appropriately adjusted to reflect any stock split, stock dividend or similar transaction occurring after the date hereof (such exchange ratio being hereinafter referred to as the "Exchange Ratio"). Notwithstanding the foregoing, the Board of Directors shall not be empowered to effect such exchange at any time after any Person (other than the Corporation, any Subsidiary of the Corporation, any employee benefit plan of the Corporation, or any such Subsidiary, any entity holding Common Shares for or pursuant to the terms of any such a plan), together with all Affiliates and Associates of such Person, becomes the Beneficial Owner of 50% or more of the Common Shares then outstanding.

(b) Immediately upon the action of the Board of Directors of the Corporation ordering the exchange of any Rights pursuant to subsection (a) of this Section 24 and without any further action and without any notice, the right to exercise such Rights shall terminate and the only right thereafter of a holder of such Rights shall be to receive that number of Common Shares equal to the number of such Rights held by such holder multiplied by the Exchange Ratio. The Corporation shall promptly give public notice of any such exchange; *provided, however*, that the failure to give, or any defect in, such notice shall not affect the validity of such exchange. The Corporation shall promptly mail a notice of any such exchange to all of the holders of such Rights at their last addresses as they appear upon the registry books of the Rights Agent. Any notice which is mailed in the manner herein provided shall be deemed given, whether or not the holder receives the notice. Each such notice of exchange will state the method by which the exchange of the Common Shares for Rights will be effected and, in the event of any partial exchange, the number of Rights which will be exchanged. Any partial exchange shall be effected pro rata based on the number of Rights (other than Rights which have become void pursuant to the provisions of Section 11(a)(ii) hereof) held by each holder of Rights.

(c) In any exchange pursuant to this Section 24, the Corporation, at its option, may substitute Preferred Shares (or equivalent preferred shares, as such term is defined in Section 11(b) hereof) for some or all of the Common Shares exchangeable for Rights, at the initial rate of one-fiftieth of a Preferred Share (or equivalent preferred share) for each Common Share, as appropriately adjusted to reflect adjustments in the voting rights of the Preferred Shares pursuant to the terms thereof, so that the fraction of a Preferred Share delivered in lieu of each Common Share shall have the same voting rights as one Common Share.

(d) In the event that there shall not be sufficient Common Shares or Preferred Shares issued but not outstanding or authorized but unissued to permit any exchange of Rights as contemplated in accordance with this Section 24, the Corporation shall take all such action as may be necessary to authorize additional Common Shares or Preferred Shares for issuance upon exchange of the Rights.

*Section 25. Notice of Certain Events.* (a) In case the Corporation shall propose (i) to pay any dividend payable in stock of any class to the holders of its Preferred Shares or to make any other distribution to the holders of its Preferred Shares (other than a regularly quarterly cash dividend), (ii) to offer to the holders of its Preferred Shares rights or warrants to subscribe for or to purchase any additional Preferred Shares or shares of stock of any class or any other securities, rights or options, (iii) to effect any reclassification of its Preferred Shares (other than a reclassification involving only the subdivision of outstanding Preferred Shares), (iv) to effect any consolidation or merger into or with any other Person (other than a Subsidiary of the Corporation in a transaction which does not violate Section 11(n) hereof), or to effect any sale or other transfer (or to permit one or more of its Subsidiaries to effect any sale or other transfer) in one or more transactions of 50% or more of the assets or earning power of the Corporation and its Subsidiaries (taken as a whole) to any other Person or Persons (other than the Corporation and/or any of its Subsidiaries in one or more transactions each of which does not violate Section 11(n) hereof), or (v) to effect the liquidation, dissolution or winding up of the Corporation, then, in each

such case, the Corporation shall give to each holder of a Right Certificate, in accordance with Section 26 hereof, a notice of such proposed action to the extent feasible and file a certificate with the Rights Agent to that effect, which shall specify the record date for the purposes of such stock dividend, or distribution of rights or warrants, or the date on which such reclassification, consolidation, merger, sale, transfer, liquidation, dissolution, or winding up is to take place and the date of participation therein by the holders of the Preferred Shares, if any such date is to be fixed, and such notice shall be so given in the case of any action covered by clause (i) or (ii) above at least twenty (20) days prior to the record date for determining holders of the Preferred Shares for purposes of such action, and in the case of any such other action, at least twenty (20) days prior to the date of the taking of such proposed action or the date of participation therein by the holders of the Preferred Shares, whichever shall be the earlier.

(b) In case of a Section 11(a)(ii) Event, then (i) the Corporation shall as soon as practicable thereafter give to each holder of a Right Certificate, in accordance with Section 26 hereof, a notice of the occurrence of such event, which notice shall describe such event and the consequences of such event to holders of Rights under Section 11(a)(ii) hereof, and (ii) all references in the preceding paragraph (a) to Preferred Shares shall be deemed thereafter to refer also to Common Shares and/or, if appropriate, other securities of the Corporation.

Section 26. *Notices.* Notices or demands authorized by this Agreement to be given or made by the Rights Agent or by the holder of any Right Certificate to or on the Corporation shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed (until another address is filed in writing with the Rights Agent) as follows:

Chesapeake Utilities Corporation  
909 Silver Lake Boulevard  
Dover, Delaware 19904

Attention: John R. Schimkaitis  
President and Chief Executive Officer

Subject to the provisions of Section 21 hereof, any notice or demand authorized by this Agreement to be given or made by the Corporation or by the holder of any Right Certificate to or on the Rights Agent shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed (until another address is filed in writing with the Corporation) as follows:

BankBoston, N.A.  
c/o EquiServe Limited Partnership  
150 Royall Street  
Canton, MA 02021

Attention: Client Administration

Notices or demands authorized by this Agreement to be given or made by the Corporation or the Rights Agent to the holder of any Right Certificate or, if prior to the Distribution Date, to the

holder of certificates representing Common Shares shall be sufficiently given or made if sent by first-class mail, postage prepaid, addressed to such holder at the address of such holder as shown on the registry books of the Corporation.

**Section 27. *Supplements and Amendments.*** Prior to the Distribution Date, the Corporation and the Rights Agent shall, if the Corporation so directs, supplement or amend any provision of this Agreement without the approval of any holders of certificates representing Common Shares. From and after the Distribution Date, the Corporation and the Rights Agent shall, if the Corporation so directs, supplement or amend this Agreement without the approval of any holders of Right Certificates in order (i) to cure any ambiguity, (ii) to correct or supplement any provision contained herein which may be defective or inconsistent with any other provisions herein, (iii) to shorten or lengthen any time period hereunder or (iv) to change or supplement the provisions hereunder in any manner which the Corporation may deem necessary or desirable and which shall not adversely affect the interests of the holders of Right Certificates (other than an Acquiring Person or an Affiliate or Associate of an Acquiring Person); *provided, however*, that this Agreement may not be supplemented or amended to lengthen, pursuant to clause (iii) of this sentence, (A) a time period relating to when the Rights may be redeemed at such time as the Rights are not then redeemable, or (B) any other time period unless such lengthening is for the purpose of protecting, enhancing or clarifying the rights of, and/or the benefits to, the holders of Rights. Upon the delivery of a certificate from an appropriate officer of the Corporation which states that the proposed supplement or amendment is in compliance with the terms of this Section 27, the Rights Agent shall execute such supplement or amendment, *provided that such* supplement or amendment does not adversely affect the rights or obligations of the Rights Agent under Section 18 or Section 20 of this Agreement. Prior to the Distribution Date, the interests of the holders of Rights shall be deemed coincident with the interests of the holders of Common Shares.

**Section 28. *Determination and Actions by the Board of Directors, etc.*** The Board of Directors of the Corporation shall have the exclusive power and authority to administer this Agreement and to exercise all rights and powers specifically granted to the Board, or the Corporation, or as may be necessary or advisable in the administration of this Agreement, including, without limitation, the right and power to (i) interpret the provisions of this Agreement, and (ii) make all determinations deemed necessary or advisable for the administration of this Agreement (including, without limitation, a determination to redeem or not redeem the Rights or to amend the Agreement and whether any proposed amendment adversely affects the interests of the holders of Right Certificates). For all purposes of this Agreement, any calculation of the number of Common Shares or other securities outstanding at any particular time, including for purposes of determining the particular percentage of such outstanding Common Shares or any other securities of which any Person is the Beneficial Owner, shall be made in accordance with the last sentence of Rule 13d-3(d)(1)(i) of the General Rules and Regulations under the Exchange Act as in effect on the date of this Agreement. All such actions, calculations, interpretations and determinations (including, for purposes of clause (y) below, all omissions with respect to the foregoing) which are done or made by the Board in good faith, shall (x) be final, conclusive and binding on the Corporation, the Rights Agent, the holders of the Right Certificates and all other parties, and (y) not subject the Board to any liability to the holders of the Right Certificates.

Section 29. *Successors.* All the covenants and provisions of this Agreement by or for the benefit of the Corporation or the Rights Agent shall bind and inure to the benefit of their respective successors and assigns hereunder.

Section 30. *Benefits of this Agreement.* Nothing in this Agreement shall be construed to give to any person or corporation other than the Corporation, the Rights Agent and the registered holders of the Right Certificates (and, prior to the Distribution Date, the Common Shares) any legal or equitable right, remedy or claim under this Agreement; but this Agreement shall be for the sole and exclusive benefit of the Corporation, the Rights Agent and the registered holders of the Right Certificates (and, prior to the Distribution Date, the Common Shares).

Section 31. *Severability.* If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated.

Section 32. *Governing Law.* This Agreement, each Right and each Right Certificate issued hereunder shall be deemed to be a contract made under the laws of the State of Delaware and for all purposes shall be governed by and construed in accordance with the laws of such State of Delaware applicable to contracts to be made and performed entirely within such state.

Section 33. *Counterparts.* This Agreement may be executed in any number of counterparts and each of such counterparts shall for all purposes be deemed to be an original, and all such counterparts shall together constitute but one and the same instrument.

Section 34. *Descriptive Headings.* Descriptive headings of the several Sections of this Agreement are inserted for convenience only and shall not control or affect the meaning or construction of any of the provisions hereof.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be duly executed and attested, all as of the date and year first above written.

Attest: William C. Boyles  
By: William C. Boyles  
Name: William C. Boyles  
Title: Corporate Secretary

**Chesapeake Utilities Corporation**  
By: John R. Schimkaitis  
Name: John R. Schimkaitis  
Title: President and Chief Executive Officer

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

**BankBoston, N.A.**  
By: Carol Mulvey-Edye  
Name: Carol Mulvey-Edye  
Title: Managing Director

**CERTIFICATE OF THE VOTING POWERS,  
DESIGNATIONS, PREFERENCES AND RELATIVE  
PARTICIPATING, OPTIONAL AND OTHER SPECIAL  
RIGHTS AND QUALIFICATIONS, LIMITATIONS  
OR RESTRICTIONS OF SERIES A  
PARTICIPATING CUMULATIVE  
PREFERRED STOCK OF  
CHESAPEAKE UTILITIES CORPORATION**

Pursuant to Section 151 of the General Corporation Law of the State of Delaware, Chesapeake Utilities Corporation (the "Corporation"), a corporation organized and existing under the General Corporation Law of the State of Delaware, in accordance with the provisions of Section 103 thereof, DOES HEREBY CERTIFY:

That, pursuant to the authority conferred upon the Board of Directors of the Corporation by Article Fourth of the Restated Certificate of Incorporation of the Corporation (the "Certificate of Incorporation"), the Board of Directors of the Corporation on August 20, 1999, adopted the following resolution creating a series of Preferred Stock designated as Series A Participating Cumulative Preferred Stock:

RESOLVED, that, pursuant to the authority vested in the Board of Directors of the Corporation in accordance with the provisions of the Certificate of Incorporation of the Corporation, a series of Preferred Stock of the Corporation is hereby created and that the designation and number of shares thereof and the voting powers, preferences and relative, participating, optional and other special rights of the shares of such series, and the qualifications, limitations or restrictions thereof, are as follows:

Section 1. *Designation, Par Value and Amount.*

The shares of such series shall be designated as "Series A Participating Cumulative Preferred Stock" (hereinafter referred to as "Series A Preferred Stock"), par value of \$0.01 per share. The number of shares initially constituting such series shall be 200,000; provided, however, that, if more than a total of 200,000 shares of Series A Preferred Stock shall be issuable upon the exercise of Rights (the "Rights") issued pursuant to the Rights Agreement, dated as of August 20, 1999, between the Corporation and BankBoston, N.A., as Rights Agent (as amended from time to time, the "Rights Agreement"), the Board of Directors of the Corporation, pursuant to Section 151(g) of the General Corporation Law of the State of Delaware, shall direct by resolution or resolutions that a certificate be properly executed, acknowledged, filed and recorded in accordance with Section 103 thereof providing for the total number of shares of Series A Preferred Stock authorized to be issued to be increased (to the extent that the Certificate of Incorporation then permits) to the largest number of whole shares (rounded up to the nearest whole number) issuable upon exercise of the Rights.



**Section 2. Dividends and Distributions.**

(a) Subject to the prior and superior rights of the holders of any shares of any other series of Preferred Stock and any other class of equity securities of the Corporation ranking prior and superior to the shares of Series A Preferred Stock with respect to dividends, the holders of shares of Series A Preferred Stock shall be entitled to receive, when, as and if declared by the Board of Directors, out of assets legally available for the purpose, quarterly dividends payable in cash on the first business day of September, December, March and June in each year (each such date being referred to herein as a "*Quarterly Dividend Payment Date*"), commencing on the first Quarterly Dividend Payment Date after the first issuance of a share or fraction of a share of Series A Preferred Stock, in an amount per share (rounded to the nearest cent) equal to the greater of (i) \$12.50 or (ii) the Formula Number times the aggregate per share amount of all cash dividends declared on the Common Stock, par value \$0.48  $\frac{2}{3}$  per share, of the Corporation (the "*Common Stock*"), since the immediately preceding Quarterly Dividend Payment Date, or, with respect to the first Quarterly Dividend Payment Date, since the first issuance of any share or fraction of a share of Series A Preferred Stock. In addition, if the Corporation shall pay any dividend or make any distribution on the Common Stock payable in assets, securities or other forms of noncash consideration (other than dividends or distributions solely in shares of Common Stock), then, in each such case, the Corporation shall simultaneously pay or make on each outstanding whole share of Series A Preferred Stock a dividend or distribution in like kind in an amount equal to such dividend or distribution on each share of the Common Stock multiplied by the Formula Number. As used herein, the "Formula Number" shall be 50; provided, however, that, if at any time after August 20, 1999, the Corporation shall (i) declare or pay any dividend on the Common Stock payable in shares of Common Stock or make any distribution on the Common Stock in shares of Common Stock, (ii) subdivide (by a stock split or otherwise) the outstanding shares of Common Stock into a larger number of shares of Common Stock, or (iii) combine (by a reverse stock split or otherwise) the outstanding shares of Common Stock into a smaller number of shares of Common Stock, then in each such event the Formula Number shall be adjusted to a number determined by multiplying the Formula Number in effect immediately prior to such event by a fraction, (A) the numerator of which is the number of shares of Common Stock that are outstanding immediately after such event and (B) the denominator of which is the number of shares of Common Stock that are outstanding immediately prior to such event (and rounding the result to the nearest whole number); and provided further, that, if at any time after August 20, 1999, the Corporation shall issue any shares of its capital stock in a merger, reclassification, or change of the outstanding shares of Common Stock, then in each such event the Formula Number shall be appropriately adjusted, as necessary, to reflect such merger, reclassification or change so that each share of Preferred Stock continues to be the economic equivalent of a Formula Number of shares of Common Stock prior to such merger, reclassification or change.

(b) The Corporation shall declare a dividend or distribution on the Series A Preferred Stock as provided in paragraph (a) above immediately prior to or at the same time it declares a dividend or distribution on the Common Stock (other than a dividend or distribution payable in shares of Common Stock), and in which case the record date for the determination of holders of

shares of Series A Preferred Stock entitled to receive a dividend or distribution declared thereon shall be the same date as the record date for any corresponding dividend or distribution on the Common Stock.

(c) Dividends shall begin to accrue and be cumulative on outstanding shares of Series A Preferred Stock from and after the Quarterly Dividend Payment Date next preceding the date of original issue of such shares of Series A Preferred Stock, unless the date of issue is a date after the record date for the determination of holders of shares of Series A Preferred Stock entitled to receive a quarterly dividend, in which event such dividends shall begin to accrue and be cumulative from the first Quarterly Dividend Payment Date following the date of issue. Accrued but unpaid dividends shall not bear interest. Dividends paid on the shares of Series A Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. Except as otherwise provided in paragraph (b) of this Section 2, the Board of Directors may fix a record date for the determination of holders of shares of Series A Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be not more than 50 days or less than 10 days prior to the date fixed for the payment of such dividend or distribution.

Section 3. *Voting Rights.* The holders of shares of Series A Preferred Stock shall have the following voting rights:

(a) Except as otherwise provided in paragraph (c) of this Section 3 and Section 11 hereof or as is required by law, the holders of shares of Series A Preferred Stock and the holders of shares of Common Stock shall vote together as one class for the election of directors and on all other matters submitted to a vote of stockholders of the Corporation.

(b) Each share of Series A Preferred Stock shall entitle the holder thereof to one vote on all matters submitted to the vote of the holders of Series A Preferred Stock, except that, when voting as a single class with the holders of the Common Stock, each share of Series A Preferred Stock shall entitle the holder to a number of votes equal to the Formula Number then in effect.

(c) (i) If, on the date used to determine stockholders of record for any meeting of stockholders for the election of directors, a default in preference dividends (as defined in subparagraph (v) below) on the Series A Preferred Stock shall exist, the holders of the Series A Preferred Stock shall have the right, voting as a class (in addition to voting together with the holders of Common Stock for the election of the other directors of the Corporation), to elect two directors (each a "Preferred Director"). Such right may be exercised (A) at any meeting of stockholders for the election of directors or (B) at a meeting of the holders of Series A Preferred Stock called for the purpose in accordance with the By-laws of the Corporation, and shall continue until all such cumulative dividends (referred to above) shall have been paid in full.

(ii) Each Preferred Director shall continue to serve as a Preferred Director for a term of one year, except that upon any termination of the right of all holders of shares of Series A Preferred Stock to vote as a class for Preferred Directors, the term of office of each Preferred Directors shall terminate. Any Preferred Director may be removed by, and shall not be

removed except by, the vote of the holders of record of a majority of the outstanding shares of Series A Preferred Stock then entitled to vote for the election of directors, present (in person or by proxy) and voting together as a single class (A) at a meeting of the stockholders, (B) at a meeting of the holders of Series A Preferred Stock called for the purpose in accordance with the By-laws of the Corporation, or (C) by a written consent signed by the holders of a majority of the then outstanding shares of Series A Preferred Stock then entitled to vote for the election of directors.

(iii) So long as a default in any preference dividends on the Series A Preferred Stock shall exist (A) any vacancy in the office of a Preferred Director may be filled (except as provided in the following clause (B)) by an instrument in writing signed by the remaining Preferred Director and filed with the Corporation or (B) in the case of the removal of any Preferred Director, the vacancy may be filled by the vote or written consent of the holders of a majority of the outstanding shares of Series A Preferred Stock then entitled to vote for the election of directors at such time as the removal shall be effected. Each director appointed as aforesaid by the remaining Preferred Director shall be deemed, for all purposes hereof, to be a Preferred Director. Whenever a default in preference dividends on the Series A Preferred Stock ceases to exist, then the number of directors constituting the Board of Directors of the Corporation shall be reduced by two.

(iv) A "default in preference dividends" on the Series A Preferred Stock shall be deemed to have occurred whenever the amount of cumulative and unpaid dividends on the Series A Preferred Stock shall be equivalent to six full quarterly dividends or more (whether or not consecutive), and, having so occurred, such default shall be deemed to exist thereafter until, but only until, all cumulative dividends on all shares of the Series A Preferred Stock then outstanding shall have been paid through the last Quarterly Dividend Payment Date.

(d) Except as set forth in this Section 3 and Section 11 hereof and as otherwise required by applicable law, holders of Series A Preferred Stock shall have no special voting rights and their consent shall not be required (except to the extent they are entitled to vote with the holders of Common Stock as set forth herein) to authorize the taking any corporate action.

#### Section 4. *Certain Restrictions.*

(a) Whenever quarterly dividends or other dividends or distributions payable on the Series A Preferred Stock, as provided in Section 2, are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series A Preferred Stock outstanding shall have been paid in full, the Corporation shall not

(i) declare or pay dividends, or make any other distributions on, or redeem, purchase or otherwise acquire for consideration, any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up of the Corporation) to the Series A Preferred Stock;

(ii) declare or pay dividends, or make any other distributions on, any shares of stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up of

the Corporation) with the Series A Preferred Stock, except dividends paid ratably on the Series A Preferred Stock and all such parity stock on which dividends are payable or in arrears in proportion to the total amounts to which the holders of all such shares are then entitled;

(iii) redeem, purchase or otherwise acquire for consideration shares of any stock ranking on a parity (either as to dividends or upon liquidation, dissolution or winding up of the Corporation) to the Series A Preferred Stock, provided that the Corporation may at any time redeem, purchase or otherwise acquire shares of any such parity stock in exchange for shares of any stock of the Corporation ranking junior (both as to dividends and upon dissolution, liquidation or winding up) to the Series A Preferred Stock;

(iv) purchase or otherwise acquire for consideration any shares of Series A Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of shares of Series A Preferred Stock upon such terms as the Board of Directors.

(b) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under paragraph (a) of this Section 4, purchase or otherwise acquire such shares at such time and on the same terms.

Section 5. *Reacquired Shares.* Any shares of Series A Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and cancelled promptly after the acquisition thereof. All such shares shall upon their cancellation become authorized but unissued shares of Preferred Stock, and may be reissued as part of a new series of Preferred Stock in accordance with the Certificate of Incorporation and applicable law.

Section 6. *Liquidation, Dissolution or Winding Up.*

(a) Subject to the prior and superior rights of holders of any shares of any other series of Preferred Stock and any other class of equity securities of the Corporation ranking prior and superior to the shares of Series A Preferred Stock, upon a liquidation, dissolution or winding up (voluntary or otherwise) of the Corporation, the holders of shares of Series A Preferred Stock shall be entitled to receive an amount equal to \$18.00 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment (the "*Series A Liquidation Preference*"). Unless and until the holders of Series A Preferred Stock receive the Series A Liquidation Preference, no distribution shall be made to the holders of shares of Common Stock, any other series of Preferred Stock, or other class of equity securities of the Corporation ranking junior to the Series A Preferred Stock upon the liquidation, dissolution or winding up of the Corporation. Following the payment of the full amount of the Series A Liquidation Preference, no additional distributions shall be made to the holders of shares of Series A Preferred Stock unless, prior thereto, the holders of shares of Common Stock shall have received an amount per share (the "*Common Stock Amount*") equal to the quotient obtained by dividing (i) the Series A Liquidation Preference by (ii) Formula Number then in effect. Following the payment of the full amount of the Series A Liquidation Preference and the Common Stock Amount respect of all outstanding shares of Series A Preferred Stock and

Common Stock, respectively, holders of Series A Preferred Stock and holders of Common Stock shall receive their ratable and proportionate share of the remaining assets to be distributed in the ratio of the Formula Number to one with respect to such Preferred Stock and Common Stock, respectively.

(b) In the event, however; that there are not sufficient assets available to permit payment in full of the Series A Liquidation Preference and the liquidation preferences of all other stock ranking on a parity with the Series A Preferred Stock, then such remaining assets shall be distributed ratably to the holders of Series A Preferred Stock and the holders of such parity shares in proportion to their respective liquidation preferences.

Section 7. *Consolidation, Merger, etc.* In case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, then in any such case the then outstanding shares of Series A Preferred Stock shall at the same time be similarly exchanged or changed in an amount per share equal to the Formula Number times the aggregate amount of stock, securities, cash and/or any other property (payable in kind), as the case may be, into which or for which each share of Common Stock is changed or exchanged.

Section 8. *No Redemption; No Sinking Fund.*

(a) The shares of Series A Preferred Stock shall not be redeemable by the Corporation or at the option of any holder of Series A Preferred Stock.

(b) The shares of Series A Preferred Stock shall not be subject to or entitled to the operation of a retirement or sinking fund.

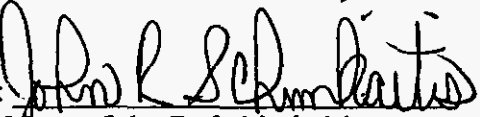
Section 9. *Ranking.* The Series A Preferred Stock shall rank junior to all other series of the Preferred Stock of the Corporation as to the payment of dividends and as to the distribution of assets upon the liquidation, dissolution or winding up of the Corporation, unless the terms of any such other series of Preferred Stock shall provide otherwise.


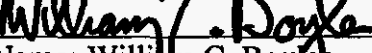
Section 10. *Fractional Shares.* The Series A Preferred Stock shall be issuable upon exercise of the Rights issued pursuant to the Rights Agreement in whole shares or in any fraction of a share that is one-fiftieth (1/50th) of a share or any integral multiple thereof, which fractional share of Series A Preferred Stock shall entitle the holder, in proportion to such holder's fractional shares, to receive dividends exercise voting rights, participate in distributions and to have the benefit of any other rights of a holder of Series A Preferred Stock. As provided in the Rights Agreement, (i) in lieu of the issuance of a fraction of a share (other one-fiftieth (1/50<sup>th</sup>) of a share or an integral multiple thereof), the Corporation may elect to make a cash payment for the fraction of a share in excess of one-fiftieth (1/50th) of a share or any integral multiple thereof and (ii) to issue depository receipts evidencing authorized fractions of a share of Series A Preferred Stock pursuant to an appropriate agreement between the Corporation and a depository selected by the Corporation; provided that such agreement shall provide that the holders of such depository receipts shall have all the rights, privileges and preferences to which they are entitled as beneficial owners of the Series A Preferred Stock represented by such depository receipts.

Section 11. *Amendment.* None of the powers, preferences and relative, participating, optional and other special rights of the Series A Preferred Stock as provided herein or in the Certificate of Incorporation shall be amended in any manner which would alter or change the powers, preferences, rights or privileges of the holders of Series A Preferred Stock so as to affect them adversely without the affirmative vote of the holders of at least 66-2/3% of the outstanding shares of Series A Preferred Stock, voting as a separate class.

IN WITNESS WHEREOF, this Certificate of Amendment is executed on behalf of the Corporation by its President and attested by its Secretary this 24<sup>th</sup> day of August, 1999.

CHESAPEAKE UTILITIES CORPORATION

By:   
Name: John R. Schimkaitis  
Title: President and Chief Executive Officer

Attest:   
By:   
Name: William C. Boyle  
Title: Corporate Secretary

**Form of Right Certificate  
Certificate**

No. R-

\_\_\_ Rights

**NOT EXERCISABLE AFTER AUGUST 20, 2009, OR EARLIER IF REDEEMED BY THE CORPORATION. THE RIGHTS ARE SUBJECT TO REDEMPTION AT \$.01 PER RIGHT ON THE TERMS SET FORTH IN THE RIGHTS AGREEMENT.**

**Right Certificate****Chesapeake Utilities Corporation**

This certifies that \_\_\_\_\_, or registered assigns, is the registered owner of the number of Rights set forth above, each of which entitles the owner thereof, subject to the terms, provisions and conditions of the Rights Agreement, dated as of August 20, 1999 (the "*Rights Agreement*"), between Chesapeake Utilities Corporation, a Delaware corporation (the "*Corporation*"), and BankBoston, N.A. (the "*Rights Agent*"), to purchase from the Corporation at any time after the Distribution Date (as such term is defined in the Rights Agreement) and prior to 5:00 P.M., New York time, on August 20, 2009, unless the Rights evidenced hereby shall have been previously redeemed by the Corporation, at the principal office or offices of the Rights Agent designated for such purpose, or at the office of its successor as Rights Agent, one-fiftieth of a fully paid non-assessable share of Series A Participating Cumulative Preferred Stock, par value \$.01 per share (the "*Preferred Shares*"), of the Corporation, at a purchase price of \$54.56 per one-fiftieth of a Preferred Share (the "*Purchase Price*"), upon presentation and surrender of this Right Certificate with the attached Form of Election to Purchase duly executed. The number of Rights evidenced by this Right Certificate (and the number of one-fiftieths of a Preferred Share which may be purchased upon exercise hereof) set forth above, and the Purchase Price set forth above, are the number and Purchase Price as of August 20, 1999, based on the Preferred Shares as constituted at such date.

Upon the occurrence of a Section 11(a)(ii) Event (as such term is defined in the Rights Agreement), if the Rights evidenced by this Right Certificate are beneficially owned by (i) an Acquiring Person or an Affiliate or Associate of any such Acquiring Person (as such terms are defined in the Rights Agreement), (ii) a transferee of any such Acquiring Person, Associate or Affiliate who becomes a transferee after the Acquiring Person becomes such, or (iii) under certain circumstances specified in the Rights Agreement, a transferee of any such Acquiring Person, Associate or Affiliate who becomes a transferee prior to or concurrently with the Acquiring Person becoming such, such Rights shall become null and void and no holder hereof shall have any right with respect to such Rights from and after the occurrence of such Section 11(a)(ii) Event.

As provided in the Rights Agreement, the Purchase Price and the number of one-fiftieths of a Preferred Share or other securities which may be purchased upon the exercise of the Rights evidenced by this Right Certificate are subject to modification and adjustment upon the happening of certain events, including Triggering Events (as such term is defined in the Rights Agreement).

This Right Certificate is subject to all of the terms, provisions and conditions of the Rights Agreement, which terms, provisions and conditions are hereby incorporated herein by reference and made a part hereof and to which Rights Agreement reference is hereby made for a full description of the rights, limitations of rights, obligations, duties and immunities hereunder of the Rights Agent, the Corporation and the holders of the Right Certificates, which limitations of rights include the temporary suspension of the exercisability of such Rights under the specific circumstances set forth in the Rights Agreement. Copies of the Rights Agreement are on file at the principal executive offices of the Corporation and the principal office or offices of the Rights Agent.

This Right Certificate, with or without other Right Certificates, upon surrender at the principal office of the Rights Agent, may be exchanged for another Right Certificate or Right Certificates of like tenor and date evidencing Rights entitling the holder to purchase a like aggregate number of Preferred Shares or other securities as the Rights evidenced by the Right Certificate or Right Certificates surrendered shall have entitled such holder to purchase. If this Right Certificate shall be exercised in part, the holder shall be entitled to receive upon surrender hereof another Right Certificate or Right Certificates for the number of whole Rights not exercised.

Subject to the provisions of the Rights Agreement, the Rights evidenced by this Certificate may be redeemed by the Corporation at a redemption price of \$.01 per Right (subject to adjustment as provided in the Rights Agreement) payable in cash or Common Shares (as such term is defined in the Rights Agreement).

No fractional Preferred Shares will be issued upon the exercise of any Right or Rights evidenced hereby (other than fractions which are one-fiftieth or integral multiples of one-fiftieth of a Preferred Share, which may, at the election of the Corporation, be evidenced by depositary receipts), but in lieu thereof a cash payment will be made, as provided in the Rights Agreement.

No holder of this Right Certificate shall be entitled to vote or receive dividends or be deemed for any purpose the holder of the Preferred Shares or of any other securities of the Corporation which may at any time be issuable on the exercise hereof, nor shall anything contained in the Rights Agreement or herein be construed to confer upon the holder hereof, as such, any of the rights of a stockholder of the Corporation or any right to vote for the election of directors or upon any matter submitted to stockholders at any meeting thereof, or to give or withhold consent to any corporate action, or to receive notice of meetings or other actions affecting stockholders (except as provided in the Rights Agreement), or to receive dividends or other distributions or to exercise any preemptive or subscription rights, or otherwise, until the Right or Rights evidenced by this Right Certificate shall have been exercised as provided in the Rights Agreement.

This Right Certificate shall not be valid or obligatory for any purpose until it shall have been countersigned by the Rights Agent.



WITNESS the facsimile signature of the proper officers of the Corporation and its corporate seal. Dated as of \_\_\_\_\_, \_\_\_\_.

[SEAL]

ATTEST:

CHESAPEAKE UTILITIES CORPORATION

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

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

Countersigned:

BANKBOSTON, N.A.

By: \_\_\_\_\_  
Authorized Signatory  
Name:  
Title:

Form of Reverse Side of Right Certificate

FORM OF ASSIGNMENT

(To be executed by the registered holder if such holder desires to transfer the Right Certificate.)

FOR VALUE RECEIVED \_\_\_\_\_ hereby sells, assigns and transfers unto \_\_\_\_\_  
(Please print name and address of transferee)

this Right Certificate, together with all right, title and interest therein, and does hereby irrevocably constitute and appoint \_\_\_\_\_ Attorney, to transfer the within Right Certificate on the books of the within-named Corporation, with full power of substitution.

Dated: \_\_\_\_\_, \_\_\_\_

\_\_\_\_\_  
Signature

**Signature Guaranteed:**

Signatures must be guaranteed by a member firm or a registered national securities exchange, a member of the National Association of Securities Dealers, Inc., or a commercial bank or trust company having an office or correspondent in the United States.

The undersigned hereby certifies that (1) the Rights evidenced by this Right Certificate are not being sold, assigned or transferred by or on behalf of a Person who is or was an Acquiring Person or an Affiliate or Associate thereof (is such terms are defined in the Right Agreement) and (2) after due inquiry and to the best knowledge of the undersigned, the undersigned did not acquire the Rights evidenced by this Right Certificate from any Person who is or was an Acquiring Person or an Affiliate or Associate thereof (as such terms are defined in the Rights Agreement).

\_\_\_\_\_  
Signature

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**FORM OF ELECTION TO PURCHASE**

(To be executed by the registered holder if such holder desires to exercise Rights represented by the Right Certificate.)

**To the Rights Agent:**

The undersigned hereby irrevocably elects to exercise \_\_\_\_\_ Rights represented by this Right Certificate to purchase the Preferred Shares, Common Shares or other securities issuable upon the exercise of such Rights and requests that certificates for such Preferred Shares, Common Shares or other securities be issued in the name of:

Please insert social security or other identifying number \_\_\_\_\_

\_\_\_\_\_  
(Please print name and address)

If such number of Rights shall not be all the Rights evidenced by this Right Certificate, a new Right Certificate for the balance remaining of such Rights shall be registered in the name of and delivered to:

Please insert social security or other identifying number \_\_\_\_\_

\_\_\_\_\_  
(Please print name and address)

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Dated: \_\_\_\_\_

\_\_\_\_\_  
Signature

Signature Guaranteed:

Signatures must be guaranteed by a member firm of a registered national securities exchange, a member of the National Association of Securities Dealers, Inc., or a commercial bank or trust company having an office or correspondent in the United States.

The undersigned hereby certifies that (1) the Rights evidenced by this Right Certificate are not being exercised by or on behalf of a Person who is or was an Acquiring Person or an Affiliate or Associate thereof (as such terms are defined in the Rights Agreement) and (2) after due inquiry and to the best knowledge of the undersigned, the undersigned did not acquire the Rights evidenced by this Rights Certificate from any Person who is or was an Acquiring Person or an Affiliate or Associate thereof (as such terms are defined in the Rights Agreement).

\_\_\_\_\_  
Signature

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*NOTICE*

The signature on the foregoing Forms of Assignment and Election and certificates must conform to the name as written upon the face of this Right Certificate in every particular, without alteration or enlargement or any change whatsoever.

In the event the certification set forth above in the Form of Assignment or the Form of Election to Purchase, as the case may be, is not completed, the Corporation and the Rights Agent will deem the Beneficial Owner of the Rights evidenced by this Right Certificate to be an Acquiring Person or an Affiliate or Associate thereof (as such terms are defined in the Rights Agreement) and such Assignment or Election to Purchase will not be honored.

**SUMMARY OF RIGHTS TO PURCHASE  
PREFERRED SHARES**

On August 20, 1999, the Board of Directors of Chesapeake Utilities Corporation (the "*Corporation*") declared a dividend distribution of one preferred share purchase right (a "*Right*") for each outstanding share of Common Stock, par value \$0.48 2/3 per share (a "*Common Share*"), of the Corporation. The dividend is payable to the stockholders of record on September 3, 1999 (the "*Record Date*"). One Right also will be issued with each Common Share issued thereafter until the Distribution Date (as defined below) and, in certain circumstances, with each Common Share issued after the Distribution Date. Except as set forth below, each Right, when it becomes exercisable, entitles the registered holder to purchase from the Corporation one-fiftieth of a share of Series A Participating Cumulative Preferred Stock, par value \$.01 per share (the "*Preferred Shares*"), of the Corporation at a price of \$54.56 per one-fiftieth of a Preferred Share (the "*Purchase Price*"), subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "*Rights Agreement*") between the Corporation and BankBoston, N.A., as Rights Agent (the "*Rights Agent*"), dated as of August 20, 1999.

**Rights Are Evidenced by Common Share Certificates until Distribution Date**

Initially, the Rights will be attached to all certificates representing Common Shares then outstanding, and no separate Right Certificates will be distributed. The Rights will separate from the Common Shares upon the earliest to occur of (i) the date of a public announcement that a person or group of affiliated or associated persons have acquired beneficial ownership of 15% or more of the outstanding Common Shares (except pursuant to a tender or exchange offer that is for all outstanding Common Shares at a price and on terms which a majority of the members of the Board of Directors who are not employees of the Corporation and who are not affiliated with the Acquiring Person (as defined below) determines to be adequate and in the best interests of the Corporation and its stockholders other than such Acquiring Person and its affiliates and associates (a "*Permitted Offer*") or (ii) 10 days (or such later date as the Board may determine) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer the consummation of which would result in a person or group becoming an Acquiring Person (as hereinafter defined) (the earliest of such dates being called the "*Distribution Date*"). A person or group whose acquisition of Common Shares causes a Distribution Date pursuant to clause (i) above is an "*Acquiring Person*." The date that a person or group becomes an Acquiring Person is the "*Shares Acquisition Date*."

The Rights Agreement provides that, until the Distribution Date, the Rights will be transferred with and only with the Common Shares. Until the Distribution Date (or earlier redemption or expiration of the Rights), new Common Share certificates issued after the Record Date upon transfer or new issuance of Common Shares will contain a notation incorporating the Rights Agreement by reference. Until the Distribution Date (or earlier redemption or expiration of the Rights), the surrender for transfer of any certificates for Common Shares outstanding as of the Record Date, with or without such notation or a copy of this Summary of Rights being attached thereto, will also constitute the transfer of the Rights associated with the Common Shares represented by such certificate. As soon as practicable following the Distribution Date,

separate certificates evidencing the Rights ("*Right Certificates*") will be mailed to holders of record of the Common Shares as of the close of business on the Distribution Date (and to each initial record holder of certain Common Shares issued after the Distribution Date), and such separate Right Certificates alone will evidence the Rights.

### **Expiration of Rights**

The Rights are not exercisable until the Distribution Date and will expire at the close of business on August 20, 2009, unless earlier redeemed by the Corporation as described below.

### **Flip-In Events**

In the event that any person becomes an Acquiring Person (the "*Flip-In Event*"), each holder of a Right will thereafter have the right to receive, upon exercise, the number of Common Shares (or, in certain circumstances, other securities of the Corporation) having a value (immediately prior to such triggering event) equal to two times the exercise price of the Right. Notwithstanding the foregoing, following the occurrence of such an event, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by any Acquiring Person or any affiliate or associate thereof will be null and void.

### **Flip-Over Events**

A Flip-Over Event will occur in the event that, at any time following the Shares Acquisition Date, (i) the Corporation is involved in a merger or other business combination transaction (whether or not the Corporation is the surviving entity) with, or (ii) more than 50% of the Corporation's assets or earning power is sold or transferred to, in either case an Acquiring Person or any of its affiliates or associates or, if the holders of the outstanding Common Shares are not treated alike, any other entity. Upon the occurrence of a Flip-Over Event, each holder of a Right (except for the Rights of an Acquiring Person or any of its affiliates and associates which, as described above, shall have become null and void) generally shall have the right to receive, upon exercise, common shares of the acquiring company having a value equal to two times the exercise price of the Right.

### **Exchange Provision**

At any time after an Acquiring Person obtains 15% or more of the Common Shares and prior to the acquisition by an Acquiring Person of 50% or more of the outstanding Common Shares, the Board of Directors may elect to exchange the Rights (other than the Rights owned by the Acquiring Person and any of its affiliates and associates), in whole or in part, for Common Shares at an exchange ratio of one Common Share per Right (subject to adjustment).

### **Adjustment of the Purchase Price and Securities Issuable upon Exercise of Rights.**

The Purchase Price payable, and the number of Preferred Shares, Common Shares or other securities issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Shares, (ii) upon the grant to holders of the Preferred Shares of certain rights or warrants to subscribe for or purchase Preferred Shares at a price, or securities

convertible into Preferred Shares with a conversion price, less than the then current market price of the Preferred Shares, or (iii) upon the distribution to holders of the Preferred Shares of evidences of indebtedness or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above). With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments require an adjustment of at least 1% in the Purchase Price.

### **Terms of the Preferred Stock**

The Preferred Shares purchasable upon exercise of the Rights will not be redeemable. Each Preferred Share will be entitled to a minimum preferential quarterly dividend payment equal to the greater of (i) \$13.00 per share (or \$.26 per 1/50th of a Preferred Share) and (ii) an aggregate dividend per share of 50 times (subject to adjustment) the dividend declared per Common Share. In the event of liquidation, the holders of the Preferred Shares will be entitled to a minimum preferential liquidation payment of \$ 900.00 per share (or \$18.00 per 1/50th of a Preferred Share); thereafter, and after the holders of the Common Shares receive a liquidation payment of \$18.00 per share, the holders of the Preferred Shares and the holders of the Common Shares will share the remaining assets in the ratio of 50 (subject to adjustment) to one for each Preferred Share and Common Share so held, respectively. In the event of any merger, consolidation or other transaction in which Common Shares are exchanged, each Preferred Share will be entitled to receive 50 times (subject to adjustment) the amount received per Common Share. The holders of Preferred Shares will be entitled to vote on all matters submitted to a vote of the Common Shares (with the Preferred Shares being entitled to 50 votes per share). In the event that the amount of accrued and unpaid dividends on the Preferred Shares is equivalent to six full quarterly dividends or more, the holders of the Preferred Shares shall have the right, voting as a class, to elect two directors in addition to the directors elected by the holders of the Common Shares until all cumulative dividends on the Preferred Shares have been paid through the last quarterly dividend payment date. These rights are protected by customary antidilution provisions.

Because of the nature of the dividend, liquidation and voting rights of the Preferred Shares, the value of a one-fiftieth interest in a Preferred Share purchasable upon the exercise of a Right should approximate the value of one Common Share.

No fractional Preferred Shares will be issued (other than fractions which are one-fiftieth or integral multiples of one-fiftieth of a Preferred Share, which may, at the election of the Corporation, be evidenced by depositary receipts) and in lieu thereof, an adjustment in cash will be made based on the market price of the Preferred Shares.

### **Redemption of Rights**

At any time prior to the earlier to occur of (i) a person becoming an Acquiring Person or (ii) the expiration of the Rights, the Corporation may redeem the Rights in whole, but not in part, at a price of \$.01 per Right (the "Redemption Price"), which redemption shall be effective upon the action of the Board of Directors. Additionally, following a Flip-In Event and prior to a Flip-Over Event, the Corporation may redeem the then outstanding Rights in whole, but not in part, at the Redemption Price, *provided* that such redemption is in connection with a merger or other

business combination transaction or series of transactions involving the Corporation in which all holders of Common Shares are treated alike but not involving an Acquiring Person or any of its affiliates or associates.

#### **Amendment of Rights Agreement**

All of the provisions of the Rights Agreement may be amended by the Board of Directors of the Corporation at any time prior to the Distribution Date without the approval of the holders of the Rights. After the Distribution Date, the provisions of the Rights Agreement may be amended by the Board of Directors without the approval of the holders of the Rights to cure any ambiguity, defect or inconsistency or to make changes which do not adversely affect the interests of holders of Rights (excluding the interests of any Acquiring Person or its affiliates or associates).

\* \* \*

A copy of the Rights Agreement has been filed with the Securities and Exchange Commission as an Exhibit to a Registration Statement on Form 8-A, dated August \_\_, 1999. A copy of the Rights Agreement is available free of charge from the Corporation. This summary description of the Rights does not purport to be complete and is qualified in its entirety by reference to the Rights Agreement, which is hereby incorporated herein by reference.

**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, D.C. 20549

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**FORM 8-K**  
**CURRENT REPORT**

Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Date of Report (Date of earliest event reported): August 24, 1999

**CHESAPEAKE UTILITIES CORPORATION**

(Exact name of registrant as specified in its charter)

<b>Delaware</b>	<b>001-11590</b>	<b>51-0064146</b>
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification No.)

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

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

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(Former name, former address and former fiscal year, if changed since last report.)



## Item 5. Other Events.

On August 20, 1999, the Board of Directors of Chesapeake Utilities Corporation (the "*Corporation*") declared a dividend distribution of one preferred share purchase right (a "*Right*") for each outstanding share of Common Stock, par value \$0.48 2/3 per share (a "*Common Share*"), of the Corporation. The dividend is payable to the stockholders of record on September 3, 1999 (the "*Record Date*"). One Right also will be issued with each Common Share issued thereafter until the Distribution Date (as defined below) and, in certain circumstances, with each Common Share issued after the Distribution Date. Except as set forth below, each Right, when it becomes exercisable, entitles the registered holder to purchase from the Corporation one-fiftieth of a share of Series A Participating Cumulative Preferred Stock, par value \$.01 per share (the "*Preferred Shares*"), of the Corporation at a price of \$54.56 per one-fiftieth of a Preferred Share (the "*Purchase Price*"), subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "*Rights Agreement*") between the Corporation and BankBoston, N.A., as Rights Agent (the "*Rights Agent*"), dated as of August 20, 1999.

The following summary of the material terms of the Rights Agreement is a general description only and is subject to the detailed terms and conditions set forth in the Rights Agreement. A copy of the Rights Agreement is attached as Exhibit 4.1 to this Form 8-K, and is hereby incorporated herein by reference.

### Rights Are Evidenced by Common Share Certificates until Distribution Date

Initially, the Rights will be attached to all certificates representing Common Shares then outstanding, and no separate Right Certificates will be distributed. The Rights will separate from the Common Shares upon the earliest to occur of (i) the date of a public announcement that a person or group of affiliated or associated persons have acquired beneficial ownership of 15% or more of the outstanding Common Shares (except pursuant to a tender or exchange offer that is for all outstanding Common Shares at a price and on terms which a majority of the members of the Board of Directors who are not employees of the Corporation and who are not affiliated with the Acquiring Person (as defined below) determines to be adequate and in the best interests of the Corporation and its stockholders other than such Acquiring Person and its affiliates and associates (a "*Permitted Offer*") or (ii) 10 days (or such later date as the Board may determine) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer the consummation of which would result in a person or group becoming an Acquiring Person (as hereinafter defined) (the earliest of such dates being called the "*Distribution Date*"). A person or group whose acquisition of Common Shares causes a Distribution Date pursuant to clause (i) above is an "*Acquiring Person*." The date that a person or group becomes an Acquiring Person is the "*Shares Acquisition Date*."

The Rights Agreement provides that, until the Distribution Date, the Rights will be transferred with and only with the Common Shares. Until the Distribution Date (or earlier redemption or expiration of the Rights), new Common Share certificates issued after the Record Date upon transfer or new issuance of Common Shares will contain a notation incorporating the Rights Agreement by reference. Until the Distribution Date (or earlier redemption or expiration of the Rights), the surrender for transfer of any certificates for Common Shares outstanding as of the Record Date, with or without such notation or a copy of this Summary of Rights being attached thereto, will also constitute the transfer of the Rights associated with the Common Shares represented by such certificate. As soon as practicable following the Distribution Date, separate certificates evidencing the Rights ("*Right Certificates*") will be mailed to holders of record of the Common Shares as of the close of business on the Distribution Date (and to each initial record holder of certain Common Shares issued after the Distribution Date), and such separate Right Certificates alone will evidence the Rights.

### Expiration of Rights

The Rights are not exercisable until the Distribution Date and will expire at the close of business on August 20, 2009, unless earlier redeemed by the Corporation as described below.

### Flip-In Events

In the event that any person becomes an Acquiring Person (the "Flip-In Event"), each holder of a Right will thereafter have the right to receive, upon exercise, the number of Common Shares (or, in certain circumstances, other securities of the Corporation) having a value (immediately prior to such triggering event) equal to two times the exercise price of the Right. Notwithstanding the foregoing, following the occurrence of such an event, all Rights that are, or (under certain circumstances specified in the Rights Agreement) were, beneficially owned by any Acquiring Person or any affiliate or associate thereof will be null and void.

### Flip-Over Events

A Flip-Over Event will occur in the event that, at any time following the Shares Acquisition Date, (i) the Corporation is involved in a merger or other business combination transaction (whether or not the Corporation is the surviving entity) with, or (ii) more than 50% of the Corporation's assets or earning power is sold or transferred to, in either case an Acquiring Person or any of its affiliates or associates or, if the holders of the outstanding Common Shares are not treated alike, any other entity. Upon the occurrence of a Flip-Over Event, each holder of a Right (except for the Rights of an Acquiring Person or any of its affiliates and associates which, as described above, shall have become null and void) generally shall have the right to receive, upon exercise, common shares of the acquiring company having a value equal to two times the exercise price of the Right.

### Exchange Provision

At any time after an Acquiring Person obtains 15% or more of the Common Shares and prior to the acquisition by an Acquiring Person of 50% or more of the outstanding Common Shares, the Board of Directors may elect to exchange the Rights (other than the Rights owned by the Acquiring Person and any of its affiliates and associates), in whole or in part, for Common Shares at an exchange ratio of one Common Share per Right (subject to adjustment).

### Adjustment of the Purchase Price and Securities Issuable upon Exercise of Rights.

The Purchase Price payable, and the number of Preferred Shares, Common Shares or other securities issuable, upon exercise of the Rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Shares, (ii) upon the grant to holders of the Preferred Shares of certain rights or warrants to subscribe for or purchase Preferred Shares at a price, or securities convertible into Preferred Shares with a conversion price, less than the then current market price of the Preferred Shares, or (iii) upon the distribution to holders of the Preferred Shares of evidences of indebtedness or assets (excluding regular quarterly cash dividends) or of subscription rights or warrants (other than those referred to above). With certain exceptions, no adjustment in the Purchase Price will be required until cumulative adjustments require an adjustment of at least 1% in the Purchase Price.

### Terms of the Preferred Stock

The Preferred Shares purchasable upon exercise of the Rights will not be redeemable. Each Preferred Share will be entitled to a minimum preferential quarterly dividend payment equal to the greater of (i) \$13.00 per share (or \$.26 per 1/50th of a Preferred Share) and (ii) an aggregate dividend per share of 50 times Share (subject to adjustment) the dividend declared per Common. In the event of liquidation, the holders of the Preferred Shares will be entitled to a minimum preferential liquidation payment of \$ 900.00 per share (or \$18.00 per 1/50th of a Preferred Share); thereafter, and after the holders of the Common Shares receive a liquidation payment of \$18.00 per share, the holders of the Preferred Shares and the holders of the Common Shares will share the remaining assets in the ratio of 50 (subject to adjustment) to one for each Preferred Share and Common Share so held, respectively. In the event of any merger, consolidation or other transaction in which Common Shares are exchanged, each Preferred Share will be entitled to receive 50 times (subject to adjustment) the amount received per Common Share. The holders of Preferred Shares will be entitled to

vote on all matters submitted to a vote of the Common Shares (with the Preferred Shares being entitled to 50 votes per share). In the event that the amount of accrued and unpaid dividends on the Preferred Shares is equivalent to six full quarterly dividends or more, the holders of the Preferred Shares shall have the right, voting as a class, to elect two directors in addition to the directors elected by the holders of the Common Shares until all cumulative dividends on the Preferred Shares have been paid through the last quarterly dividend payment date. These rights are protected by customary antidilution provisions.

Because of the nature of the dividend, liquidation and voting rights of the Preferred Shares, the value of a one-fiftieth interest in a Preferred Share purchasable upon the exercise of a Right should approximate the value of one Common Share.

No fractional Preferred Shares will be issued (other than fractions which are one-fiftieth or integral multiples of one-fiftieth of a Preferred Share, which may, at the election of the Corporation, be evidenced by depositary receipts) and in lieu thereof, an adjustment in cash will be made based on the market price of the Preferred Shares.

Because of the nature of the dividend, liquidation and voting rights of the Preferred Shares, the value of a one-fiftieth interest in a Preferred Share purchasable upon the exercise of a Right should approximate the value of one Common Share.

#### Redemption of Rights

At any time prior to the earlier to occur of (i) a person becoming an Acquiring Person or (ii) the expiration of the Rights, the Corporation may redeem the Rights in whole, but not in part, at a price of \$.01 per Right (the "Redemption Price"), which redemption shall be effective upon the action of the Board of Directors. Additionally, following a Flip-In Event and prior to a Flip-Over Event, the Corporation may redeem the then outstanding Rights in whole, but not in part, at the Redemption Price, provided that such redemption is in connection with a merger or other business combination transaction or series of transactions involving the Corporation in which all holders of Common Shares are treated alike but not involving an Acquiring Person or any of its affiliates or associates.

#### Amendment of Rights Agreement

All of the provisions of the Rights Agreement may be amended by the Board of Directors of the Corporation at any time prior to the Distribution Date without the approval of the holders of the Rights. After the Distribution Date, the provisions of the Rights Agreement may be amended by the Board of Directors without the approval of the holders of the Rights to cure any ambiguity, defect or inconsistency or to make changes which do not adversely affect the interests of holders of Rights (excluding the interests of any Acquiring Person or its affiliates or associates).

#### **Item 7. Financial Statement Exhibits.**

- (a) Not applicable
- (b) Not applicable
- (c) Exhibits

4.1 Rights Agreement, dated as of August 20, 1999, between Chesapeake Utilities Corporation and BankBoston, N.A., as Rights Agent, including (i) the form of Certificate of Voting Powers, Designations, Preferences and Rights of Series A Participating Cumulative Preferred Stock attached thereto as Exhibit A, (ii) the form of Rights Certificate attached thereto as Exhibit B, and (iii) the Summary of Rights to Purchase Preferred Shares attached thereto as Exhibit C.

**SIGNATURE**

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 hereunto duly authorized.

**CHESAPEAKE UTILITIES CORPORATION**

By: /s/ JOHN R. SCHIMKAITIS  
John R. Schimkaitis  
President and Chief Executive Officer

Dated: August 24, 1999