

CHESAPEAKE UTILITIES CORP

Form 10-K

March 06, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended: December 31, 2013

Commission File Number: 001-11590

CHESAPEAKE UTILITIES CORPORATION

(Exact name of registrant as specified in its charter)

State of Delaware

(State or other jurisdiction of  
incorporation or organization)

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:

Title of each class

Common Stock—par value per share \$0.4867

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

8.25% Convertible Debentures Due 2014

(Title of class)

51-0064146

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

Name of each exchange on which registered  
New York Stock Exchange, Inc.

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes . No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) 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.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "accelerated filer," "large accelerated filer" and "smaller reporting

company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller Reporting Company

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

The aggregate market value of the common shares held by non-affiliates of Chesapeake Utilities Corporation as of June 30, 2013, the last business day of its most recently completed second fiscal quarter, based on the last trade price on that date, as reported by the New York Stock Exchange, was approximately \$473.7 million.

As of February 28, 2014 9,669,772 shares of common stock were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the 2014 Annual Meeting of Stockholders are incorporated by reference in Part II and Part III.

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GLOSSARY OF DEFINITIONS

401(k) SERP: Supplemental Executive Retirement Savings Plan

AFUDC: Allowance for funds used during construction

ASC: Accounting Standards Codification

ASU: Accounting Standards Update

Austin Cox: Austin Cox Home Services, Inc.

BravePoint: BravePoint®, Inc., our advanced information services subsidiary, headquartered in Norcross, Georgia

Calpine: Calpine Energy Services, L.P.

CDD: Cooling degree-days, which is the measure of the variation in weather based on the extent to which the daily average temperature (from 10:00 am to 10:00 am) is above 65 degrees Fahrenheit

Chesapeake: Chesapeake Utilities Corporation, its divisions and its subsidiaries, as appropriate in the context of the disclosure

Chesapeake Service Company: Chesapeake Service Company, a subsidiary of Chesapeake and the parent company of Skipjack, BravePoint, CIC and ESRE

Chesapeake Pension Plan: A defined benefit pension plan sponsored by Chesapeake

Chesapeake Postretirement Plan: An unfunded postretirement health care and life insurance plan sponsored by Chesapeake

Chesapeake SERP: An unfunded supplemental executive retirement pension plan sponsored by Chesapeake

CIC: Chesapeake Investment Company is an affiliated investment company incorporated in Delaware

Columbia: Columbia Gas Transmission, LLC

Company: Chesapeake Utilities Corporation, its divisions and its subsidiaries, as appropriate in the context of the disclosure

CP: Certificate of Public Convenience and Necessity

Crescent: Crescent Propane, Inc.

Deferred Compensation Plan: A non-qualified, deferred compensation arrangement under which certain of our executives and members of the Board of Directors are able to defer payment of all or a part of certain specified types of compensation, including executive cash bonuses, executive performance shares, and directors' retainers and fees

Delmarva Peninsula: A peninsula on the east coast of the United States of America occupied by Delaware and portions of Maryland and Virginia

Dodd-Frank Act: The Dodd-Frank Wall Street Reform and Consumer Protection Act

DPA: Delaware Division of the Public Advocate

DSCP: Directors Stock Compensation Plan

Dt: Dekatherm, which is a natural gas unit of measurement that includes a standard measure for heating value

Dts/d: Dekatherms per day

Eastern Shore: Eastern Shore Natural Gas Company, a wholly-owned natural gas transmission subsidiary of Chesapeake

EGWIC: Eastern Gas & Water Investment Company, LLC, an affiliate of Eastern Shore Gas Company

EPA: United States Environmental Protection Agency

ESG: Eastern Shore Gas Company and its affiliates

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ESRE: Eastern Shore Real Estate, Inc., a subsidiary that owns and leases office buildings in Delaware and Maryland to affiliates of Chesapeake.

FASB: Financial Accounting Standards Board

FERC: Federal Energy Regulatory Commission, an independent agency of the Federal government that regulates the interstate transmission of electricity, natural gas, and oil

FDEP: Florida Department of Environmental Protection

FDOT: Florida Department of Transportation

FGT: Florida Gas Transmission Company

Flo-gas: Flo-gas Corporation, a subsidiary of FPU

Fort Meade: The natural gas system purchased by FPU from the City of Fort Meade, Florida

FPU: Florida Public Utilities Company, a wholly-owned subsidiary of Chesapeake as of October 28, 2009, the date we acquired FPU

FPU Medical Plan: A separate unfunded postretirement medical plan for FPU sponsored by Chesapeake

FPU Pension Plan: A separate defined benefit pension plan for FPU sponsored by Chesapeake

FRP: Fuel Retention Percentage

GAAP: Accounting principles generally accepted in the United States of America

Glades: Glades Gas Co., Inc.

GRIP: Gas Reliability Infrastructure Program, which is a surcharge to natural gas customers designed to recover capital and other program-related costs, inclusive of an appropriate return on investment, associated with accelerating the replacement of qualifying distribution mains and services in Florida

GSR: Gas Service Rates

Gulf: Columbia Gulf Transmission Company

Gulf Power: Gulf Power Company

Gulfstream: Gulfstream Natural Gas System, LLC

HDD: Heating degree-days, which is a measure of the variation in weather based on the extent to which the daily average temperature (from 10:00 am to 10:00 am) is below 65 degrees Fahrenheit

IFRS: International Financial Accounting Standards

IGC: Indiantown Gas Company

IRS: Internal Revenue Service

Marianna Commission: The City Commission of Marianna, Florida

MDE: Maryland Department of Environment

MGP: Manufactured gas plant, which is a site where coal was previously used to manufacture gaseous fuel for industrial, commercial and residential use

MWH: Megawatt hour, which is a unit of measurement for electricity

NAM: Natural Attenuation Monitoring

Note Agreement: Note Purchase Agreement entered into by Chesapeake with Note Holders on September 5, 2013

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Note Holders: PAR U Hartford Life & Annuity Comfort Trust, The Prudential Insurance Company of America, The Gibraltar Life Insurance Co., Ltd., The Penn Mutual Life Insurance Company, Thrivent Financial for Lutherans, United of Omaha Life Insurance Company, and Companion Life Insurance Company, which are collectively the lenders that entered into the Note Agreement with Chesapeake on September 5, 2013

Notes: Series A and B unsecured Senior Notes that have been or will be entered into with the Note Holders

NRG: NRG Energy Center Dover LLC

NYSE: New York Stock Exchange

OTC: Over-the-counter

PBF Energy: PBF Energy Inc.

Peninsula Pipeline: Peninsula Pipeline Company, Inc., our wholly-owned Florida intrastate pipeline subsidiary

Peoples Gas: The Peoples Gas System division of Tampa Electric Company

PESCO: Peninsula Energy Services Company, Inc., our wholly-owned natural gas marketing subsidiary

PIP: Performance Incentive Plan

PSC: Public Service Commission, which is the state agency that regulates the rates and services provided by Chesapeake's natural gas and electric distribution operations in Delaware, Maryland and Florida and Peninsula Pipeline in Florida

Rayonier: Rayonier Performance Fibers, LLC

Sandpiper: Sandpiper Energy, Inc.

Sanford Group: FPU and other responsible parties involved with the Sanford environmental site

SEC: Securities and Exchange Commission

Series A Notes: Series A of the unsecured Senior Notes issued on December 16, 2013 pursuant to the Note Agreement

Series B Notes: Series B of the unsecured Senior Notes to be issued on May 15, 2014 pursuant to the Note Agreement

Sharp: Sharp Energy, Inc., our wholly-owned propane distribution subsidiary

Sharpgas: Sharpgas, Inc., a subsidiary of Sharp

SICP: 2013 Stock and Incentive Compensation Plan, which replaced DSCP and PIP effective May 2, 2013

Skipjack: Skipjack, Inc. a subsidiary that owns and leases office buildings in Delaware and Maryland to affiliates of Chesapeake

S&P 500 Index: Standard & Poor's 500 Index

TETLP: Texas Eastern Transmission, LP

TOU: Time-of-use

Transco: Transcontinental Gas Pipe Line Company, LLC

Virginia LP: Virginia LP Gas, Inc.

Xeron: Xeron, Inc., our propane wholesale marketing subsidiary, based in Houston, Texas

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PART I

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

Safe Harbor for Forward-Looking Statements

We make statements in this Annual Report on Form 10-K that do not directly or exclusively relate to historical facts. Such statements are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. One can typically identify forward-looking statements by the use of forward-looking words, such as “project,” “believe,” “expect,” “anticipate,” “intend,” “plan,” “estimate,” “continue,” “potential,” “forecast” or other similar words, or future conditional verbs such as “may,” “will,” “should,” “would” or “could.” These statements represent our intentions, plans, expectations, assumptions and beliefs about future financial performance, business strategy, projected plans and objectives of the Company. These statements are subject to many risks and uncertainties. In addition to the risk factors described under Item 1A “Risk Factors,” the following important factors, among others, could cause actual future results to differ materially from those expressed in the forward-looking statements:

- state and federal legislative and regulatory initiatives that affect cost and investment recovery, have an impact on rate structures, and affect the speed at and the degree to which competition enters the electric and natural gas industries (including deregulation);
- the outcomes of regulatory, tax, environmental and legal matters, including whether pending matters are resolved within current estimates and whether the costs associated with such matters are adequately covered by insurance or recovered in rates;
- the loss of customers due to government-mandated sale of our utility distribution facilities;
- industrial, commercial and residential growth or contraction in our markets or service territories;
- the weather and other natural phenomena, including the economic, operational and other effects of hurricanes, ice storms and other damaging weather events;
- the timing and extent of changes in commodity prices and interest rates;
- general economic conditions, including any potential effects arising from terrorist attacks and any consequential hostilities or other external factors over which we have no control;
- changes in environmental and other laws and regulations to which we are subject and environmental conditions of property that we now or may in the future own or operate;
- the results of financing efforts, including our ability to obtain financing on favorable terms, which can be affected by various factors, including credit ratings and general economic conditions;
- the impact to the asset values and resulting higher costs and funding obligations of the Company's pension and other postretirement benefit plans as a result of potential downturns in the financial markets, lower discount rates or impacts associated with the Patient Protection and Affordable Care Act;
- the creditworthiness of counterparties with which we are engaged in transactions;
- the extent of success in connecting natural gas and electric supplies to transmission systems and in expanding natural gas and electric markets;
- the effect of accounting pronouncements issued periodically by accounting standard-setting bodies;
- conditions of the capital markets and equity markets during the periods covered by the forward-looking statements;
- the ability to successfully execute, manage and integrate merger, acquisition or divestiture plans, regulatory or other limitations imposed as a result of a merger, acquisition or divestiture, and the success of the business following a merger, acquisition or divestiture;
- the ability to establish and maintain new key supply sources;
- the effect of spot, forward and future market prices on our distribution, wholesale marketing and energy trading businesses;
- the effect of competition on our businesses;
- the ability to construct facilities at or below estimated costs;
- risks related to cyber-attack or failure of information technology systems; and

•changes in technology affecting our advanced information services business.



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ITEM 1. BUSINESS.

CORPORATE OVERVIEW

Chesapeake Utilities Corporation is a Delaware corporation formed in 1947. We are a diversified energy company engaged, through our operating divisions and subsidiaries, in various energy and other businesses. We operate primarily on the Delmarva Peninsula and throughout Florida, providing natural gas distribution and transmission, electric distribution and propane distribution service. The core of our business is regulated utilities, which provide stable earnings from their utility operations. Our unregulated businesses provide opportunities to achieve returns greater than those of a traditional utility. The following charts present operating income by energy served and geographic area for the year ended December 31, 2013 and average investment by energy served and geographic area as of December 31, 2013.

OPERATING SEGMENTS

We operate within three reportable segments: Regulated Energy, Unregulated Energy and Other.

The Regulated Energy segment includes our natural gas distribution, natural gas transmission and electric distribution operations. All operations in this segment are regulated, as to their rates and service, by the PSC having jurisdiction in each state in which we operate or by the FERC in the case of Eastern Shore.

The Unregulated Energy segment includes our propane distribution, propane wholesale marketing and natural gas marketing operations, which are unregulated as to their rates and services. Also included in this segment are other unregulated energy services, such as energy-related merchandise sales and heating, ventilation and air conditioning, plumbing and electrical services.

The Other segment consists primarily of our advanced information services operation. Also included in this reportable segment are unregulated subsidiaries that own real estate leased to Chesapeake and certain corporate costs not allocated to other operations.

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The following chart shows, in simplified form, our principal business structure:

The following table shows the size of each of our operating segments based on operating income for the year ended December 31, 2013 and total assets as of December 31, 2013:

(dollars in thousands)	Operating Income		Total Assets		
Regulated Energy	\$50,084	80	% \$708,950	85	%
Unregulated Energy	12,353	20	% 100,585	12	%
Other	297	—	% 27,987	3	%
Total	\$62,734	100	% \$837,522	100	%

Additional financial information by business segment is set forth in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operation and Item 8. Financial Statements and Supplementary Data (see Note 5, Segment Information, in the Consolidated Financial Statements).

**REGULATED ENERGY****Overview of Business**

Regulated Energy is our largest segment and consists of our natural gas distribution operations in Delaware, Maryland and Florida; our electric distribution operation in Florida and our natural gas transmission operations on the Delmarva Peninsula and in Florida. Our natural gas and electric distribution operations, which are local distribution utilities, generate revenues based on tariff rates approved by the PSC of each state in which we operate. The PSCs, however, have authorized our utilities to negotiate rates, based on approved methodologies, with customers that have competitive alternatives. Eastern Shore, our interstate natural gas transmission subsidiary, bills its customers based upon the FERC-approved tariff rates, and the FERC has also authorized Eastern Shore to negotiate rates above or below the FERC-approved tariff rates. Peninsula Pipeline, our Florida intrastate pipeline subsidiary subject to regulation by Florida PSC, has negotiated contracts with third-party customers and with certain affiliates. Our rates are designed to provide us with the opportunity to generate revenues to recover all prudently incurred costs and provide a return on rate base sufficient to pay interest on debt and a reasonable return for our shareholders. Rate base generally consists of the original cost of utility plant less accumulated depreciation on utility plant in service, working capital and certain other assets and depending upon the regulatory jurisdictions, may also include deferred income tax liabilities and other additions or deletions.

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The natural gas commodity market for Chesapeake's Florida division and FPU's Indiantown division has been deregulated. Accordingly, marketers, rather than a traditional utility, sell natural gas to end-use customers in those jurisdictions. For all of our other local distribution utilities, we have fuel cost recovery mechanisms authorized by the PSCs that allow us to periodically adjust fuel rates to reflect changes in the wholesale cost of natural gas and electricity and to ensure we recover all of the costs prudently incurred in purchasing natural gas and electricity for our customers.

**Weather**

Revenues from our residential and commercial sales are affected by seasonal variations in weather conditions, which directly influence the volume of natural gas and electricity sold and delivered. Specifically, customer demand substantially increases during the winter months, when natural gas and electricity are used for heating. For electricity, customer demand also increases during the summer months, when electricity is used for cooling. Accordingly, the volumes sold for these purposes are directly affected by the severity of summer and winter weather and can vary substantially from year to year. We measure the relative impact of weather by using an accepted degree-day methodology. Degree-day data is used to estimate amounts of energy required to maintain comfortable indoor temperature levels based on each day's average temperature. A degree-day is the measure of the variation in the weather based on the extent to which the average daily temperature (from 10:00 am to 10:00 am) falls above or below 65 degrees Fahrenheit. Each degree of temperature below 65 degrees Fahrenheit is counted as one heating degree-day. Each degree of temperature above 65 degrees Fahrenheit is counted as one cooling degree-day. Normal heating degree-days are based on the most recent 10-year average.

In an effort to stabilize the level of net revenues collected from customers in Maryland regardless of weather conditions, Chesapeake's Maryland division implemented a weather normalization adjustment for our residential heating and smaller commercial heating customers. A weather normalization adjustment is a billing adjustment mechanism that is designed to eliminate the effect of deviations from average seasonal temperatures on utility net revenues. For all of our other local distribution utilities, we do not currently have any weather normalization or "decoupled" rate mechanisms.

**Recent Acquisition**

On May 31, 2013, we completed the purchase of the operating assets of ESG. Approximately 11,000 residential and commercial underground propane distribution system customers acquired in this purchase are now being served by Sandpiper, our new subsidiary, and are subject to rate and service regulation by the Maryland PSC. We are evaluating the potential conversion of some of the underground propane distribution systems to natural gas distribution. Although these customers are currently being served with propane, we include Sandpiper's operating results in the Delmarva natural gas distribution operation.

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## Operational Highlight

The following table presents operating revenues, volume and average customers by customer class for our natural gas and electric distribution operations for the year ended December 31, 2013:

(in thousands)	Delmarva Natural Gas Distribution <sup>(2)</sup>		Florida Natural Gas Distribution <sup>(3)</sup>		FPU Electric Distribution				
<b>Operating Revenues</b>									
Residential	\$52,594	59	%	\$26,543	34	%	\$41,349	55	%
Commercial	28,445	32	%	36,591	46	%	38,430	51	%
Industrial	6,349	7	%	16,197	21	%	4,088	5	%
Other <sup>(1)</sup>	1,869	2	%	(555)	(1)	%	(8,917)	(11)	%
<b>Total Operating Revenues</b>	<b>\$89,257</b>	<b>100</b>	<b>%</b>	<b>\$78,776</b>	<b>100</b>	<b>%</b>	<b>\$74,950</b>	<b>100</b>	<b>%</b>
<b>Volume (in Dts for natural gas/MWHs for electric)</b>									
Residential	3,189,000	30	%	1,542,732	7	%	289,745	45	%
Commercial	3,378,707	31	%	4,133,188	18	%	309,813	48	%
Industrial	4,169,615	39	%	17,143,536	75	%	31,120	5	%
Other	69,090	—	%	(81,723)	—	%	18,347	2	%
<b>Total</b>	<b>10,806,412</b>	<b>100</b>	<b>%</b>	<b>22,737,733</b>	<b>100</b>	<b>%</b>	<b>649,025</b>	<b>100</b>	<b>%</b>
<b>Average Customers</b>									
Residential	60,685	90	%	64,056	90	%	23,742	76	%
Commercial	6,445	10	%	5,904	8	%	7,407	24	%
Industrial	110	—	%	1,005	2	%	2	—	%
Other	5	—	%	—	—	%	—	—	%
<b>Total</b>	<b>67,245</b>	<b>100</b>	<b>%</b>	<b>70,965</b>	<b>100</b>	<b>%</b>	<b>31,151</b>	<b>100</b>	<b>%</b>

<sup>(1)</sup> Operating Revenues from "Other" sources include unbilled revenue, under (over) recoveries of fuel cost, conservation revenue, other miscellaneous charges, fees for billing services provided to third parties and adjustments for pass-through taxes.

<sup>(2)</sup> Delmarva natural gas distribution operation includes Chesapeake's Delaware and Maryland divisions in addition to Sandpiper.

<sup>(3)</sup> Florida natural gas distribution operation includes Chesapeake's Florida Division, FPU and FPU's Indiantown and Fort Meade divisions.

The following table presents operating revenues and design day capacity for Eastern Shore for the year ended December 31, 2013 and contracted firm transportation capacity at December 31, 2013:

(in thousands)	Eastern Shore		
<b>Operating Revenues</b>			
Local distribution companies - affiliated <sup>(1)</sup>	\$16,326	44	%
Local distribution companies - non-affiliated	8,473	23	%
Commercial and industrial	12,321	33	%
Other <sup>(2)</sup>	45	—	%
<b>Total Operating Revenues</b>	<b>\$37,165</b>	<b>100</b>	<b>%</b>

Contracted firm transportation capacity (in Dts/d)

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Local distribution companies - affiliated	100,652	43	%
Local distribution companies - non-affiliated	67,293	29	%
Commercial and industrial	65,934	28	%
Total	233,879	100	%
Designed day capacity (in Dts/d)	234,379	—	

(1) Eastern Shore's service to our local distribution affiliates is based on FERC-approved rates and is an integral component of the cost associated with providing natural gas supplies for those affiliates. We eliminate operating revenues of Eastern Shore against the cost of sales of those affiliates; however, our local distribution affiliates include this amount in their purchased fuel cost and recover it through fuel cost recovery mechanisms.

(2) Operating revenues from "Other" sources are from rental of gas properties.

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Peninsula Pipeline has three contracts with both affiliated and non-affiliated customers to provide firm transportation service. All of the contracts provide a fixed annual transportation fee. For the year ended December 31, 2013, operating revenues of Peninsula Pipeline were \$2.8 million, \$2.2 million of which were related to service to FPU under a contract with FPU, which has been approved by the Florida PSC. Peninsula Pipeline's operating revenue from FPU is eliminated against the cost of sales in consolidation; however, FPU includes this amount in its purchased fuel cost and recovers it through the fuel cost recovery mechanism.

## Regulatory Matters

The following table highlights the key regulatory structure and the most recent base rate proceeding information for each of our major utilities:

	Chesapeake - Delaware Division	Chesapeake - Florida Division	FPU Natural Gas	FPU Electric	Chesapeake - Maryland Division	Eastern Shore
Commission Structure:	5 commissioners Part-Time Gubernatorial Appointment	5 commissioners Full-Time Gubernatorial Appointment	5 commissioners Full-Time Gubernatorial Appointment	5 commissioners Full-Time Gubernatorial Appointment	5 commissioners Full-Time Gubernatorial Appointment	5 commissioners Full-Time Presidential Appointment
Regulatory Jurisdiction:	Delaware PSC	Florida PSC	Florida PSC	Florida PSC	Maryland PSC	FERC
Base Rate Proceeding: Delay in collection of rates subsequent to filing application	60 days	90 days	90 days	90 days	180 days	Up to 180 days
Date of most recent application	7/6/2007	7/14/2009	12/17/2008	5/31/2006	5/1/2006	12/30/2010
Effective date of permanent rates	9/30/2008	1/14/2010	1/14/2010 <sup>(1)</sup>	5/22/2008	12/1/2007	7/29/2011
Rate increase (decrease) approved	\$325,000	\$2,536,300	\$7,969,000	\$3,856,900	\$648,000	\$805,000
Rate of return approved	10.25% <sup>(2)</sup>	10.80% <sup>(2)</sup>	10.85% <sup>(2)</sup>	11.00% <sup>(2)</sup>	10.75% <sup>(2)</sup>	13.90% <sup>(3)</sup>

<sup>(1)</sup> Effective date of the Order approving settlement agreement, which adjusted rates originally approved on June 4, 2009.

<sup>(2)</sup> Allowed return on equity.

<sup>(3)</sup> Allowed pre-tax, pre-interest rate of return

Our average investments in 2013 for regulated operations were: \$92.0 million for Delmarva natural gas distribution; \$177.0 million for Florida natural gas and electric distribution; and \$139.3 million for natural gas transmission.

The terms of the settlement agreement in Eastern Shore's most recent base rate proceeding provides a five-year moratorium on Eastern Shore's right to file a base rate increase and other parties' rights to challenge Eastern Shore's rates. It allows Eastern Shore to file for rate adjustments during those five years in the event certain costs related to government-mandated obligations are incurred and Eastern Shore's pre-tax earnings do not equal or exceed 13.9 percent. Eastern Shore is also required to file a base rate proceeding by January 2017.

In May 2013, the Maryland PSC approved our application for approval of the acquisition of the ESG operating assets and the transfer of the ESG franchises to Sandpiper. In this application, the Maryland PSC also approved a new gas

service tariff and rates applicable to natural gas and propane distribution customers in Worcester County, Maryland. Sandpiper is required to file a base rate proceeding within two and a half years of Sandpiper's new service in Worcester County, Maryland, which commenced in May 2013.

In addition to the base rates approved by the PSCs, certain of our local distribution utilities have additional surcharge mechanisms, which were separately approved by their respective PSCs. Most notable surcharge mechanisms include Delaware's additional charges to facilitate natural gas service offerings designed to increase the availability of natural gas in portions of eastern Sussex County, Delaware, and Florida's GRIP surcharge designed to recover capital and other costs, inclusive of an appropriate return on investment, associated with accelerating the replacement of qualifying distribution mains.

See Item 8. Financial Statements and Supplementary Data (Note 18, Rates and Other Regulatory Activities, in the Consolidated Financial Statements) for more information.

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Competition

Our natural gas and electric distribution operations and our natural gas transmission operations compete with other forms of energy, including natural gas, electricity, oil, propane and other alternative sources of energy. The principal competitive factors are price and, to a lesser extent, accessibility. Our natural gas distribution operations have several large industrial customers that are able to use fuel oil or propane as an alternative to natural gas. When oil or propane prices decline, these interruptible customers may convert to an alternative fuel source to satisfy their fuel requirements, and our sales volumes may decline. To address the uncertainty of alternative fuel prices, we use flexible pricing arrangements on both the supply and sales sides of our business to compete with alternative fuel price fluctuations.

Large industrial natural gas customers may be able to bypass our distribution and transmission systems and make direct connections with “upstream” interstate transmission pipelines when such connections are economically feasible. Certain large industrial electric customers may be capable of generating electricity for their own consumption. Although the risk of bypassing our systems is not considered significant, we may adjust services and rates for these customers to retain their business in certain situations.

Supplies, Transmission and Storage

We believe that the availability of supply and transmission of natural gas and electricity is adequate under existing arrangements to meet the anticipated needs of customers.

Chesapeake’s Delaware and Maryland divisions use their firm transportation resources to meet a significant percentage of their projected demand requirements. They purchase firm natural gas supplies to meet those projected requirements with purchases of baseload, daily spot supplies and storage service. They have both firm and interruptible transportation service contracts with five interstate “open access” pipeline companies (Eastern Shore, Transco, Columbia, Gulf and TETLP) in order to meet customer demand. Their distribution system is directly interconnected with Eastern Shore’s pipeline, which is directly interconnected with the upstream pipelines of Transco, Columbia and TETLP. The Gulf pipeline is directly interconnected with Columbia and indirectly interconnected with Eastern Shore’s pipeline. Chesapeake’s Delaware division has 71,754 Dts of maximum daily firm transportation capacity with Eastern Shore through contracts expiring on various dates between 2014 and 2027. It also has a total of 67,363 Dts of maximum daily firm transportation capacity with four upstream pipelines through contracts expiring between 2014 and 2028. Chesapeake’s Maryland division has 27,898 Dts of maximum daily firm transportation capacity with Eastern Shore through contracts expiring on various dates between 2014 and 2027 and a total of 26,818 Dts of maximum daily firm transportation capacity with four upstream pipelines through contracts expiring between 2014 and 2027. The Delaware and Maryland divisions also have the capability to use propane-air peak-shaving equipment to supplement or displace natural gas purchases.

Chesapeake's Delaware and Maryland divisions contract with an unaffiliated energy marketing and risk management company through an asset management agreement to optimize their transportation and storage capacity and secure adequate supply of natural gas. The asset manager pays our divisions a fee, which our divisions share with their customers. The current asset management agreement expires in March 2015.

Sandpiper has a capacity, supply and operating agreement with EGWIC to purchase propane over a six-year term. Sandpiper's initial annual commitment is estimated at approximately 7.4 million gallons. Sandpiper also has 1,000 Dts of maximum daily firm transportation capacity with Eastern Shore through a contract expiring in 2027.

Chesapeake’s Florida division has firm transportation service agreements with FGT and Gulfstream, totaling 26,092 to 28,639 Dts of daily firm transportation capacity expiring on various dates between 2020 and 2025. As a result of the deregulation of the natural gas sales market in Florida, the Florida PSC approved a program permitting the release of all of the capacity under these agreements to various third parties, including PESCO, our natural gas marketing subsidiary. We are contingently liable to FGT and Gulfstream if any party that acquired the capacity through release fails to pay the capacity charge.

FPU has firm transportation service agreements with FGT, Florida City Gas and Peninsula Pipeline, totaling 31,543 to 57,107 Dts of daily firm transportation capacity expiring on various dates between 2016 and 2033. FPU uses gas



marketers and producers to procure all of its gas supplies to meet projected requirements. FPU also uses Peoples Gas to provide wholesale gas sales service in areas far from its interconnections with FGT.

Eastern Shore has three contracts with Transco for a total of 7,292 Dts of firm daily storage injection and withdrawal entitlements and total storage capacity of 288,003 Dts expiring on various dates between 2018 and 2023. Eastern Shore retains these firm storage services in order to provide swing transportation service and firm storage service to customers requesting such services.

FPU primarily purchases its wholesale electricity from two suppliers JEA and Gulf Power, under full requirements contracts expiring in December 2017 and 2019, respectively. The JEA contract provides generation and transmission service to northeast Florida. The Gulf Power contract provides generation and transmission service to northwest Florida. Our electric distribution operation also has a renewable energy purchase agreement with Rayonier that expires in 2023. FPU is committed under the Rayonier contract to purchase between 1.7 MWH and 3.0 MWH of electricity annually.

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UNREGULATED ENERGY

Overview of Business

Our Unregulated Energy segment provides propane distribution, propane wholesale marketing, natural gas marketing services and other unregulated energy-related services to customers. Revenues generated from the Unregulated Energy segment are not subject to any federal, state or local pricing regulations. Our businesses in the Unregulated Energy segment typically complement our regulated businesses by offering propane as a fuel source where natural gas is not readily available or providing natural gas marketing service to customers who are able to procure their own supplies. Through competitive pricing and supply management, these businesses provide the opportunity to generate returns greater than those of a traditional utility.

Propane Distribution - Overview of Business

Our propane distribution operations sell propane primarily to residential, commercial/industrial and wholesale customers on the Delmarva Peninsula and in southeastern Pennsylvania through Sharp and Sharpgas and in Florida through FPU and Flo-gas. Many of our propane distribution customers are “bulk delivery” customers. We make deliveries of propane to the bulk delivery customers as needed, based on the level of propane remaining in the tank located at the customer’s premises. We invoice and record revenues for our bulk delivery service customers at the time of delivery, rather than upon customers’ actual usage, since the customers typically own the propane gas in the tank on their premises. We also have underground propane distribution systems serving various neighborhoods and communities. For the customers served by underground propane distribution systems, we have installed meters on their premises to measure consumption and bill them monthly.

Propane Distribution - Weather

Revenues from our propane distribution sales activities are affected by seasonal variations in weather conditions. Weather conditions directly influence the volume of propane sold and delivered to customers; specifically, customers’ demand substantially increases during the winter months when propane is used for heating. The timing of deliveries to the bulk delivery customers can also vary significantly from year to year depending on weather variation. Accordingly, the propane volumes sold for this purpose are directly affected by the severity of winter weather and can vary substantially from year to year. Sustained warmer-than-normal temperatures will tend to reduce propane use, while sustained colder-than-normal temperatures will tend to increase consumption.

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## Propane Distribution - Operational Highlights

For the year ended December 31, 2013, operating revenues, total gallons sold and average customers by customer class for our Delmarva and Florida propane distribution operations were as follows:

(in thousands)	Delmarva Peninsula		Florida		
Operating Revenues					
Residential bulk	\$24,573	31	% \$5,526	28	%
Residential metered	7,723	10	% 4,779	24	%
Commercial bulk	18,169	23	% 6,692	33	%
Commercial metered	—	—	% 1,899	9	%
Wholesale	24,576	31	% 610	3	%
Other <sup>(1)</sup>	4,591	5	% 525	3	%
Total Operating Revenues	\$79,632	100	% \$20,031	100	%
Volume (in gallons)					
Residential bulk	9,192	22	% 1,391	21	%
Residential metered	3,318	8	% 1,027	15	%
Commercial bulk	10,482	25	% 3,136	47	%
Commercial metered	—	—	% 673	10	%
Wholesale	18,885	45	% 449	7	%
Other	—	—	% (42 )	—	%
Total	41,877	100	% 6,634	100	%
Average customers					
Residential bulk	23,760	67	% 8,542	53	%
Residential metered	7,255	20	% 6,441	40	%
Commercial bulk	3,962	11	% 1,014	6	%
Commercial metered	—	—	% 264	1	%
Wholesale	32	—	% 3	—	%
Other	715	2	% —	—	%
Total	35,724	100	% 16,264	100	%

<sup>(1)</sup> Operating revenues from "Other" sources include revenues from customer loyalty programs; delivery, service and appliance fees; and unbilled revenues.

## Propane Distribution - Competition

We compete with several other propane distributors in our geographic markets, primarily on the basis of price and our responsive and reliable service. Our competitors generally include local outlets of national distributors and local independent distributors, whose proximity to customers entails lower costs to provide service. As an energy source, propane competes with home heating oil and electricity, which are typically more expensive (based on equivalent unit of heat value). Since natural gas has historically been less expensive than propane, propane is generally not distributed in geographic areas served by natural gas pipeline or distribution systems.

## Propane Distribution - Supplies, Transportation and Storage

We purchase propane for our propane distribution operations primarily from suppliers, including major oil companies, independent producers of natural gas liquids and from Xeron. Although supplies of propane from these and other sources are generally readily available for purchase, extreme market conditions, such as significant fluctuation in weather, closing of refineries and disruption in supply chain, could result in a reduction in available supplies.

Propane is transported by trucks and railroad cars from refineries, natural gas processing plants or pipeline terminals to our bulk storage facilities. We own various bulk propane storage facilities with an aggregate capacity of approximately 3.6 million gallons in Delaware, Maryland, Pennsylvania, Virginia and Florida. From these storage facilities, propane is delivered by “bobtail” trucks, owned and operated by us, to tanks located at the customers’ premises.

**Propane Wholesale Marketing**

Through Xeron, we market propane to major independent oil and petrochemical companies, wholesale resellers and retail propane companies located primarily in the southeastern United States. Xeron enters into forward contracts with various counterparties to commit to purchase or sell an agreed-upon quantity of propane at an agreed-upon price at a specified future date, which typically

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ranges from one to six months from the execution of the contract. At the expiration of the forward contracts, Xeron typically settles its purchases and sales financially, without taking physical delivery of the propane. Xeron also enters into futures and other option contracts that are traded on the InterContinentalExchange, Inc. The level and profitability of the propane wholesale marketing activity is affected by both propane wholesale price volatility and liquidity in the wholesale market. In 2013, Xeron had operating revenues, net of the associated cost of propane sold totaling approximately \$1.3 million. For further discussion of Xeron's wholesale marketing activities, market risks and controls that monitor Xeron's risks, refer to Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations — Market Risk. Xeron does not own physical storage facilities or equipment to transport propane; however, it contracts for storage and pipeline capacity to facilitate the sale of propane on a wholesale basis.

### Natural Gas Marketing

We provide natural gas supply and supply management services through PESCO to 3,136 customers in Florida and 27 other customers, located primarily on the Delmarva Peninsula. In 2013, PESCO had operating revenues of \$53.7 million in Florida and \$8.0 million from customers located primarily on the Delmarva Peninsula. PESCO competes with regulated utilities and other unregulated third-party marketers to sell natural gas supplies directly to commercial and industrial customers through competitively-priced contracts. PESCO does not own or operate any natural gas transmission or distribution assets. The gas that PESCO sells is delivered to retail customers through affiliated and non-affiliated local distribution company systems and transmission pipelines. PESCO bills its customers directly or through the billing services of the regulated utilities that deliver the gas.

### Other Unregulated Businesses

We provide heating, ventilation and air conditioning, plumbing and electrical services through Austin Cox to residential, commercial and industrial customers throughout the lower Delmarva Peninsula. FPU sells energy-related merchandise in Florida. Operating revenues in 2013 from these other unregulated businesses totaled \$4.1 million.

### OTHER

#### Overview of Business

The "Other" segment consists primarily of BravePoint, our advanced information services subsidiary; other unregulated subsidiaries, including Skipjack and ESRE that own real estate leased to affiliates; and certain unallocated corporate costs, which are not directly attributable to a specific business unit.

#### Advanced Information Services

BravePoint provides domestic and a limited number of international clients with information technology services and solutions for both enterprise and e-business applications. BravePoint provides the following products and services to its clients: Pro-2, ProfitZoom, 360 Analytics, Application Evolution, Software Development, Integration, Database services, Managed DBA, Application Expertise and Marketing Consulting. For the year ended December 31, 2013, BravePoint's operating revenue was \$19.1 million.

#### Other Subsidiaries

Skipjack and ESRE own and lease office buildings in Delaware and Maryland to affiliates of Chesapeake. CIC is an affiliated investment company incorporated in Delaware.

### ENVIRONMENTAL COMPLIANCE

We are subject to federal, state and local laws and regulations governing environmental quality and pollution control. These laws and regulations require us to remove or remediate the effect on the environment of the disposal or release of specified substances at current and former operating sites. We have participated in the investigation, assessment or remediation, and have exposures at six former MGP sites. At December 31, 2013, we had \$10.7 million in environmental liabilities, representing our estimate of such future costs principally related to two of the six former MGP sites. The most significant site is located in West Palm Beach, Florida, where FPU previously operated an MGP and is currently implementing a remedial plan approved by the FDEP. The estimated cost of remediation for the West Palm Beach site ranges from approximately \$4.5 million to \$15.4 million. Chesapeake is also currently assessing a remediation plan and actively remediating a former MGP site in Winter Haven, Florida. The estimated cost of

remediation for the Winter Haven site ranges from approximately \$443,000 to \$1.0 million. Base rates of our local distribution utilities include recovery of environmental remediation costs adequate to fully recover our current estimate of cost of remediation. We continue to expect that any additional costs related to environmental remediation and related activities beyond our current estimate will be recoverable from customers through rates. For additional information on each site, refer to Item 8. Financial Statements and Supplementary Data (see Note 19, Environmental Commitments and Contingencies in the Consolidated Financial Statements).

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EMPLOYEES

As of December 31, 2013, we had a total of 842 employees, 122 of whom are union employees represented by two labor unions: the International Brotherhood of Electrical Workers and Commercial Workers Union, whose collective bargaining agreements expire in 2014 and 2016.

FINANCIAL INFORMATION ABOUT GEOGRAPHICAL AREAS

All of our material operations, customers and assets are located in the United States.

AVAILABLE INFORMATION AND CORPORATE GOVERNANCE DOCUMENTS

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and other reports and amendments to these reports that we file with or furnish to the SEC are available free of charge at our website, [www.chpk.com](http://www.chpk.com), as soon as reasonably practicable after we electronically file these reports with, or furnish these reports to, the SEC. The content of this website is not part of this report. These reports, and amendments to these reports, that we file with or furnish to the SEC are also available on the SEC's website, [www.sec.gov](http://www.sec.gov). The public may also read and copy any materials that we file with the SEC at the SEC's Public Reference Room, 100 F Street, N.E., Washington, DC 20549-5546. The public may obtain information from the Public Reference Room by calling the SEC at 1-800-SEC-0330.

In addition, the following documents are available free of charge on our website, [www.chpk.com](http://www.chpk.com):

- Business Code of Ethics and Conduct applicable to all employees, officers and directors;
- Code of Ethics for Financial Officers;
- Corporate Governance Guidelines;
- Charters for the Audit Committee, Compensation Committee and Corporate Governance Committee of the Board Directors; and
- Corporate Governance Guidelines on Director Independence.

Any of these reports or documents may also be obtained by writing to: Corporate Secretary; c/o Chesapeake Utilities Corporation, 909 Silver Lake Boulevard, Dover, DE 19904.

If we make any amendment to, or grant a waiver of, any provision of the Business Code of Ethics and Conduct or the Code of Ethics for Financial Officers applicable to our principal executive officer, president, principal financial officer, principal accounting officer or controller, the amendment or waiver will be disclosed within four business days in a press release, by website disclosure, or by filing a current report on Form 8-K with the SEC.

CERTIFICATION TO THE NYSE

Our Chief Executive Officer certified to the NYSE on June 4, 2013, that as of that date, he was unaware of any violation by Chesapeake of the NYSE's corporate governance listing standards.

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ITEM 1A. RISK FACTORS.

The following is a discussion of the primary factors that may affect the operations or financial performance of our regulated and unregulated businesses. Refer to the section entitled Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations of this report for an additional discussion of these and other related factors that affect our operations and/or financial performance.

FINANCIAL RISKS

Instability and volatility in the financial markets could negatively impact our ability to access capital at competitive rates.

Our business strategy includes the continued pursuit of growth, both organically and through acquisitions. To the extent that we do not generate sufficient cash flow from operations, we may incur additional indebtedness to finance our growth. We rely on access to both short-term and long-term capital markets as a significant source of liquidity for capital requirements not satisfied by the cash flows from our operations. We are committed to maintaining a sound capital structure and strong credit ratings to provide the financial flexibility needed to access capital markets when required. However, if we are not able to access capital at competitive rates, our ability to implement our strategic plan, undertake improvements and make other investments required for our future growth may be limited.

A downgrade in our credit rating could adversely affect our access to capital markets and our cost of capital.

Our ability to obtain adequate and cost-effective capital depends on our credit ratings, which are greatly affected by our financial performance and the liquidity of financial markets. A downgrade in our current credit ratings could adversely affect our access to capital markets, as well as our cost of capital.

If we fail to comply with our debt covenant obligations, we could experience adverse financial consequences that could affect our liquidity and ability to borrow funds.

Our long-term debt obligations and committed short-term lines of credit contain financial covenants related to debt-to-capital ratios and interest-coverage ratios. Failure to comply with any of these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of outstanding debt obligations or the inability to borrow under certain credit agreements. Any such acceleration would cause a material adverse change in our financial condition.

An increase in interest rates may adversely affect our results of operations and cash flows.

An increase in interest rates, without the recovery of the higher cost of debt in the sales and/or transportation rates we charge our utility customers, could adversely affect future earnings. An increase in short-term interest rates would negatively affect our results of operations, which depend on short-term lines of credit to finance accounts receivable and storage gas inventories, as well as to temporarily finance capital expenditures.

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

Inflation affects the cost of supply, labor, products and services required for operations, maintenance and capital improvements. To help cope with the effects of inflation on our capital investments and returns, we seek rate increases from regulatory commissions for regulated operations and closely monitor the returns of our unregulated operations.

There can be no assurance that we will be able to obtain adequate and timely rate increases to offset the effects of inflation. To compensate for fluctuations in propane gas prices, we adjust our propane selling prices to the extent allowed by the market. There can be no assurance, however, that we will be able to increase propane sales prices sufficiently to compensate fully for such fluctuations in the cost of propane gas to us.

Our energy marketing subsidiaries are exposed to market risks, beyond our control, which could adversely affect our financial results and capital requirements.

Our energy marketing subsidiaries are subject to market risks beyond our control, including market liquidity and commodity price volatility. Although we maintain risk management policies, we may not be able to offset completely the price risk associated with volatile commodity prices, which could lead to volatility in earnings. Physical trading also has price risk on any net open positions at the end of each trading day, as well as volatility resulting from:

(i) intra-day fluctuations of natural gas and/or propane prices, and (ii) daily price movements between the time natural



gas and/or propane is purchased or sold for future delivery and the time the related purchase or sale is economically hedged. The determination of our net open position at the end of any trading day requires us to make assumptions as to future circumstances, including the use of natural gas and/or propane by our customers in relation to its anticipated market positions. Because the price risk associated with any net open position at the end of such day

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may increase if the assumptions are not realized, we review these assumptions daily. Net open positions may increase volatility in our financial condition or results of operations if market prices move in a significantly favorable or unfavorable manner, because the changes in fair value of trading contracts are immediately recognized as profits or losses for financial accounting purposes. This volatility may occur, with a resulting increase or decrease in earnings or losses, even though the expected profit margin is essentially unchanged from the date the transactions were consummated.

Our energy marketing subsidiaries are exposed to credit risk of their counterparties.

Our energy marketing subsidiaries extend credit to counterparties and continually monitor and manage collections aggressively. Each of these subsidiaries is exposed to the risk that it may not be able to collect amounts owed to it. If the counterparty to such a transaction fails to perform, and any underlying collateral is inadequate, we could experience financial losses.

Our energy marketing subsidiaries are dependent upon the availability of credit to successfully operate their businesses.

Our energy marketing subsidiaries are dependent upon the availability of credit to buy propane and natural gas for resale or to trade. If financial market conditions decline generally, or the financial condition of these subsidiaries or of our Company declines, then the cost of credit available to these subsidiaries could increase. If credit is not available, or if credit is more costly, our results of operations, cash flows and financial condition may be adversely affected. Current market conditions have adversely impacted the return on plan assets for our pension plans, which may require significant additional funding.

We have pension plans that are closed to new employees and the future benefits are frozen. The costs of providing benefits and related funding requirements of these plans are subject to changes in the market value of the assets that fund the plans and the discount rates used to estimate the pension benefit obligations. As a result of the extreme volatility and disruption in the domestic and international equity, bond and interest rate markets in recent years, the asset values and benefit obligations of Chesapeake's and FPU's Pension Plans have fluctuated significantly since 2008. The funded status of the plans and the related costs reflected in our financial statements are affected by various factors that are subject to an inherent degree of uncertainty, particularly in the current economic environment. Future losses of asset values and further declines in discount rates may necessitate accelerated funding of the plans in the future to meet minimum federal government requirements as well as higher pension expense to be recorded in future years. Adverse changes in the asset values and benefit obligations of our pension plans may require us to record higher pension expense and fund obligations earlier than originally planned, which would have an adverse impact on our cash flows from operations, decrease borrowing capacity and increase interest expense.

## OPERATIONAL RISKS

Fluctuations in weather may cause a significant variance in our earnings.

Our natural gas and propane distribution operations are sensitive to fluctuations in weather conditions, which directly influence the volume of natural gas and propane we sell and deliver to our customers. A significant portion of our natural gas and propane distribution revenues is derived from the sales and deliveries of natural gas and propane to residential and commercial heating customers during the five-month peak heating season (November through March). If the weather is warmer than normal, we sell and deliver less natural gas and propane to customers, and earn less revenue, which could adversely affect our results of operations, cash flows and financial condition.

Our electric operation is also affected by variations in general weather conditions and particularly unusually severe weather conditions. Electricity is generally less seasonal than natural gas and propane sales because it is used for both heating and cooling in our service areas.

The amount and availability of natural gas, propane and electricity supplies are difficult to predict; a substantial reduction in available supplies could reduce our earnings in those segments.

Natural gas, propane and electricity production can be affected by factors beyond our control, such as weather and closings of energy generation facilities and refineries. If we are unable to obtain sufficient natural gas, electricity and propane supplies to meet demand, results in those businesses may be adversely affected. Any substantial decrease in the availability of supplies of natural gas, propane and electricity could result in increased supply costs and higher prices for customers, which could also adversely affect our financial condition and results of operations.

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We rely on a limited number of natural gas, propane and electricity suppliers, the loss of which could have a material adverse effect on our financial condition and results of operations.

We have entered into various agreements with suppliers to purchase natural gas, propane and electricity to serve our customers. The loss of any significant suppliers or our inability to renew these contracts at favorable terms upon their expiration could significantly affect our ability to serve our customers and have a material adverse impact on our financial condition and results of operations.

A substantial disruption or lack of growth in interstate natural gas pipeline transmission and storage capacity and electric transmission capacity may impair our ability to meet customers' existing and future requirements.

In order to meet existing and future customer demands for natural gas and electricity, we must acquire sufficient supplies of natural gas and electricity, interstate pipeline transmission and storage capacity, and electric transmission capacity to serve such requirements. We must contract for reliable and adequate upstream transmission capacity for our distribution systems while considering the dynamics of the interstate pipeline and storage and electric transmission markets, our own on-system resources, as well as the characteristics of our markets. Our financial condition and results of operations would be materially and adversely affected if the future availability of these capacities were insufficient to meet future customer demands for natural gas and electricity. Currently, our Florida natural gas operation relies primarily on one pipeline system, FGT, for most of its natural gas supply and transmission. Our Florida electric operation relies primarily on two suppliers, Gulf Power for the northwest service territory and JEA for the northeast service territory. Any interruption to these systems could adversely affect our ability to meet the demands of FPU's customers and our earnings.

Commodity price increases may adversely affect the operating costs and competitive positions of our natural gas, electric and propane distribution operations, which may adversely affect our results of operations, cash flows and financial condition.

Natural Gas/Electric. Higher natural gas prices can significantly increase the cost of gas billed to our natural gas customers. Increases in the cost of coal, natural gas and other fuels used to generate electricity can significantly increase the cost of electricity billed to our electric customers. Damage to the production or transportation facilities of our suppliers, decreasing their supply of natural gas and electricity, could result in increased supply costs and higher prices for our customers. Such cost increases generally have no immediate effect on our revenues and net income because of our regulated fuel cost recovery mechanisms. Our net income, however, may be reduced by higher expenses that we may incur for uncollectible customer accounts and by lower volumes of natural gas and electricity deliveries when customers reduce their consumption. Therefore, increases in the price of natural gas, coal and other fuels can affect our operating cash flows and the competitiveness of natural gas and electricity as energy sources.

Propane. Propane costs are subject to volatile changes as a result of product supply or other market conditions, including weather and economic and political factors affecting crude oil and natural gas supply or pricing. For example, weather conditions could damage production or transportation facilities, which could result in decreased supplies of propane, increased supply costs and higher prices for customers. Such cost changes can occur rapidly and can affect profitability. There is no assurance that we will be able to pass on propane cost increases fully or immediately, particularly when propane costs increase rapidly. Therefore, average retail sales prices can vary significantly from year to year as product costs fluctuate in response to propane, fuel oil, crude oil and natural gas commodity market conditions. In addition, in periods of sustained higher commodity prices, declines in retail sales volumes due to reduced consumption and increased amounts of uncollectible accounts may adversely affect net income.

Our propane inventory is subject to inventory valuation risk, which may result in a write-down of inventory.

Our propane distribution operations own bulk propane storage facilities, with an aggregate capacity of approximately 3.6 million gallons. We purchase and store propane based on several factors, including inventory levels and the price outlook. We may purchase large volumes of propane at current market prices during periods of low demand and low prices, which generally occur during the summer months. Propane is a commodity, and as such, its price is subject to

volatile fluctuations in response to changes in supply or other market conditions. We have no control over these market conditions. Consequently, the wholesale price of the propane that we purchase can change rapidly over a short period of time. The retail market price for propane could fall below the price at which we made the purchases, which would adversely affect our profits or cause sales from that inventory to be unprofitable. In addition, falling propane prices may result in inventory write-downs, as required by GAAP, if the market price of propane falls below our weighted average cost of inventory, which could adversely affect net income.

Operating events affecting public safety and the reliability of our natural gas and electric distribution and transmission systems could adversely affect our operations and increase our costs.

Our natural gas and electric operations are exposed to operational events and risks, such as major leaks, outages, mechanical failures and breakdown, operations below expected level of performance or efficiency and accidents that could affect public safety and the reliability of our distribution and transmission systems, significantly increase costs and cause loss of customer confidence.

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If we are unable to recover from customers through the regulatory process, all or some of these costs and our authorized rate of return, our results of operations, financial condition and cash flows could be adversely affected.

We operate in a competitive environment, and we may lose customers to competitors.

**Natural Gas.** Our natural gas marketing operations compete with third-party suppliers to sell natural gas to commercial and industrial customers. Our natural gas transmission and distribution operations compete with interstate pipelines when our transmission and/or distribution customers are located close enough to a competing pipeline to make direct connections economically feasible. Failure to retain and grow our customer base in the natural gas operations would have an adverse effect on our financial condition, cash flows and results of operations.

**Electric.** While there is active wholesale power sales competition in Florida, our retail electric business through FPU has remained substantially free from direct competition from other electric service providers. Generally, however, our retail electric business through FPU remains subject to competition from other energy sources. Changes in the competitive environment caused by legislation, regulation, market conditions or initiatives of other electric power providers, particularly with respect to retail competition, could adversely affect our results of operations, cash flows and financial condition.

**Propane.** Our propane distribution operations compete with other propane distributors, primarily on the basis of service and price. Some of our competitors have significantly greater resources. Our ability to grow the propane distribution business is contingent upon capturing additional market share, expanding into new markets, and successfully utilizing pricing programs that retain and grow our customer base. Failure to retain and grow our customer base in our propane distribution operations would have an adverse effect on our results of operations, cash flows and financial condition.

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

Energy conservation could lower energy consumption and adversely affect our earnings.

We have seen various legislative and regulatory initiatives to promote energy efficiency and conservation at both federal and state levels. In response to the initiatives in the states in which we operate, we have put into place programs to promote energy efficiency by our current and potential customers. To the extent a PSC allows us to recover the cost of such energy efficiency programs, funding for such programs is recovered through the rates we charge to our regulated customers. However, lower energy consumption as a result of energy efficiency and conservation by current and potential customers may adversely affect our results of operations, cash flows and financial condition.

Changes in technology may adversely affect BravePoint's competitiveness.

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

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

Fluctuating commodity prices may affect our earnings and financing costs because our propane distribution and wholesale marketing operations use derivative instruments, including forwards, futures, swaps and puts, to hedge price risk. While we have risk management policies and operating procedures in place to control our exposure to risk, if we purchase derivative instruments that are not properly matched to our exposure, our results of operations, cash flows, and financial condition may be adversely affected.

Changes in customer growth may affect earnings and cash flows.

Our ability to increase gross margins in our regulated energy and unregulated propane distribution businesses is dependent upon growth in the residential construction market, adding new commercial and industrial customers and

conversion of customers to natural gas, electricity or propane from other energy sources. Slowdowns in growth may adversely affect our gross margin, earnings and cash flows.

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Our businesses are capital intensive, and the increased costs and/or delays of capital projects may adversely affect our future earnings.

Our businesses are capital intensive and require significant investments in on-going infrastructure projects. There are limited materials and qualified vendors that can be used in our projects. Our ability to complete our infrastructure projects on a timely basis and manage the overall cost of those projects is affected by the availability of the necessary materials and qualified vendors. Our future earnings could be adversely affected if we are unable to manage such capital projects effectively, or if full recovery of such capital costs is not permitted in future regulatory proceedings. Our regulated energy business may be at risk if franchise agreements are not renewed.

Our regulated natural gas and electric distribution operations hold franchises in each of the incorporated municipalities that require franchise agreements in order to provide natural gas and electricity. Our natural gas and electric distribution operations are currently in negotiations for franchises with certain municipalities for new service areas and renewal of some existing franchises. Ongoing financial results would be adversely impacted from the loss of service to certain operating areas within our electric or natural gas territories in the event that franchise agreements were not renewed.

A strike, work stoppage or a labor dispute could adversely affect our operations.

We are party to collective bargaining agreements with various labor unions at some of our Florida operations. A strike, work stoppage or a labor dispute with a union or employees represented by a union could cause interruption to our operations. If a strike, work stoppage or other labor dispute were to occur, our results could be adversely affected. Accidents, natural disasters, severe weather (such as a major hurricane) and acts of terrorism could adversely impact earnings.

Inherent in energy transmission and distribution activities are a variety of hazards and operational risks, such as leaks, ruptures, fires, explosions, sabotage and mechanical problems. Natural disasters and severe weather may damage our assets, cause operational interruptions and result in the loss of human life. The threat of terrorism and the impact of retaliatory military and other action by the United States and its allies may lead to increased political, economic and financial market instability and volatility in the price of natural gas, electricity and propane that could affect our operations. In addition, future acts of terrorism could be directed against companies operating in the United States, and companies in the energy industry may face a heightened risk of exposure to acts of terrorism. The insurance industry may also be affected by natural disasters, severe weather and acts of terrorism, and as a result, the availability of insurance covering risks against which we and our competitors typically insure may be limited. In addition, the insurance we are able to obtain may have higher deductibles, higher premiums and more restrictive policy terms, which could adversely affect our results of operations, financial condition and cash flows.

A security breach disrupting our operating systems and facilities or exposing confidential information may adversely affect our reputation, disrupt our operations and increase our costs.

Security breaches of our information technology infrastructure, including cyber-attacks and cyber-terrorism, could lead to system disruptions or generate facility shutdowns. If such an attack or security breach were to occur, our business, results of operations and financial condition could be adversely affected. Additionally, the protection of customer, employee and Company data is crucial to our operational security. A breakdown or a breach in our systems that results in the unauthorized release of individually identifiable customer or other sensitive data could occur and have an adverse effect on our reputation, results of operations and financial condition. A breakdown or breach could also materially increase our costs of maintaining our system and protecting it against future breakdowns or breaches. We take reasonable precautions to safeguard our information systems from cyber-attacks and security breaches; however, there is no guarantee that the procedures implemented to protect against unauthorized access to our information systems are adequate to safeguard against all attacks and breaches.

**REGULATORY, LEGAL AND ENVIRONMENTAL RISKS**

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



The Delaware, Maryland and Florida PSCs regulate our utility operations in those states. Eastern Shore is regulated by the FERC. The PSCs and the FERC set the rates that we can charge customers for services subject to their regulatory jurisdiction. Our ability to obtain timely future rate increases and rate supplements to maintain current rates of return depends on regulatory approvals, and there can be no assurance that our regulated operations will be able to obtain such approvals or maintain currently authorized

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rates of return. When our earnings from the regulated utilities exceed the authorized rate of return, the respective PSC, or the FERC in the case of Eastern Shore, may require us to reduce our rates charged to customers in the future.

We are dependent upon construction of new facilities to support future growth in earnings in our natural gas and electric distribution and natural gas transmission operations.

Construction of new facilities required to support future growth is subject to various regulatory and developmental risks, including but not limited to: (i) our ability to obtain necessary approvals and permits from regulatory agencies on a timely basis and on terms that are acceptable to us; (ii) potential changes in federal, state and local statutes and regulations, including environmental requirements, that prevent a project from proceeding or increase the anticipated cost of the project; (iii) inability to acquire rights-of-way or land rights on a timely basis on terms that are acceptable to us; (iv) lack of anticipated future growth in available natural gas and electricity supply; and (v) insufficient customer throughput commitments.

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

Our operations are subject to the operating hazards and risks normally incidental to handling, storing, transporting, transmitting and delivering natural gas, electricity and propane to end users. From time to time, we are a defendant in legal proceedings arising in the ordinary course of business. We maintain insurance policies with insurers to cover our general liabilities in the amount of \$51 million, which we believe are reasonable and prudent. There can be no assurance, however, that such insurance will be adequate to protect us from all material expenses related to potential future claims for personal injury and property damage or that such levels of insurance will be available in the future at economical prices.

We may face certain regulatory and financial risks related to pipeline safety legislation.

A number of legislative proposals to implement increased oversight over natural gas pipeline operations and increased investment in facilities to inspect pipeline facilities, upgrade pipeline facilities, or control the impact of a breach of such facilities are pending at the federal level. Additional operating expenses and capital expenditures may be necessary to remain in compliance with the increased federal oversight resulting from such proposals. If such legislation is adopted and we incur additional expenses and expenditures as a result, our financial condition, results of operations and cash flows could be adversely affected, particularly if we are not authorized through the regulatory process to recover from customers some or all of these costs and our authorized rate of return.

Costs of compliance with environmental laws may be significant.

We are subject to federal, state and local laws and regulations governing environmental quality and pollution control.

These evolving laws and regulations may require expenditures over a long period of time to control environmental effects at our current and former operating sites, especially former MGP sites. Compliance with these legal obligations requires us to commit capital. If we fail to comply with environmental laws and regulations, even if such failure is caused by factors beyond our control, we may be assessed civil or criminal penalties and fines.

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

Further, existing environmental laws and regulations may be revised, or new laws and regulations seeking to protect the environment may be adopted and be applicable to us. Revised or additional laws and regulations could result in additional operating restrictions on our facilities or increased compliance costs, which may not be fully recoverable. Derivatives legislation and the implementation of related rules could have an adverse impact on our ability to hedge risks associated with our business.

The Dodd-Frank Act regulates derivative transactions, which include certain instruments used in our risk management activities. The Dodd-Frank Act contemplates that most swaps will be required to be cleared through a registered clearing facility and traded on a designated exchange or swap execution facility, subject to certain exceptions for entities that use swaps to hedge or mitigate commercial risk. Although the Dodd-Frank Act includes significant new provisions regarding the regulation of derivatives, the impact of those requirements will not be known definitively

until regulations have been adopted and fully implemented by both the SEC and the Commodities Futures Trading Commission, and market participants establish registered clearing facilities under those regulations. The legislation and any new regulations could increase the operational and transactional cost of derivatives contracts and affect the number and/or creditworthiness of available counterparties.

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Our business may be subject in the future to additional regulatory and financial risks associated with global warming and climate change.

There have been a number of federal and state legislative and regulatory initiatives proposed in recent years in an attempt to control or limit the effects of global warming and overall climate change, including greenhouse gas emissions, such as carbon dioxide. The adoption of this type of legislation by Congress or similar legislation by states or the adoption of related regulations by federal or state governments mandating a substantial reduction in greenhouse gas emissions in the future could have far-reaching and significant impacts on the energy industry. Such new legislation or regulations could result in increased compliance costs for us or additional operating restrictions on our business, affect the demand for natural gas and propane or impact the prices we charge to our customers. At this time, we cannot predict the potential impact of such laws or regulations that may be adopted on our future business, financial condition or financial results.

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ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

Key Properties

We own approximately 1,214 miles of natural gas distribution mains (together with related service lines, meters and regulators) located in New Castle, Kent and Sussex Counties, Delaware; and Cecil, Caroline, Dorchester, Wicomico and Worcester Counties, Maryland. We own 2,642 miles of natural gas distribution mains (and related equipment) in Nassau, Polk, Osceola, Citrus, DeSoto, Liberty, Hillsborough, Holmes, Jackson, Gadsden, Gilchrist, Union, Washington, Pasco, Suwannee, Palm Beach, Broward, Martin, Marion, Seminole and Volusia Counties, Florida. In addition, we have adequate gate stations to handle receipt of the gas into each of the distribution systems. We also own facilities in Delaware and Maryland, which we use for propane-air injection during periods of peak demand. We own and operate through Eastern Shore approximately 437 miles of transmission pipeline, extending from supply interconnects at Parkesburg, Daleville and Honey Brook, Pennsylvania; and Hockessin, Delaware, to 90 delivery points in southeastern Pennsylvania, Delaware and the eastern shore of Maryland. We also own and operate through Peninsula Pipeline approximately e