CHESAPEAKE UTILITIES CORP
Form 10-Q
November 09, 2006

United States
Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended: September 30, 2006

OR

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

For the transition period from ______ to ______

Commission File Number: 001-11590

Chesapeake Utilities Corporation
(Exact name of registrant as specified in its charter)

Delaware	**51-0064146**
(State or other jurisdiction of incorporation or organization)	(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 [X] No [ ]

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

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

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

Common Stock, par value $0.4867 — 5,990,582 shares outstanding as of October 31, 2006.

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

For the Three Months Ended September 30,		2006		2005
Operating Revenues	$	**35,141,530**	$	35,155,121
Operating Expenses				
Cost of sales, excluding costs below		**21,758,558**		21,957,971
Operations		**9,446,616**		9,815,819
Maintenance		**513,356**		461,586
Depreciation and amortization		**2,044,179**		1,889,266
Other taxes		**1,216,684**		1,129,628
Total operating expenses		**34,979,393**		35,254,270
Operating Income (Loss)		**162,137**		(99,149)
Other income (loss) net of other expenses		**(12,091)**		19,493
Interest charges		**1,340,879**		1,272,196
Loss Before Income Taxes		**(1,190,833)**		(1,351,852)
Income taxes		**(534,254)**		(658,078)
Net Loss		**($656,579)**		($693,774)
Earnings Per Share of Common Stock:				
Basic		**($0.11)**		($0.12)
Diluted		**($0.11)**		($0.12)
Basic weighted average shares outstanding		**5,973,149**		5,851,926
Diluted weighted average shares outstanding		**5,973,149**		5,851,926
Cash Dividends Declared Per Share of Common Stock:	$	**0.290**	$	0.285

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

For the Nine Months Ended September 30,		**2006**		**2005**
Operating Revenues	**$**	**170,395,955**	$	155,220,745
Operating Expenses				
Cost of sales, excluding costs below		**116,188,846**		101,453,132
Operations		**27,899,729**		29,325,623
Maintenance		**1,540,963**		1,279,820
Depreciation and amortization		**6,058,529**		5,701,357
Other taxes		**3,903,155**		3,730,674
Total operating expenses		**155,591,222**		141,490,606
Operating Income		**14,804,733**		13,730,139
Other income net of other expenses		**130,208**		330,354
Interest charges		**4,335,568**		3,823,140
Income Before Income Taxes		**10,599,373**		10,237,353
Income taxes		**4,027,027**		3,902,407
Net Income	**$**	**6,572,346**	$	6,334,946
Earnings Per Share of Common Stock:				
Basic	**$**	**1.11**	$	1.09
Diluted	**$**	**1.10**	$	1.07
Basic weighted average shares outstanding		**5,945,119**		5,823,144
Diluted weighted average shares outstanding		**6,069,893**		5,982,303
Cash Dividends Declared Per Share of Common Stock:	**$**	**0.865**	$	0.850

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

For the Nine Months Ended September 30,	**2006**	**2005**
Operating Activities		
Net Income	**$ 6,572,346**	$ 6,334,946
Adjustments to reconcile net income to net operating cash:		
Depreciation and amortization	**6,058,529**	5,701,357
Depreciation and accretion included in other costs	**2,288,509**	2,006,726
Deferred income taxes, net	**(2,304,070)**	(922,437)
Unrealized loss on commodity contracts	**(708,915)**	(630,560)
Unrealized loss on investments	**(65,810)**	(18,866)
Employee benefits and compensation	**1,344,924**	1,333,363
Other, net	**(3,085)**	(2,508)
Changes in assets and liabilities:		
Purchase of investments	**(120,476)**	(1,183,889)
Accounts receivable and accrued revenue	**17,284,220**	4,828,374
Propane inventory, storage gas and other inventory	**(1,477,854)**	(5,432,158)
Regulatory assets	**3,729,326**	686,281
Prepaid expenses and other current assets	**(770,470)**	(478,960)
Other deferred charges	**35,101**	(40,790)
Long-term receivables	**108,608**	141,221
Accounts payable and other accrued liabilities	**(19,769,594)**	3,077,798
Income taxes receivable	**3,123,440**	92,961
Accrued interest	**1,024,865**	897,341
Customer deposits and refunds	**767,474**	305,828
Accrued compensation	**(842,766)**	108,798
Regulatory liabilities	**2,785,999**	1,999,921
Other liabilities	**(85,854)**	148,823
Net cash provided by operating activities	**18,974,447**	18,953,570
Investing Activities		
Property, plant and equipment expenditures	**(28,335,269)**	(19,940,043)
Environmental recoveries (expenditures)	**(9,625)**	205,689
Net cash used by investing activities	**(28,344,894)**	(19,734,354)

Financing Activities				
Common stock dividends		**(4,462,307)**		(4,334,573)
Issuance of stock for Dividend Reinvestment Plan		**228,352**		282,453
Cash settlement of warrants		**(434,782)**		-
Change in cash overdrafts due to outstanding checks		**1,042,051**		842,674
Net borrowing under line of credit agreements		**14,790,072**		4,779,169
Repayment of long-term debt		**(1,929,619)**		(1,794,596)
Net cash provided (used) by financing activities		**9,233,767**		(224,873)
Net Decrease in Cash and Cash Equivalents		**(136,680)**		(1,005,657)
Cash and Cash Equivalents — Beginning of Period		**2,487,658**		1,611,761
Cash and Cash Equivalents — End of Period	**$**	**2,350,978**	$	606,104
Supplemental Disclosures of Non-Cash Investing Activities:				
Capital property and equipment acquired on account, but not paid as of September 30	**$**	**4,291,387**	**$**	**68,504**

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

Assets	September 30, 2006	December 31, 2005
Property, Plant and Equipment		
Natural gas distribution and transmission	**$ 238,607,537**	$ 220,685,461
Propane	**43,174,349**	41,563,810
Advanced information services	**951,500**	1,221,177
Other plant	**9,110,426**	9,275,729
Total property, plant and equipment	**291,843,812**	272,746,177
Less: Accumulated depreciation and amortization	**(83,605,340)**	(78,840,413)
Plus: Construction work in progress	**17,711,608**	7,598,531
Net property, plant and equipment	**225,950,080**	201,504,295
Investments	**1,871,921**	1,685,635
Current Assets		
Cash and cash equivalents	**2,350,978**	2,487,658
Accounts receivable (less allowance for uncollectible accounts of $849,292 and $861,378, respectively)	**39,638,501**	54,284,011
Accrued revenue	**2,077,674**	4,716,383
Propane inventory, at average cost	**7,462,209**	6,332,956
Other inventory, at average cost	**1,580,509**	1,538,936
Regulatory assets	**633,663**	4,434,828
Storage gas prepayments	**8,935,207**	8,628,179
Income taxes receivable	**-**	2,725,840
Deferred income taxes	**1,643,394**	-
Prepaid expenses	**2,780,135**	2,021,164
Other current assets	**3,189,770**	1,596,797
Total current assets	**70,292,040**	88,766,752
Deferred Charges and Other Assets		
Goodwill	**674,451**	674,451
Other intangible assets, net	**195,329**	205,683
Long-term receivables	**852,826**	961,434
Other regulatory assets	**1,194,483**	1,178,232
Other deferred charges	**930,265**	1,003,393
Total deferred charges and other assets	**3,847,354**	4,023,193
Total Assets	**$ 301,961,395**	$ 295,979,875

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Balance Sheets (Unaudited)

Capitalization and Liabilities	**September 30, 2006**	**December 31, 2005**
Capitalization		
Stockholders' equity		
Common Stock, par value $0.4867 per share (authorized 12,000,000 shares) [(1)]	**$ 2,910,261**	$ 2,863,212
Additional paid-in capital	**41,927,856**	39,619,849
Retained earnings	**44,276,164**	42,854,894
Accumulated other comprehensive income	**(578,151)**	(578,151)
Deferred compensation obligation	**1,104,670**	794,535
Treasury stock	**(1,104,670)**	(797,156)
Total stockholders' equity	**88,536,130**	84,757,183
Long-term debt, net of current maturities	**56,792,273**	58,990,363
Total capitalization	**145,328,403**	143,747,546
Current Liabilities		
Current portion of long-term debt	**4,929,091**	4,929,091
Short-term borrowing	**51,314,364**	35,482,241
Accounts payable	**27,994,213**	45,645,228
Customer deposits and refunds	**5,908,474**	5,140,999
Accrued interest	**1,583,586**	558,719
Dividends payable	**1,733,280**	1,676,398
Income taxes payable	**397,600**	-
Deferred income taxes	**-**	1,150,828
Accrued compensation	**2,652,758**	3,793,244
Regulatory liabilities	**3,801,066**	550,546
Other accrued liabilities	**5,431,341**	3,560,055
Total current liabilities	**105,745,773**	102,487,349
Deferred Credits and Other Liabilities		
Deferred income taxes	**24,738,777**	24,248,624
Deferred investment tax credits	**325,973**	367,085
Other regulatory liabilities	**1,590,010**	2,008,779
Environmental liabilities	**241,538**	352,504
Accrued pension costs	**3,126,275**	3,099,882
Accrued asset removal cost	**18,057,163**	16,727,268
Other liabilities	**2,807,483**	2,940,838
Total deferred credits and other liabilities	**50,887,219**	49,744,980

Commitments and Contingencies ***(Note 4)***				
Total Capitalization and Liabilities	**$**	**301,961,395**	$	295,979,875

(1) Shares issued were 5,979,769 and 5,883,099 for 2006 and 2005, respectively.
Shares outstanding were 5,979,769 and 5,883,002 for 2006 and 2005, respectively.

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Stockholders' Equity (Unaudited)

		For the Nine Months Ended September 30, 2006		For the Twelve Months Ended December 31, 2005
Common Stock				
Balance — beginning of period	$	**2,863,212**	$	2,812,538
Dividend Reinvestment Plan		**13,664**		20,038
Retirement Savings Plan		**11,161**		10,255
Conversion of debentures		**7,688**		11,004
Performance shares and options exercised		**14,536**		9,377
Balance — end of period	$	**2,910,261**	$	2,863,212
Additional Paid-in Capital				
Balance — beginning of period	$	**39,619,849**	$	36,854,717
Dividend Reinvestment Plan		**846,573**		1,224,874
Retirement Savings Plan		**700,506**		682,829
Conversion of debentures		**260,784**		373,259
Performance shares and options exercised		**887,426**		484,170
Exercise of warrants		**(387,282)**		-
Balance — end of period	$	**41,927,856**	$	39,619,849
Retained Earnings				
Balance — beginning of period	$	**42,854,894**	$	39,015,087
Net income		**6,572,346**		10,467,614
Cash dividends declared		**(5,151,076)**		(6,627,807)
Balance — end of period	$	**44,276,164**	$	42,854,894
Accumulated Other Comprehensive Income				
Balance — beginning of period		**($578,151)**		(527,246)
Minimum pension liability adjustment, net of tax		**-**		(50,905)
Balance — end of period		**($578,151)**		($578,151)
Deferred Compensation Obligation				
Balance — beginning of period	$	**794,535**	$	816,044
New deferrals		**310,135**		130,426
Payout of deferred compensation		**-**		(151,935)
Balance — end of period	$	**1,104,670**	$	794,535
Treasury Stock				
Balance — beginning of period		**($797,156)**		($1,008,696)
		(310,135)		(130,426)

New deferrals related to compensation obligation				
Purchase of treasury stock [1]		**(37,719)**		(182,292)
Sale and distribution of treasury stock [2]		**40,340**		524,258
Balance — end of period		**($1,104,670)**		($797,156)
Total Stockholders' Equity	**$**	**88,536,130**	$	84,757,183

(1) Amount includes shares purchased in the open market for the Company's Rabbi Trust to secure it's obligations under the Company's Supplemental Executive Retirement Savings Plan ("SERP plan").

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

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

Chesapeake Utilities Corporation and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

	For the Nine Months Ended September 30, 2006	For the Twelve Months Ended December 31, 2005
Net income	**$ 6,572,346**	$ 10,467,614
Minimum pension liability adjustment, net of tax benefit of $33,615	**-**	(50,905)
Comprehensive Income	**$ 6,572,346**	$ 10,416,709

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

Notes to the Condensed Consolidated Financial Statements

1. Basis of Presentation

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

The accompanying unaudited consolidated financial statements have been prepared in compliance with the rules and regulations of the Securities and Exchange Commission ("SEC") and United States of America Generally Accepted Accounting Principles ("GAAP"). In accordance with these rules and regulations, certain information and disclosures normally required for audited financial statements have been condensed or omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto, included in the Company's latest Annual Report on Form 10-K for the year ended December 31, 2005 filed on March 7, 2006. In the opinion of management, these statements reflect normal recurring adjustments that are necessary for a fair presentation of the Company's results of operations, financial position and cash flows for the interim periods presented.

2. Comprehensive Income (Loss)

Comprehensive income contains items that are excluded from "net income (loss)" and recorded directly to stockholders' equity. Chesapeake did not have any adjustments to the components of comprehensive income that are required to be reported by Financial Accounting Standards Board ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income," for the three and nine months ended September 30 2006 and 2005. Accumulated other comprehensive income was ($578,151) at September 30, 2006 and December 31, 2005 and ($527,246) at September 30, 2005 and December 31, 2004.

3. Calculation of Earnings Per Share ("EPS")

For the Periods Ended September 30,	Three Months Ended 2006	Three Months Ended 2005	Nine Months Ended 2006	Nine Months Ended 2005
Calculation of Basic Earnings Per Share:				
Net Income (Loss)	**($656,579)**	($693,774)	**$ 6,572,346**	$ 6,334,946
Weighted average shares outstanding	**5,973,149**	5,851,926	**5,945,119**	5,823,144
Basic Earnings Per Share	**($0.11)**	($0.12)	**$ 1.11**	$ 1.09
Calculation of Diluted Earnings Per Share:				
Reconciliation of Numerator:				
Net Income (Loss)	**($656,579)**	($693,774)	**$ 6,572,346**	$ 6,334,946
Effect of 8.25% Convertible debentures (1)	**-**	-	**79,900**	94,441
Adjusted numerator — Diluted	**($656,579)**	($693,774)	**$ 6,652,246**	$ 6,429,387

Reconciliation of Denominator:				
Weighted shares outstanding — Basic	**5,973,149**	5,851,926	**5,945,119**	5,823,144
Effect of dilutive securities [1]				
Stock options	**-**	-	**-**	371
Warrants	**-**	-	**-**	11,262
8.25% Convertible debentures	**-**	-	**124,774**	147,526
Adjusted denominator — Diluted	**5,973,149**	5,851,926	**6,069,893**	5,982,303
Diluted Earnings per Share	**($0.11)**	($0.12)	**$ 1.10**	$ 1.07

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

4. Commitments and Contingencies

Environmental Matters

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

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

Dover Gas Light Site

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

The Company has reviewed its remediation costs incurred to date for the Dover Gas Light site and has concluded that all costs incurred have been paid. The Company does not expect any future environmental expenditures for this site. Through September 30, 2006, the Company has incurred approximately $9.7 million in costs related to environmental testing and remedial action studies at the site. Approximately $10.0 million has been recovered through September 2006 from other parties or through rates. As of September 30, 2006, a regulatory liability of approximately $343,000, representing the over-recovery portion of the clean-up costs, has been recorded. The over-recovery is temporary and will be refunded by the Company to customers in future rates.

Salisbury Town Gas Light Site

In cooperation with the MDE, the Company has completed remediation of the Salisbury Town Gas Light site, located in Salisbury, Maryland, where it was determined that a former manufactured gas plant had caused localized ground-water contamination. During 1996, the Company completed construction and began Air Sparging and Soil-Vapor Extraction ("AS/SVE") remediation procedures. Chesapeake has been reporting the remediation and monitoring results to the MDE on an ongoing basis since 1996. In February 2002, the MDE granted permission to permanently decommission the AS/SVE system and to discontinue all on-site and off-site well monitoring, except for one well that is being maintained for continued product monitoring and recovery. In November 2002, Chesapeake submitted a letter to the MDE requesting a No Further Action determination. The Company has been in discussions with the MDE regarding such request and is awaiting a determination from the MDE.

Through September 30, 2006, the Company has incurred approximately $2.9 million for remedial actions and environmental studies at the Salisbury Town Gas Light site. Of this amount, approximately $1.8 million has been recovered through insurance proceeds or in rates. On September 26, 2006, the Company received approval from the Maryland Public Service Commission to recover through its rates charged to customers the remaining $1.1 million of the incurred environmental remediation costs.

Winter Haven Coal Gas Site

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

The Company has accrued a liability of $242,000 as of September 30, 2006 for the Winter Haven Coal Gas site. Through September 30, 2006, the Company has incurred approximately $1.6 million of environmental costs associated with this site. At September 30, 2006, the Company had collected $102,000 through rates in excess of costs incurred. A regulatory asset of approximately $140,000, representing the uncollected portion of the estimated clean-up costs, has also been recorded. The Company expects to recover the remaining costs through rates.

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

Other

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

Other Commitments and Contingencies

Natural Gas and Propane Supply

The Company’s natural gas and propane distribution operations have entered into contractual commitments to purchase gas from various suppliers. The contracts have various expiration dates. In November 2004, the Company renewed its contract with an energy marketing and risk management company to manage a portion of the Company’s natural gas transportation and storage capacity. The contract expires March 31, 2007.

Corporate Guarantees

The Company has issued corporate guarantees to certain vendors of its propane wholesale marketing subsidiary, its Florida natural gas marketing subsidiary, and Delmarva propane distribution subsidiary. These corporate guarantees provide for the payment of propane and natural gas purchases in the event of the subsidiaries' default. The liabilities for these purchases are recorded in the Consolidated Financial Statements. The aggregate amount guaranteed at September 30, 2006, totaled $18.9 million, with the guarantees expiring on various dates in 2006 and 2007.

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

Application of SFAS No. 71

Certain assets and liabilities of the Company are accounted for in accordance with SFAS No. 71 ¾"Accounting for the Effects of Certain Types of Regulation." SFAS No. 71 provides guidance for public utilities and other regulated operations where the rates (prices) charged to customers are subject to regulatory review and approval. Regulators sometimes include allowable costs in a period other than the period in which the costs would be charged to expense by an unregulated enterprise. That procedure can create assets, reduce assets, or create liabilities for the regulated enterprise. For financial reporting, an incurred cost for which a regulator permits recovery in a future period is accounted for like an incurred cost that is reimbursable under a cost-reimbursement type contract. The Company believes that all regulatory assets as of September 30, 2006 are probable of recovery through rates. If the Company were required to terminate the application of SFAS No. 71 to its regulated operations, all such deferred amounts would be recognized in the income statement at that time. This would result in a charge to earnings, net of applicable income taxes, that could be material.

Other

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

5. Recent Authoritative Pronouncements on Financial Reporting and Accounting

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

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

In September 2006, the FASB issued Statement No. 157, “Fair Value Measurements ” (“SFAS No. 157”), which clarifies that the term fair value is intended to mean a market-based measure, not an entity-specific measure and gives the highest priority to quoted prices in active markets in determining fair value. SFAS No. 157 requires disclosures about (1) the extent to which companies measure assets and liabilities at fair value, (2) the methods and assumptions used to measure fair value, and (3) the effect of fair value measures on earnings. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is continuing to evaluate the impact of this new standard, if any, on the Company’s financial statements.

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans — an amendment of FASB Statements No. 87, 88, 106 and 132(R).” This statement would require a company to (a) recognize in its statement of financial position an asset for a plan’s overfunded status or a liability for a plan’s underfunded status, (b) measure a plan’s assets and its obligations that determine its funded status as of the end of the employer’s fiscal year, and (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur and to report the changes as adjustments to comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006. The requirement to measure the plan assets and benefit obligations as of the date of the employer’s fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2006. The Company does not anticipate that the adoption of SFAS No. 158 will have a material impact on the Company’s financial position, and anticipates no impact to the statements of income or cash flows.

In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements” (“SAB 108”), which provides interpretive guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 is effective as of the end of our 2006 fiscal year, allowing a one-time transitional cumulative effect adjustment to beginning retained earnings as of January 1, 2006, for errors that were not previously deemed material, but are material under the guidance in SAB 108. The Company does not anticipate that the adoption of SAB 108 will have a material impact on our Consolidated Financial Statements.

6. Segment Information

Chesapeake uses the management approach to identify operating segments. Chesapeake organizes its business around differences in products or services and the operating results of each segment are regularly reviewed by the Company's chief operating decision maker in order to make decisions about resources and to assess performance. The following table presents information about the Company's reportable segments.

For the Periods Ended Septe	Three Months Ended	Nine Months Ended