CHESAPEAKE ENERGY CORP
Form 10-Q
November 06, 2013

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, 2013
[ ] Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from to
Commission File No. 1-13726
Chesapeake Energy Corporation
(Exact name of registrant as specified in its charter)

Oklahoma	73-1395733
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
6100 North Western Avenue	
Oklahoma City, Oklahoma	73118
(Address of principal executive offices)	(Zip Code)

(405) 848-8000
(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 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 [X] NO [ ]

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 "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer [X] Accelerated Filer [ ] Non-accelerated Filer [ ] Smaller Reporting Company [ ]

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

As of November 4, 2013, there were 665,098,207 shares of our $0.01 par value common stock outstanding.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	September 30, 2013	December 31, 2012
	($ in millions)	
CURRENT ASSETS:		
Cash and cash equivalents ($1 and $1 attributable to our VIE)	$987	$287
Restricted cash	75	111
Accounts receivable	2,440	2,245
Short-term derivative assets	11	58
Deferred income tax asset	185	90
Other current assets	296	153
Current assets held for sale	—	4
Total Current Assets	3,994	2,948
PROPERTY AND EQUIPMENT:		
Natural gas and oil properties, at cost based on full cost accounting:		
Evaluated natural gas and oil properties ($488 and $488 attributable to our VIE)	55,175	50,172
Unevaluated properties	12,282	14,755
Oilfield services equipment	2,179	2,130
Other property and equipment	3,360	3,778
Total Property and Equipment, at Cost	72,996	70,835
Less: accumulated depreciation, depletion and amortization (($151) and ($58) attributable to our VIE)	(36,472)	(34,302)
Property and equipment held for sale, net	597	634
Total Property and Equipment, Net	37,121	37,167
LONG-TERM ASSETS:		
Investments	615	728
Long-term derivative assets	2	2
Other long-term assets	556	766
TOTAL ASSETS	$42,288	$41,611

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS – (Continued)
(Unaudited)

	September 30, 2013	December 31, 2012
	($ in millions)	
CURRENT LIABILITIES:		
Accounts payable	$1,730	$1,710
Short-term derivative liabilities ($7 and $4 attributable to our VIE)	170	105
Accrued interest	153	226
Current maturities of long-term debt, net	—	463
Other current liabilities ($24 and $21 attributable to our VIE)	3,625	3,741
Current liabilities held for sale	—	21
Total Current Liabilities	5,678	6,266
LONG-TERM LIABILITIES:		
Long-term debt, net	12,736	12,157
Deferred income tax liabilities	3,423	2,807
Long-term derivative liabilities ($1 and $3 attributable to our VIE)	519	934
Asset retirement obligations	404	375
Other long-term liabilities	1,180	1,176
Total Long-Term Liabilities	18,262	17,449
CONTINGENCIES AND COMMITMENTS (Note 4)		
EQUITY:		
Chesapeake Stockholders' Equity:		
Preferred stock, $0.01 par value, 20,000,000 shares authorized: 7,251,515 shares outstanding	3,062	3,062
Common stock, $0.01 par value, 1,000,000,000 shares authorized: 667,472,869 and 666,467,664 shares issued	7	7
Paid-in capital	12,443	12,293
Retained earnings	905	437
Accumulated other comprehensive loss	(169)	(182)
Less: treasury stock, at cost; 2,246,069 and 2,147,724 common shares	(52)	(48)
Total Chesapeake Stockholders' Equity	16,196	15,569
Noncontrolling interests	2,152	2,327
Total Equity	18,348	17,896
TOTAL LIABILITIES AND EQUITY	$42,288	$41,611

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

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	($ in millions except per share data)			
REVENUES:				
Natural gas, oil and NGL	$1,586	$1,437	$5,444	$4,622
Marketing, gathering and compression	3,032	1,381	6,871	3,710
Oilfield services	249	152	650	446
Total Revenues	4,867	2,970	12,965	8,778
OPERATING EXPENSES:				
Natural gas, oil and NGL production	282	320	877	1,005
Production taxes	62	53	173	141
Marketing, gathering and compression	3,009	1,339	6,781	3,631
Oilfield services	211	116	543	321
General and administrative	120	145	336	436
Restructuring and other termination benefits	63	3	203	4
Natural gas, oil and NGL depreciation, depletion and amortization	652	762	1,945	1,856
Depreciation and amortization of other assets	79	66	234	233
Impairment of natural gas and oil properties	—	3,315	—	3,315
Impairments of fixed assets and other	85	38	343	281
Net (gains) losses on sales of fixed assets	(132)	7	(290)	5
Total Operating Expenses	4,431	6,164	11,145	11,228
INCOME (LOSS) FROM OPERATIONS	436	(3,194)	1,820	(2,450)
OTHER INCOME (EXPENSE):				
Interest expense	(40)	(36)	(164)	(63)
Losses on investments	(22)	(23)	(26)	(87)
Impairment of investment	—	—	(10)	—
Gains (losses) on sales of investments	3	31	(7)	1,061
Losses on purchases of debt	—	—	(70)	—
Other income (expense)	10	(9)	18	2
Total Other Income (Expense)	(49)	(37)	(259)	913
INCOME (LOSS) BEFORE INCOME TAXES	387	(3,231)	1,561	(1,537)
INCOME TAX EXPENSE (BENEFIT):				
Current income taxes	7	22	9	24
Deferred income taxes	140	(1,282)	585	(623)
Total Income Tax Expense (Benefit)	147	(1,260)	594	(599)
NET INCOME (LOSS)	240	(1,971)	967	(938)
Net income attributable to noncontrolling interests	(38)	(41)	(127)	(131)
NET INCOME (LOSS) ATTRIBUTABLE TO CHESAPEAKE	202	(2,012)	840	(1,069)
Preferred stock dividends	(43)	(43)	(128)	(128)
Premium on purchase of preferred shares of a subsidiary	—	—	(69)	—
Earnings allocated to participating securities	(3)	—	(14)	—
	$156	$(2,055)	$629	$(1,197)

NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS				
EARNINGS (LOSS) PER COMMON SHARE:				
Basic	$0.24	$(3.19)	$0.96	$(1.86)
Diluted	$0.24	$(3.19)	$0.96	$(1.86)
CASH DIVIDEND DECLARED PER COMMON SHARE	$0.0875	$0.0875	$0.2625	$0.2625
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING (in millions):				
Basic	656	644	654	643
Diluted	656	644	654	643

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

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	($ in millions)			
NET INCOME (LOSS)	$240	$(1,971)	$967	$(938)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAX:				
Unrealized gain on derivative instruments, net of income tax expense of $1 million, $1 million, $1 million and $1 million	2	3	2	3
Reclassification of (gain) loss on settled derivative instruments, net of income tax expense (benefit) of $1 million, ($3) million, $8 million and ($10) million	2	(6)	13	(18)
Unrealized loss on investments, net of income tax benefit of ($1) million, ($2) million, ($4) million and ($4) million	(1)	(3)	(6)	(7)
Reclassification of (gain) loss on investment, net of income tax expense (benefit) of ($1) million, $0, $3 million and $0	(2)	—	4	—
Other Comprehensive Income (Loss)	1	(6)	13	(22)
COMPREHENSIVE INCOME (LOSS)	241	(1,977)	980	(960)
COMPREHENSIVE INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(38)	(41)	(127)	(131)
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO CHESAPEAKE	$203	$(2,018)	$853	$(1,091)

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2013	2012
	($ in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME (LOSS)	$967	$(938)
ADJUSTMENTS TO RECONCILE NET INCOME TO CASH PROVIDED BY OPERATING ACTIVITIES:		
Depreciation, depletion and amortization	2,179	2,089
Deferred income tax expense (benefit)	585	(623)
Derivative (income) expense	(90)	(828)
Cash (payments) receipts on derivative settlements, net	(91)	388
Stock-based compensation	78	93
Net (gains) losses on sales of fixed assets	(290)	6
Impairment of natural gas and oil properties	—	3,315
Impairments of fixed assets and other	317	256
Losses on investments	30	147
(Gains) losses on sales of investments	7	(1,061)
Losses on purchases of debt	12	—
Impairment of investment	10	—
Restructuring and other termination benefits	164	4
Other	35	76
Changes in assets and liabilities	(352)	(946)
Net Cash Provided By Operating Activities	3,561	1,978
CASH FLOWS FROM INVESTING ACTIVITIES:		
Drilling and completion costs	(4,470)	(7,525)
Acquisitions of proved and unproved properties	(811)	(2,813)
Proceeds from divestitures of proved and unproved properties	2,789	2,445
Additions to other property and equipment	(639)	(1,916)
Proceeds from sales of other assets	796	219
Additions to investments	(8)	(261)
Proceeds from sales of investments	115	2,000
(Increase) decrease in restricted cash	177	(280)
Other	4	(23)
Net Cash Used In Investing Activities	(2,047)	(8,154)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from credit facilities borrowings	7,136	13,986
Payments on credit facilities borrowings	(7,268)	(13,614)
Proceeds from issuance of senior notes, net of discount and offering costs	2,274	1,263
Proceeds from issuance of term loans, net of discount and offering costs	—	3,789
Cash paid to purchase debt	(2,116)	—
Cash paid for common stock dividends	(175)	(170)
Cash paid for preferred stock dividends	(128)	(128)
Cash paid on financing derivatives	(62)	(36)
Cash paid for prepayment of mortgage	(55)	—
Proceeds from sales of noncontrolling interests	5	1,056

Proceeds from other financings	22	225
Cash paid to purchase preferred shares of a subsidiary	(212)	—
Distributions to noncontrolling interest owners	(164)	(163)
Other	(71)	(227)
Net Cash Provided By (Used In) Financing Activities	(814)	5,981
Change in cash and cash equivalents classified as current assets held for sale	—	(14)
Net increase (decrease) in cash and cash equivalents	700	(209)
Cash and cash equivalents, beginning of period	287	351
Cash and cash equivalents, end of period	$987	$142

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS – (Continued)
(Unaudited)

Supplemental disclosures to the condensed consolidated statements of cash flows are presented below:

	Nine Months Ended September 30,	
	2013	2012
	($ in millions)	
SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest, net of capitalized interest	$62	$—
Income taxes, net of refunds received	$14	$31
SUPPLEMENTAL DISCLOSURE OF SIGNIFICANT NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Change in accrued drilling and completion costs	$(97)	$(103)
Change in accrued acquisitions of proved and unproved properties	$(1)	$60
Change in accrued additions to other property and equipment	$(80)	$57

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)

	Nine Months Ended September 30,	
	2013	2012
	($ in millions)	
PREFERRED STOCK:		
Balance, beginning and end of period	$3,062	$3,062
COMMON STOCK:		
Balance, beginning and end of period	7	7
PAID-IN CAPITAL:		
Balance, beginning of period	12,293	12,146
Stock-based compensation	156	116
Reduction in tax benefit from stock-based compensation	(10)	(18)
Exercise of stock options	4	2
Balance, end of period	12,443	12,246
RETAINED EARNINGS:		
Balance, beginning of period	437	1,608
Net income (loss) attributable to Chesapeake	840	(1,069)
Dividends on common stock	(175)	(170)
Dividends on preferred stock	(128)	(128)
Premium on purchase of preferred shares of a subsidiary	(69)	—
Balance, end of period	905	241
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):		
Balance, beginning of period	(182)	(166)
Hedging activity	15	(15)
Investment activity	(2)	(7)
Balance, end of period	(169)	(188)
TREASURY STOCK – COMMON:		
Balance, beginning of period	(48)	(33)
Purchase of 249,498 and 357,565 shares for company benefit plans	(6)	(9)
Release of 151,153 and 49,591 shares from company benefit plans	2	1
Balance, end of period	(52)	(41)
TOTAL CHESAPEAKE STOCKHOLDERS' EQUITY	16,196	15,327
NONCONTROLLING INTERESTS:		
Balance, beginning of period	2,327	1,337
Sales of noncontrolling interests	5	1,056
Net income attributable to noncontrolling interests	127	131
Distributions to noncontrolling interest owners	(164)	(160)
Purchase of preferred shares of a subsidiary	(143)	—
Balance, end of period	2,152	2,364
TOTAL EQUITY	$18,348	$17,691

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

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation and Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying unaudited condensed consolidated financial statements of Chesapeake Energy Corporation (“Chesapeake” or the “Company”) and its subsidiaries have been prepared in accordance with the instructions to Form 10-Q as prescribed by the Securities and Exchange Commission (SEC). This Form 10-Q relates to the three and nine months ended September 30, 2013 (the “Current Quarter” and the “Current Period”, respectively) and the three and nine months ended September 30, 2012 (the “Prior Quarter” and the “Prior Period”, respectively). Chesapeake’s annual report on Form 10-K for the year ended December 31, 2012 (“2012 Form 10-K”) includes certain definitions and a summary of significant accounting policies and should be read in conjunction with this Form 10-Q. All material adjustments (consisting solely of normal recurring adjustments) which, in the opinion of management, are necessary for a fair presentation of the results for the interim periods have been reflected. The accompanying condensed consolidated financial statements of Chesapeake include the accounts of our direct and indirect wholly owned subsidiaries and entities in which Chesapeake holds a controlling interest. All significant intercompany accounts and transactions have been eliminated. The results for the Current Quarter and Current Period are not necessarily indicative of the results to be expected for the full year.

Critical Accounting Policies

We consider accounting policies related to variable interest entities, natural gas and oil properties, derivatives and income taxes to be critical policies. These policies are summarized in Item 7 of our 2012 Form 10-K.

Risks and Uncertainties

Our primary business strategy over the last few years was to continue growing our reserves and production while transitioning from an asset base primarily focused on natural gas to an asset base more balanced between natural gas and liquids production. This was a capital-intensive strategy, and we made capital expenditures historically and in the Current Period that exceeded our cash flow from operations, supplementing such cash flows with borrowings, proceeds from strategic joint ventures and sales of assets that we determined were noncore or did not fit our long-term plans. The full year 2013 gap between forecasted capital expenditures and expected cash flow from operations is approximately $3.5 billion; however, this expected spending gap has been fully covered by joint venture and asset sales proceeds received year to date. We are working to execute our business with greater financial discipline and are targeting to balance capital expenditures with cash flow from operations over time. We expect to have the flexibility to fund any short-term disparities using our $4.0 billion corporate revolving credit facility, which was undrawn at September 30, 2013. As we apply available cash from future asset sales and operations towards reducing our financial leverage and complexity, we may incur various cash and noncash charges including but not limited to impairments of fixed assets, lease termination charges or financing extinguishment costs.

We continue to have significant exposure to natural gas prices. Approximately 70% of our estimated proved reserve volumes as of December 31, 2012 were natural gas, and natural gas represented approximately 73% and 80% of our natural gas, oil and NGL sales volumes for the Current Quarter and the year ended December 31, 2012, respectively. To add more certainty to our future estimated cash flows, we currently have downside price protection, in the form of over-the-counter derivative contracts, on approximately 80% of our remaining 2013 estimated natural gas production at an average price of $3.69 per mcf and 91% of our remaining 2013 estimated oil production at an average price of $95.59 per bbl. We also have derivative contracts providing downside price protection in 2014 on 251 bcf of natural gas at an average price of $4.22 per mcf and 22 mmbbls of oil at an average price of $93.79 per bbl. While our use of derivative contracts allows us to reduce our exposure to price volatility on our cash flows and EBITDA (defined as earnings before interest, taxes, depreciation, depletion and amortization), the derivative contracts we elect to enter into for any period depend on our outlook on future prices and our risk assessment. Low natural gas, oil and NGL prices can reduce our estimate of proved reserves, potentially resulting in a future write-down of the carrying value of our natural gas and oil properties. In 2012, when natural gas prices reached 10-year lows, we reduced our estimate of proved reserves by 3.1 tcfe, or 17%, primarily due to the impact of downward natural gas price revisions, and we incurred a $3.3 billion write-down of the carrying value of our natural gas and oil properties. Future impairments of the carrying value of our natural gas and oil properties, if any, will be dependent on many factors, including natural gas, oil and NGL prices, production rates, levels of reserves, the evaluation of costs excluded from amortization, the timing and impact of asset sales, future development costs and service costs.

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(unaudited)

Assets and Liabilities Held for Sale

In the Current Period, we determined we would sell certain of our buildings and land (other than our core campus) in the Oklahoma City area. In addition, as of September 30, 2013, we were continuing to pursue the sale of various land and buildings located in the Fort Worth, Texas area. The land and buildings in both the Oklahoma City and Fort Worth areas are reported under our other segment. We are also pursuing the sale of various other property and equipment, including certain drilling rigs, compressors and gathering systems. The drilling rigs are reported under our oilfield services operating segment and the compressors and gathering systems are reported under our marketing, gathering and compression operating segment. These assets are being actively marketed, and we believe it is probable they will be sold over the next 12 months. As a result, these assets qualified as held for sale as of September 30, 2013. Natural gas and oil properties that we intend to sell are not presented as held for sale pursuant to the rules governing full cost accounting for oil and gas properties. A summary of the assets and liabilities held for sale on our condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012 is detailed below.

	September 30, 2013	December 31, 2012
	($ in millions)	
Accounts receivable	$—	$4
Current assets held for sale	$—	$4
Natural gas gathering systems and treating plants, net of accumulated depreciation	$10	$352
Oilfield services equipment, net of accumulated depreciation	26	27
Compressors, net of accumulated depreciation	242	—
Buildings and land, net of accumulated depreciation	319	255
Property and equipment held for sale, net	$597	$634
Accounts payable	$—	$4
Accrued liabilities	—	17
Current liabilities held for sale	$—	$21

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(unaudited)

Accumulated Other Comprehensive Income (Loss)

For the Current Period, changes in accumulated other comprehensive income (loss) by component, net of tax, are detailed below.

	Net Gains (Losses) on Cash Flow Hedges	Net Gains (Losses) on Investments	Total
	($ in millions)		
Balance, December 31, 2012	$(189)	$7	$(182)
Other comprehensive income before reclassifications	2	(6)	(4)
Amounts reclassified from accumulated other comprehensive income	13	4	17
Net current period other comprehensive income	15	(2)	13
Balance, September 30, 2013	$(174)	$5	$(169)

For the Current Quarter and the Current Period, amounts reclassified from accumulated other comprehensive income (loss), net of tax, into the condensed consolidated statement of operations are detailed below.

Details About Accumulated Other Comprehensive Income (Loss) Components	Affected Line Item in the Statement Where Net Income is Presented	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
		($ in millions)	
Net losses on cash flow hedges:			
Commodity contracts	Natural gas, oil and NGL revenues	$2	$13
Investments:			
Impairment of investment	Impairment of investment	—	6
Sale of investment	Gain on sale of investment	(2)	(2)
Total reclassifications for the period, net of tax		$—	$17

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(unaudited)

2. Earnings Per Share

For the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, our contingent convertible senior notes did not have a dilutive effect and therefore were excluded from the calculation of diluted earnings per share (EPS). See Note 3 for further discussion of our contingent convertible senior notes. Participating securities, for purposes of our EPS computations, consist of unvested restricted stock issued to our employees and non-employee directors that provide dividend rights.

For the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, the following shares of cumulative convertible preferred stock and unvested restricted stock and associated adjustments to net income, consisting of dividends on such shares, were excluded from the calculation of diluted EPS, as the effect was antidilutive:

	Net Income Adjustments	Shares
	($ in millions)	(in millions)
Three Months Ended September 30, 2013:		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$21	56
5.75% cumulative convertible preferred stock (series A)	$16	39
5.00% cumulative convertible preferred stock (series 2005B)	$3	5
4.50% cumulative convertible preferred stock	$3	6
Unvested restricted stock	$3	2
Three Months Ended September 30, 2012:		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$21	56
5.75% cumulative convertible preferred stock (series A)	$16	39
5.00% cumulative convertible preferred stock (series 2005B)	$3	5
4.50% cumulative convertible preferred stock	$3	6
Unvested restricted stock	$—	3
Nine Months Ended September 30, 2013:		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$64	56
5.75% cumulative convertible preferred stock (series A)	$47	40
5.00% cumulative convertible preferred stock (series 2005B)	$8	5
4.50% cumulative convertible preferred stock	$9	6
Unvested restricted stock	$14	3
Nine Months Ended September 30, 2012:		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$64	56
5.75% cumulative convertible preferred stock (series A)	$47	39
5.00% cumulative convertible preferred stock (series 2005B)	$8	5
4.50% cumulative convertible preferred stock	$9	6
Unvested restricted stock	$—	4

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)
(unaudited)

3. Debt

Our long-term debt consisted of the following as of September 30, 2013 and December 31, 2012:

	September 30, 2013	December 31, 2012
	($ in millions)	
Term loan due 2017	$2,000	$2,000
7.625% senior notes due 2013	—	464
9.5% senior notes due 2015	1,265	1,265
3.25% senior notes due 2016	500	—
6.25% euro-denominated senior notes due 2017[a]	465	454
6.5% senior notes due 2017	660	660
6.875% senior notes due 2018	97	474
7.25% senior notes due 2018	669	669
6.625% senior notes due 2019[b]	650	650
6.775% senior notes due 2019	—	1,300
6.625% senior notes due 2020	1,300	1,300
6.875% senior notes due 2020	500	500
6.125% senior notes due 2021	1,000	1,000
5.375% senior notes due 2021	700	—
5.75% senior notes due 2023	1,100	—
2.75% contingent convertible senior notes due 2035[c]	396	396
2.5% contingent convertible senior notes due 2037[c]	1,168	1,168
2.25% contingent convertible senior notes due 2038[c]	347	347
Corporate revolving bank credit facility	—	—
Oilfield services revolving bank credit facility	285	418
Discount on senior notes and term loan[d]	(380)	(465)
Interest rate derivatives[e]	14	20
Total debt, net	12,736	12,620
Less current maturities of long-term debt, net[f]	—	(463)
Total long-term debt, net	$12,736	$12,157

(a) The principal amount shown is based on the exchange rate of $1.3527 to €1.00 and $1.3193 to €1.00 as of September 30, 2013 and December 31, 2012, respectively. See Note 7 for information on our related foreign currency derivatives.

(b) Issuers are Chesapeake Oilfield Operating, L.L.C. (COO), an indirect wholly owned subsidiary of the Company, and Chesapeake Oilfield Finance, Inc. (COF), a wholly owned subsidiary of COO formed solely to facilitate the offering of the 6.625% Senior Notes due 2019. COF is nominally capitalized and has no operations or revenues. Chesapeake Energy Corporation is the issuer of all other senior notes and the contingent convertible senior notes.

(c) The holders of our contingent convertible senior notes may require us to repurchase, in cash, all or a portion of their notes at 100% of the principal amount of the notes on any of four dates that are five, ten, fifteen and twenty years before the maturity date. The notes are convertible, at the holder's option, prior to maturity under certain circumstances into cash and, if applicable, shares of our common stock using a net share settlement process. One such triggering circumstance is when the price of our common stock exceeds a threshold amount during a specified period in a fiscal quarter. Convertibility based on common stock price is measured quarterly. In the Current Quarter, the price of our common stock was below the threshold level for each series of the contingent convertible senior notes during the specified period and, as a result, the holders do not have the option to convert

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their notes into cash and common stock in the fourth quarter of 2013 under this provision. The notes are also convertible, at the holder's option, during specified five-day periods if the trading price of the notes is below certain levels determined by reference to the trading price of our common stock. During the Current Quarter, the notes were not convertible under this provision. In general, upon conversion of a contingent convertible senior note, the holder will receive cash equal to the principal amount of the note and common stock for the note's conversion value in excess of such principal amount. We will pay contingent interest on the convertible senior notes after they have been outstanding at least ten years under certain conditions. We may redeem the convertible senior notes once they have been outstanding for ten years at a redemption price of 100% of the principal amount of the notes, payable in cash. The optional repurchase dates, the common stock price conversion threshold amounts and the ending date of the first six-month period in which contingent interest may be payable for the contingent convertible senior notes are as follows:

Contingent Convertible Senior Notes	Repurchase Dates	Common Stock Price Conversion Thresholds	Contingent Interest First Payable (if applicable)
2.75% due 2035	November 15, 2015, 2020, 2025, 2030	$48.31	May 14, 2016
2.5% due 2037	May 15, 2017, 2022, 2027, 2032	$63.62	November 14, 2017
2.25% due 2038	December 15, 2018, 2023, 2028, 2033	$107.01	June 14, 2019

(d) Discount as of September 30, 2013 and December 31, 2012 included $322 million and $376 million, respectively, associated with the equity component of our contingent convertible senior notes. This discount is amortized based on an effective yield method. The discount also included $34 million and $40 million as of September 30, 2013 and December 31, 2012, respectively, associated with our term loan discussed further below.

(e) See Note 7 for further discussion related to these instruments.

(f) As of December 31, 2012, there was $1 million of discount associated with the 7.625% Senior Notes due 2013.

Term Loan

In November 2012, we established an unsecured five-year term loan credit facility in an aggregate principal amount of $2.0 billion for net proceeds of $1.935 billion. Our obligations under the facility rank equally with our outstanding senior notes and contingent convertible senior notes and are unconditionally guaranteed on a joint and several basis by our direct and indirect wholly owned subsidiaries that are subsidiary guarantors under the indentures for such notes. Amounts borrowed under the facility bear interest at our option, at either (i) the Eurodollar rate, which is based on the London Interbank Offered Rate (LIBOR), plus a margin of 4.50% or (ii) a base rate equal to the greater of (a) the Bank of America, N.A. prime rate, (b) the federal funds effective rate plus 0.50% per annum and (c) the Eurodollar rate that would be applicable to a Eurodollar loan with an interest period of one month plus 1% per annum, in each case, plus a margin of 3.50%. The Eurodollar rate is subject to a floor of 1.25% per annum, and the base rate is subject to a floor of 2.25% per annum. Interest is payable quarterly or, if the Eurodollar rate applies, it may be payable at more frequent intervals.

The term loan matures on December 2, 2017 and may be voluntarily repaid at a make-whole price in the first year, at par plus a specified premium in the second and third years and at any time thereafter at par. The term loan may also be refinanced or amended to extend the maturity date at our option, subject to lender approval.

The term loan credit agreement contains negative covenants substantially similar to those contained in the Company's corporate revolving bank credit facility, including covenants that limit our ability to incur indebtedness, grant liens, make investments, loans and restricted payments and enter into certain business combination transactions. Other covenants include additional restrictions regarding the incurrence of certain unsecured indebtedness, the incurrence of secured indebtedness, the disposition of assets and the prepayment of certain indebtedness. The term loan credit agreement does not contain financial maintenance covenants.

We were in compliance with all covenants under the term loan credit agreement as of September 30, 2013. If we should fail to perform our obligations under the agreement, the term loan could be terminated and any outstanding borrowings under the term loan credit agreement could be declared immediately due and payable. The term loan credit agreement also has cross default provisions that apply to other indebtedness of Chesapeake and its restricted subsidiaries with an outstanding principal amount in excess of $125 million.

Chesapeake Senior Notes and Contingent Convertible Senior Notes

The Chesapeake senior notes and the contingent convertible senior notes are unsecured senior obligations of Chesapeake and rank equally in right of payment with all of our other existing and future senior unsecured indebtedness and rank senior in right of payment to all of our future subordinated indebtedness. Chesapeake is a holding company and owns no operating assets and has no significant operations independent of its subsidiaries. Chesapeake's obligations under the senior notes and the contingent convertible senior notes are jointly and severally, fully and unconditionally guaranteed by certain of our direct and indirect wholly owned subsidiaries. See Note 16 for condensed consolidating financial information regarding our guarantor and non-guarantor subsidiaries.

We may redeem the senior notes, other than the contingent convertible senior notes, at any time at specified make-whole or redemption prices. Our senior notes are governed by indentures containing covenants that may limit our ability and our subsidiaries' ability to incur certain secured indebtedness, enter into sale/leaseback transactions, and consolidate, merge or transfer assets. The indentures governing the senior notes and the contingent convertible senior notes do not have any financial or restricted payment covenants. The senior notes and contingent convertible senior notes indentures have cross default provisions that apply to other indebtedness the Company or any guarantor subsidiary may have from time to time with an outstanding principal amount of at least $50 million, depending on the indenture.

We are required to account for the liability and equity components of our convertible debt instruments separately and to reflect interest expense at the interest rate of similar nonconvertible debt at the time of issuance. The applicable rates for our 2.75% Contingent Convertible Senior Notes due 2035, our 2.5% Contingent Convertible Senior Notes due 2037 and our 2.25% Contingent Convertible Senior Notes due 2038 are 6.86%, 8.0% and 8.0%, respectively.

During the Current Period, we issued $2.3 billion in aggregate principal amount of senior notes at par in a registered public offering. The offering included three series of notes: $500 million in aggregate principal amount of 3.25% Senior Notes due 2016; $700 million in aggregate principal amount of 5.375% Senior Notes due 2021; and $1.1 billion in aggregate principal amount of 5.75% Senior Notes due 2023. We used a portion of the net proceeds of $2.274 billion to repay outstanding indebtedness under our corporate revolving bank credit facility and purchase certain senior notes. We purchased $217 million in aggregate principal amount of our 7.625% Senior Notes due 2013 for $221 million and $377 million in aggregate principal amount of our 6.875% Senior Notes due 2018 for $405 million pursuant to tender offers which expired on April 12, 2013. We recorded a loss of approximately $37 million associated with the tender offers, including $32 million in premiums and $5 million of unamortized deferred charges. During the Current Quarter, we retired at maturity the remaining $247 million aggregate principal amount outstanding of our 7.625% Senior Notes due 2013.

During the Prior Period, we issued $1.3 billion in aggregate principal amount of our 6.775% Senior Notes due 2019 (the "2019 Notes") in a registered public offering. We used the net proceeds of $1.263 billion from the offering to repay outstanding indebtedness under our corporate revolving bank credit facility. On May 13, 2013, we redeemed the 2019 Notes at par pursuant to notice of special early redemption. We recorded a loss of approximately $33 million associated with the redemption, including $19 million of unamortized deferred charges and $14 million of discount. As described in the following paragraph, the special early redemption was the subject of recent litigation.

In March 2013, the Company brought suit in the U.S. District Court for the Southern District of New York (the "Court") against The Bank of New York Mellon Trust Company, N.A. ("BNY Mellon"), the indenture trustee for the 2019 Notes. The Company sought a declaration that the notice it issued on March 15, 2013 to redeem all of the 2019 Notes at par (plus accrued interest through the redemption date) was timely and effective pursuant to the special early redemption provision of the supplemental indenture governing the 2019 Notes. BNY Mellon asserted that the March 15, 2013 notice was not effective to redeem the 2019 Notes at par because it was not timely for that purpose and because of the specific phrasing in the notice that provided it would not be effective unless the Court concluded it was timely. The

Court conducted a trial on the matter in late April and on May 8, 2013 ruled in the Company's favor. On May 11, 2013, BNY Mellon filed notice of an appeal of the decision with the United States Court of Appeals for the Second Circuit and the appeal is currently pending.

No scheduled principal payments are required on our senior notes until 2015.

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COO Senior Notes

The COO senior notes are the unsecured senior obligations of COO and rank equally in right of payment with all of COO’s other existing and future senior unsecured indebtedness and rank senior in right of payment to all of its future subordinated indebtedness. The COO senior notes are jointly and severally, fully and unconditionally guaranteed by all of COO’s wholly owned subsidiaries, other than de minimis subsidiaries. The notes may be redeemed by COO at any time at specified make-whole or redemption prices and, prior to November 15, 2014, up to 35% of the aggregate principal amount may be redeemed in connection with certain equity offerings. Holders of the COO notes have the right to require COO to repurchase their notes upon a change of control on the terms set forth in the indenture, and COO must offer to repurchase the notes upon certain asset sales. The COO senior notes are subject to covenants that may, among other things, limit the ability of COO and its subsidiaries to make restricted payments, incur indebtedness, issue preferred stock, create liens, and consolidate, merge or transfer assets. The COO senior notes have cross default provisions that apply to other indebtedness COO or any of its guarantor subsidiaries may have from time to time with an outstanding principal amount of $50 million or more.

Under a registration rights agreement, we agreed to file a registration statement enabling holders of the COO senior notes to exchange the privately placed COO senior notes for publicly registered notes with substantially the same terms. The exchange offer was completed on July 19, 2013.

Bank Credit Facilities

During the Current Period, we had two revolving bank credit facilities as sources of liquidity. In addition, in the Prior Period, we had a midstream credit facility. In June 2012, we paid off and terminated our midstream credit facility. Our remaining revolving bank credit facilities are described below.

	Corporate Credit Facility[(a)]	Oilfield Services Credit Facility[(b)]
	($ in millions)	
Facility structure	Senior secured revolving	Senior secured revolving
Maturity date	December 2015	November 2016
Borrowing capacity	$4,000	$500
Amount outstanding as of September 30, 2013	$—	$285
Letters of credit outstanding as of September 30, 2013	$23	$—

(a) Co-borrowers are Chesapeake Exploration, L.L.C., Chesapeake Appalachia, L.L.C. and Chesapeake Louisiana, L.P.

(b) Borrower is COO.

Our credit facilities do not contain material adverse change or adequate assurance covenants. Although the applicable interest rates under our corporate credit facility fluctuate slightly based on our long-term senior unsecured credit ratings, our credit facilities do not contain provisions which would trigger an acceleration of amounts due under the respective facilities or a requirement to post additional collateral in the event of a downgrade of our credit ratings.

Corporate Credit Facility. Our $4.0 billion syndicated revolving bank credit facility is used for general corporate purposes. Borrowings under the facility are secured by proved reserves and bear interest at our option at either (i) the greater of the reference rate of Union Bank, N.A. or the federal funds effective rate plus 0.50%, both of which are subject to a margin that varies from 0.50% to 1.25% per annum according to our senior unsecured long-term debt ratings, or (ii) the Eurodollar rate, which is based on LIBOR, plus a margin that varies from 1.50% to 2.25% per annum according to our senior unsecured long-term debt ratings. The collateral value and borrowing base are determined periodically. The unused portion of the facility is subject to a commitment fee of 0.50% per annum. Interest is payable quarterly or, if LIBOR applies, it may be payable at more frequent intervals.

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Our corporate credit facility agreement contains various covenants and restrictive provisions which limit our ability to incur additional indebtedness, make investments or loans and create liens and require us to maintain an indebtedness to total capitalization ratio and an indebtedness to EBITDA ratio, in each case as defined in the agreement. We were in compliance with all covenants under our corporate credit facility agreement as of September 30, 2013.

In September 2012, we entered into an amendment to the credit facility agreement, effective September 30, 2012. The amendment, among other things, adjusted our required indebtedness to EBITDA ratio through the earlier of (i) December 31, 2013 and (ii) the date on which we elected to reinstate the indebtedness to EBITDA ratio in effect prior to the amendment (in either case, the "Amendment Effective Period"). The credit facility amendment also increased the applicable margin by 0.25% for borrowings during the Amendment Effective Period when credit extensions exceeded 50% of the borrowing capacity. The amendment did not allow our collateral value securing the borrowings to be more than $75 million below the collateral value that was in effect as of September 30, 2012 during the Amendment Effective Period. During the Amendment Effective Period, the amendment increased the maximum indebtedness to EBITDA ratio to 6.00 to 1.00 as of September 30, 2012, 5.00 to 1.00 as of December 31, 2012 and 4.75 to 1.00 as of March 31, 2013. On June 28, 2013, we elected to reinstate the indebtedness to EBITDA ratio to 4.00 to 1.00, which was the ratio in effect prior to the amendment.

Our corporate credit facility is fully and unconditionally guaranteed, on a joint and several basis, by Chesapeake and certain of our wholly owned subsidiaries. If we should fail to perform our obligations under the credit facility agreement, the revolving credit commitment could be terminated and any outstanding borrowings under the facility could be declared immediately due and payable. Such acceleration, if involving a principal amount of $50 million or more, would constitute an event of default under our senior note and contingent convertible senior note indentures, which could in turn result in the acceleration of a significant portion of such indebtedness. The credit facility agreement also has cross default provisions that apply to our secured hedging facility, equipment master lease agreements, term loan and other indebtedness of Chesapeake and its restricted subsidiaries with an outstanding principal amount in excess of $125 million. In addition, the facility contains a restriction on our ability to declare and pay cash dividends on our common or preferred stock if an event of default has occurred.

Oilfield Services Credit Facility. Our $500 million syndicated oilfield services revolving bank credit facility is used to fund capital expenditures and for general corporate purposes associated with our oilfield services operations. Borrowings under the oilfield services credit facility are secured by all of the assets of the wholly owned subsidiaries of COO, itself an indirect wholly owned subsidiary of Chesapeake. The facility has initial commitments of $500 million and may be expanded to $900 million at COO's option, subject to additional bank participation. Borrowings under the credit facility are secured by all of the equity interests and assets of COO and its wholly owned subsidiaries (the restricted subsidiaries for this facility, which are unrestricted subsidiaries under Chesapeake's senior notes, contingent convertible senior notes, term loan and corporate revolving bank credit facility), and bear interest at our option at either (i) the greater of the reference rate of Bank of America, N.A., the federal funds effective rate plus 0.50%, or one-month LIBOR plus 1.00%, all of which are subject to a margin that varies from 1.00% to 1.75% per annum, or (ii) the Eurodollar rate, which is based on LIBOR plus a margin that varies from 2.00% to 2.75% per annum. The unused portion of the credit facility is subject to a commitment fee that varies from 0.375% to 0.50% per annum. Both margins and commitment fees are determined according to the most recent leverage ratio described below. Interest is payable quarterly or, if LIBOR applies, it may be payable at more frequent intervals.

The oilfield services credit facility agreement contains various covenants and restrictive provisions which limit the ability of COO and its restricted subsidiaries to enter into asset sales, incur additional indebtedness, make investments or loans and create liens. The agreement requires maintenance of a leverage ratio based on the ratio of lease-adjusted indebtedness to earnings before interest, taxes, depreciation, amortization and rent (EBITDAR), a senior secured leverage ratio based on the ratio of secured indebtedness to EBITDA and a fixed charge coverage ratio based on the ratio of EBITDAR to lease-adjusted interest expense, in each case as defined in the agreement. COO was in compliance with all covenants under the agreement as of September 30, 2013. If COO or its restricted subsidiaries should fail to perform their obligations under the agreement, the revolving credit commitment could be terminated and any outstanding borrowings under the facility could be declared immediately due and payable. Such acceleration, if involving a principal amount of $50 million or more, would constitute an event of default under our COO senior note indenture, which could in turn result in the acceleration of the COO senior note indebtedness. The oilfield services credit facility agreement also has cross default provisions that apply to other indebtedness COO and its restricted subsidiaries may have from time to time with an outstanding principal amount in excess of $15 million.

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4. Contingencies and Commitments

Contingencies

Litigation and Regulatory Proceedings

The Company is involved in a number of litigation and regulatory proceedings (including those described below). Many of these proceedings are in early stages, and many of them seek an indeterminate amount of damages. We estimate and provide for potential losses that may arise out of litigation and regulatory proceedings to the extent that such losses are probable and can be reasonably estimated. Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total estimated liability in respect of litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses after considering, among other factors, the progress of each case or proceeding, our experience and the experience of others in similar cases or proceedings, and the opinions and views of legal counsel. We account for legal defense costs in the period the costs are incurred.

July 2008 Common Stock Offering. On February 25, 2009, a putative class action was filed in the U.S. District Court for the Southern District of New York against the Company and certain of its officers and directors along with certain underwriters of the Company's July 2008 common stock offering. The plaintiff filed an amended complaint on September 11, 2009 alleging that the registration statement for the offering contained material misstatements and omissions and seeking damages under Sections 11, 12 and 15 of the Securities Act of 1933 of an unspecified amount and rescission. The action was transferred to the U.S. District Court for the Western District of Oklahoma on October 13, 2009. Chesapeake and the officer and director defendants moved for summary judgment on grounds of loss causation and materiality on December 28, 2011, and the motion was granted as to all claims as a matter of law on March 29, 2013. Final judgment in favor of Chesapeake and the officer and director defendants was entered on June 21, 2013, and the plaintiff filed a notice of appeal on July 19, 2013 in the U.S. Court of Appeals for the Tenth Circuit. We are currently unable to assess the probability of loss or estimate a range of potential loss associated with this matter.

A derivative action relating to the July 2008 offering filed in the U.S. District Court for the Western District of Oklahoma on September 6, 2011 is pending. Following the denial on September 28, 2012 of its motion to dismiss and pursuant to court order, nominal defendant Chesapeake filed an answer in the case on October 12, 2012. By stipulation between the parties, the individual defendants are not required to answer the complaint unless and until the plaintiff establishes standing to pursue claims derivatively.

2012 Securities and Shareholder Litigation. A putative class action was filed in the U.S. District Court for the Western District of Oklahoma on April 26, 2012 against the Company and its former CEO, Aubrey K. McClendon. On July 20, 2012, the court appointed a lead plaintiff, which filed an amended complaint on October 19, 2012 against the Company, Mr. McClendon and certain other officers. The amended complaint asserted claims under Sections 10(b) (and Rule 10b-5 promulgated thereunder) and 20(a) of the Securities Exchange Act of 1934 based on alleged misrepresentations regarding the Company's asset monetization strategy, including liabilities associated with its volumetric production payment (VPP) transactions, as well as Mr. McClendon's personal loans and the Company's internal controls. On December 6, 2012, the Company and other defendants filed a motion to dismiss the action. On April 10, 2013, the Court granted the motion, and on April 16, 2013 entered judgment against the plaintiff and dismissed the complaint with prejudice. The plaintiff filed a notice of appeal on June 14, 2013 in the U.S. Court of Appeals for the Tenth Circuit. We are currently unable to assess the probability of loss or estimate a range of potential loss associated with this matter.

A related federal consolidated derivative action and an Oklahoma state court derivative action are stayed pursuant to the parties' stipulation pending resolution of the appeal in the federal securities class action. Two additional related state court derivative actions were appealed to the Oklahoma Supreme Court, one on May 31, 2013 and the other on June 20, 2013. In both cases, the District Court of Oklahoma County, Oklahoma had granted Chesapeake's motion to dismiss for lack of derivative standing.

In June and July 2012, three putative class actions were filed in the U.S. District Court for the Western District of Oklahoma against the Company, Chesapeake Energy Savings and Incentive Stock Bonus Plan (the Plan), and certain of the Company's officers and directors alleging breaches of fiduciary duties under the Employee Retirement Income Security Act (ERISA). The three cases have been consolidated, and the Plan was not named in the consolidated amended complaint which was filed on February 21, 2013. The action was brought on behalf of participants and beneficiaries of the Plan and alleged that, as fiduciaries of the Plan, defendants owed fiduciary duties, which they purportedly breached by, among other things, failing to manage and administer the Plan's assets with appropriate skill and care and engaging in activities that were in conflict with the best interest of the Plan. The plaintiffs sought class certification, damages of an unspecified amount, equitable relief, and attorneys' fees and other costs. The defendants filed a motion to dismiss on April 22, 2013, which was granted on October 11, 2013. We are currently unable to assess the probability of loss or estimate a range of potential loss associated with this matter.
On May 8, 2012, a derivative action was filed in the District Court of Oklahoma County, Oklahoma against the Company's directors alleging, among other things, breaches of fiduciary duties and corporate waste related to the Company's officers, and directors' use of the Company's fractionally owned corporate jets. On August 21, 2012, the District Court granted the Company's motion to dismiss for lack of derivative standing, and the plaintiff appealed the ruling on December 6, 2012.
Regulatory Proceedings. On May 2, 2012, Chesapeake and Mr. McClendon received notice from the U.S. Securities and Exchange Commission that its Fort Worth Regional Office had commenced an informal inquiry into, among other things, certain of the matters alleged in the foregoing lawsuits. On December 21, 2012, the SEC's Fort Worth Regional Office advised Chesapeake that its inquiry is continuing as an investigation. The Company is providing information and testimony to the SEC pursuant to subpoenas and otherwise in connection with this matter and is also responding to related inquiries from other governmental and regulatory agencies and self-regulatory organizations.
The Company has received, from the U.S. Department of Justice (DOJ) and certain state governmental agencies, subpoenas and demands for documents, information and testimony in connection with investigations into possible violations of federal and state laws relating to our purchase and lease of oil and gas rights. Chesapeake has engaged in discussions with the DOJ and state agencies and continues to respond to such subpoenas and demands, including the subpoena issued by the DOJ's Antitrust Division, Midwest Field Office on June 29, 2012 relating to an investigation into possible violations of antitrust laws being conducted by a grand jury in the Western District of Michigan and a subpoena issued by the Michigan Department of Attorney General on September 16, 2013 relating to its investigation of possible violations of that state's criminal solicitation law. Chesapeake's Board of Directors commenced in June 2012 its own investigation of certain conduct covered by the DOJ subpoena, and in February 2013, the Company announced the Board's conclusion that the Company did not violate antitrust laws in connection with the acquisition of Michigan oil and gas rights in 2010.
Business Operations. Chesapeake is involved in various other lawsuits and disputes incidental to its business operations, including commercial disputes, personal injury claims, royalty claims, property damage claims and contract actions. With regard to contract actions, various mineral or leasehold owners have filed lawsuits against us seeking specific performance to require us to acquire their natural gas and oil interests and pay acreage bonus payments, damages based on breach of contract and/or, in certain cases, punitive damages based on alleged fraud. The Company has successfully defended a number of these cases in various courts, has settled others and believes that it has substantial defenses to the claims made in those pending at the trial court and on appeal. Regarding royalty claims, Chesapeake and other natural gas producers have been named in various lawsuits alleging royalty underpayment. The suits allege that we used below-market prices, made improper deductions, used improper measurement techniques and/or entered into arrangements with affiliates that resulted in underpayment of royalties in connection with the production and sale of natural gas and NGL. The Company is defending against certain pending claims, has resolved a number of claims through negotiated settlements of past and future royalties and has prevailed in various other lawsuits.
Based on management's current assessment, we are of the opinion that no pending or threatened lawsuit or dispute relating to the Company's business operations is likely to have a material adverse effect on its consolidated financial position, results of operations or cash flows. The final resolution of such matters could exceed amounts accrued, however, and actual results could differ materially from management's estimates.
Environmental Risk

The nature of the natural gas and oil business carries with it certain environmental risks for Chesapeake and its subsidiaries. Chesapeake has implemented various policies, procedures, training and auditing to reduce and mitigate such environmental risks. Chesapeake conducts periodic reviews, on a company-wide basis, to assess changes in our environmental risk profile. Environmental reserves are set for environmental liabilities for which economic losses are probable and reasonably estimable. We manage our exposure to environmental liabilities in acquisitions by using an evaluation process that seeks to identify pre-existing contamination or compliance concerns and addressing the potential liability. Depending on the extent of an identified environmental concern, Chesapeake may, among other things, exclude a property from the transaction, require the seller to remediate the property to our satisfaction in an acquisition or agree to assume liability for the remediation of the property.

There are presently pending against our subsidiary, Chesapeake Appalachia, L.L.C. (CALLC), orders for compliance first initiated in the 2010 fourth quarter by the U.S. Environmental Protection Agency (EPA) related to our compliance with Clean Water Act (CWA) permitting requirements in West Virginia. We have responded to all pending orders and are actively working with the EPA to resolve these and similar matters. We expect that resolution of pending EPA matters will include monetary sanctions exceeding $100,000, but we believe any associated liability will not have a material effect on the consolidated financial position, results of operations or cash flow of the Company.

For one West Virginia site that was subject to an EPA order for compliance, CALLC pled guilty on December 3, 2012 to three misdemeanor counts of unauthorized discharge of dredged or fill materials into a water of the U.S. We have paid the applicable fine in full, our restoration of the site has been completed and approved by the government, and we believe that CALLC is in compliance with the terms of probation. By operation of law, a CWA conviction triggers “disqualification”, by which the disqualified entity is prohibited from receiving federal contracts or benefits until the EPA certifies that the conditions giving rise to the conviction have been corrected. Disqualification of CALLC has not had, and we do not expect it to have, a material adverse impact on our business.

Commitments

Rig Leases

In a series of transactions beginning in 2006, our drilling subsidiary sold 94 drilling rigs (of which 28 rigs have been repurchased) and related equipment and entered into master lease agreements under which we agreed to lease the rigs from the buyer for initial terms of five to ten years. The lease commitments are guaranteed by Chesapeake and certain of its subsidiaries. These transactions were recorded as sales and operating leasebacks and any related net gains are amortized to oilfield services expenses over the lease term. Under the leases, we can exercise an early purchase option or we can purchase the rigs at the expiration of the lease for the fair market value at the time. In addition, in most cases, we have the option to renew a lease for negotiated new terms at the expiration of the lease. Commitments related to rig lease payments are not recorded in the accompanying condensed consolidated balance sheets. As of September 30, 2013, the minimum aggregate undiscounted future rig lease payments were approximately $239 million. Subsequent to September 30, 2013, we repurchased nine rigs for approximately $70 million from lessors, lowering our minimum aggregate undiscounted future rig lease payments by approximately $58 million. See Note 18 for further discussion of the repurchases.

Chesapeake has contracts with various drilling contractors to utilize approximately 11 rigs with terms ranging from one to three years. These commitments are not recorded in the accompanying condensed consolidated balance sheets. As of September 30, 2013, the aggregate undiscounted minimum future payments under these drilling rig commitments were approximately $82 million.

Compressor Leases

Through various transactions beginning in 2007, our compression subsidiary sold 2,558 compressors (of which 250 units have been repurchased), a significant portion of its compressor fleet, and entered into a master lease agreement under which we agreed to lease the compressors from the buyer for initial terms of four to ten years. The lease commitments are guaranteed by Chesapeake and certain of its subsidiaries. These transactions were recorded as sales and operating leasebacks, and any related net gains are amortized to marketing, gathering and compression expenses over the lease term. Under the leases, we can exercise an early purchase option or we can purchase the compressors at the expiration of the lease for the fair market value at the time. In addition, in most cases we have the option to renew a lease for negotiated new terms at the expiration of the lease. Commitments related to compressor lease payments are not recorded in the accompanying condensed consolidated balance sheets. As of September 30, 2013, the minimum

aggregate undiscounted future compressor lease payments were approximately $348 million.
Gathering, Processing and Transportation Agreements
We have contractual commitments with midstream service companies and pipeline carriers for future gathering, processing and transportation of natural gas and liquids to move certain of our production to market. Working interest owners and royalty interest owners, where appropriate, will be responsible for their proportionate share of these costs. Commitments related to gathering, processing and transportation agreements are not recorded in the accompanying condensed consolidated balance sheets; however, they are reflected as adjustments to future natural gas, oil and NGL sales prices used in our proved reserves estimates.
The aggregate undiscounted commitments under our gathering, processing and transportation agreements, excluding any reimbursement from working interest and royalty interest owners, are presented below.

	September 30, 2013 ($ in millions)
2013	$510
2014	2,010
2015	1,821
2016	1,910
2017	1,942
2018 - 2099	9,546
Total	$17,739

Drilling Commitments
In December 2011, as part of our Utica joint venture development agreement with Total S.A. (Total) (see Note 8), we committed to spud no less than 90 cumulative Utica wells by December 31, 2012, 270 cumulative wells by December 31, 2013 and 540 cumulative wells by July 31, 2015. Through September 30, 2013, we had spud 357 cumulative Utica wells and had met our 2012 and 2013 commitments. If we fail to meet the drilling commitment at July 31, 2015 for any reason other than a force majeure event, the drilling carry percentage used to determine our promoted well reimbursement will be reduced from 60% to 45% for the number of wells drilled in the subsequent 12-month period represented by the shortfall versus our drilling commitment. As such, any reduction would only affect the timing of the receipt of the drilling carry but not the total drilling carry to be received.
We have also committed to drill wells in conjunction with our CHK Utica and CHK C-T financial transactions and in conjunction with the formation of the Chesapeake Granite Wash Trust. See Note 6 for discussion of these transactions and commitments.
Property and Equipment Purchase Commitments
Much of the oilfield services and other equipment we purchase requires long production lead times. As a result, we have outstanding orders and commitments for such equipment. As of September 30, 2013, we had $50 million of purchase commitments related to future inventory and capital expenditures for oilfield services and other equipment.
Natural Gas and Liquids Purchase Commitments
We regularly commit to purchase natural gas and liquids from other owners in the properties we operate, including owners associated with our VPP transactions. Production purchased under these arrangements is based on market prices at the time of production, and the purchased natural gas and liquids are resold at market prices. See Note 8 for further discussion of our VPP transactions.
Net Acreage Maintenance Commitments
Under the terms of our joint venture agreements with Statoil, Total and Sinopec (see Note 8), we are required to extend, renew or replace certain expiring joint leasehold, at our cost, to ensure that the net acreage is maintained in certain designated areas. To date, we have satisfied our replacement commitments under the Statoil and Sinopec agreements. We did not fully meet the initial net acreage maintenance commitment with Total under the terms of our Barnett Shale joint venture agreement as of the December 31, 2012 measurement date and recorded a $26 million charge in impairments of fixed assets and other in our condensed consolidated statements of operations for an estimated shortfall of approximately 13,000 net acres. As of September 30, 2013, we revised our estimate of the net acreage shortfall as of December 31, 2012 to be approximately 14,000 net acres and anticipate making a cash payment of approximately $28 million to Total in the 2013 fourth quarter. Total has disputed our estimate of the shortfall,

however, and the final resolution of this matter could exceed amounts we have accrued for maintenance of Total's acreage position.

Affiliate Commitments

Under the terms of our corporate revolving bank credit facility, certain of our subsidiaries, including our oilfield services companies, are not guarantors of the credit facility debt. Transactions under certain agreements between us and our non-guarantor subsidiaries could affect our EBITDA or indebtedness for purposes of our credit facility covenant calculations, but they would have no effect on the condensed consolidated financial statements because the transactions would be eliminated through consolidation. See Note 3 for discussion of our covenant calculations.

In October 2011, we entered into a services agreement with our wholly owned subsidiary, COO, under which we guarantee the utilization of a portion of COO's drilling rig and hydraulic fracturing fleets during the term of the agreement. Through October 2016, we are subject to monetary penalties if we do not operate a specific number of COO's drilling rigs or utilize a specific number of its hydraulic fracturing fleets. As of September 30, 2013, we had accrued a nominal amount for non-utilization pursuant to the agreement and eliminated its impact in consolidation. Any monetary penalties incurred in future periods would also be eliminated in consolidation.

Other Commitments

In April 2011, we entered into a master frac service agreement with our equity affiliate, FTS International, Inc. (FTS), which expires on December 31, 2014. Pursuant to this agreement, we are committed to enter into a predetermined number of backstop contracts, providing at least a 10% gross margin to FTS, if utilization of FTS fleets falls below a certain level. To date, we have not entered into any backstop contracts.

In July 2011, we agreed to invest $155 million in preferred equity securities of Sundrop Fuels, Inc., a privately held cellulosic biofuels company based in Longmont, Colorado. As of September 30, 2013, we had funded $115 million of our commitment. The remaining tranches of preferred equity investment will be scheduled around certain funding and operational milestones that are expected to be reached in the 2014 first quarter. See Note 9 for further discussion of this investment.

In December 2011, we sold Appalachia Midstream Services, L.L.C., a wholly owned subsidiary of our wholly owned subsidiary, Chesapeake Midstream Development, L.L.C. (CMD), to Access Midstream Partners, L.P. (NYSE:ACMP) for total consideration of $884 million. In addition, CMD committed to pay ACMP for any quarterly shortfall between the actual adjusted EBITDA from the assets sold and specified quarterly targets totaling $100 million in 2012 and $150 million in 2013. We recorded this guarantee at an estimated fair value of $27 million at the time of the sale. No payment was required for the Current Period or for 2012, and we recognized an $11 million gain in the Current Period associated with the release of this guarantee. The remaining $8 million fair value is included in other current liabilities on our condensed consolidated balance sheet as of September 30, 2013. We will release this liability in the 2013 fourth quarter if CMD is not required to make a payment under the guarantee. If payment is required, we will record the difference between the liability and the associated payment in earnings.

As part of our normal course of business, we enter into various agreements providing, or otherwise arranging, financial or performance assurances to third parties on behalf of our wholly owned guarantor subsidiaries. These agreements may include future payment obligations or commitments regarding operational performance that effectively guarantee our subsidiaries' future performance.

In connection with divestitures, our purchase and sale agreements generally provide indemnification to the counterparty for liabilities incurred as a result of a breach of a representation or warranty by the indemnifying party or in regards to perfecting title to property. These indemnifications generally have a discrete term and are intended to protect the parties against risks that are difficult to predict or cannot be quantified at the time of the consummation of a particular transaction.

Certain of our natural gas and oil properties are burdened by non-operating interests such as royalty and overriding royalty interests, including overriding royalty interests sold through our VPP transactions. As the holder of the working interest from which such interests have been created, we have the responsibility to bear the cost of developing and producing the reserves attributable to such interests. See Note 8 for further discussion of our VPP transactions.

5. Other Liabilities

Other current liabilities as of September 30, 2013 and December 31, 2012 are detailed below.

	September 30, 2013	December 31, 2012
	($ in millions)	
Revenues and royalties due others	$1,621	$1,337
Accrued natural gas, oil and NGL drilling and production costs	417	525
Joint interest prepayments received	472	749
Accrued compensation and benefits	276	225
Other accrued taxes	178	130
Accrued dividends	102	101
Other	559	674
Total other current liabilities	$3,625	$3,741

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Other long-term liabilities as of September 30, 2013 and December 31, 2012 are detailed below.

	September 30, 2013	December 31, 2012
	($ in millions)	
CHK Utica ORRI conveyance obligation[(a)]	$256	$275
CHK C-T ORRI conveyance obligation[(b)]	153	164
Financing obligations[(c)]	191	175
Mortgages payable[(d)]	—	56
Other	580	506
Total other long-term liabilities	$1,180	$1,176

(a) $23 million and $18 million of the total $279 million and $293 million obligations are recorded in other current liabilities as of September 30, 2013 and December 31, 2012, respectively. See Note 6 for further discussion of the transaction.

(b) $10 million and $14 million of the total $163 million and $178 million obligations are recorded in other current liabilities as of September 30, 2013 and December 31, 2012, respectively. See Note 6 for further discussion of the transaction.

(c) Consists primarily of an obligation related to 111 real estate surface properties in the Fort Worth area that we financed in 2009 for approximately $145 million and we entered into a 40-year master lease agreement under which we agreed to lease the sites for approximately $15 million to $27 million annually. This lease transaction was recorded as a financing lease and the cash received was recorded with an offsetting long-term liability on the condensed consolidated balance sheet. Chesapeake exercised its option to repurchase one of the properties in 2011 and four of the properties in the Current Period. See Note 18 for a discussion of the termination of this lease agreement on November 1, 2013.

(d) In 2009, we financed our regional Barnett Shale headquarters building in Fort Worth, Texas for net proceeds of approximately $54 million with a five-year term loan which had a floating interest rate of prime plus 275 basis points. In the Current Period, we prepaid the term loan in full without penalty. As of September 30, 2013, the building was classified as property and equipment held for sale on our condensed consolidated balance sheet.

6. Stockholders’ Equity, Stock-Based Compensation, Performance Share Units and Noncontrolling Interests

Common Stock

The following is a summary of the changes in our common shares issued for the nine months ended September 30, 2013 and 2012:

	Nine Months Ended September 30, 2013	2012
	(in thousands)	
Shares issued as of January 1	666,468	660,888
Restricted stock issuances (net of forfeitures)[(a)]	684	5,758
Stock option exercises	321	309
Shares issued as of September 30	667,473	666,955

(a) In June 2013, we began granting restricted stock units (RSUs) in lieu of restricted stock awards (RSAs) to non-employee directors, and in the Current Quarter, we began granting RSUs in lieu of RSAs to employees. Shares of common stock underlying RSUs are issued when the units vest, whereas restricted shares of common stock are issued on the grant date of RSAs. We refer to RSAs and RSUs collectively as restricted stock.

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Preferred Stock
The following reflects the shares outstanding and liquidation preference of our preferred shares for the nine months ended September 30, 2013 and 2012:

	5.75%	5.75% (A)	4.50%	5.00% (2005B)	Total
Shares outstanding as of January 1, 2013 and 2012 and September 30, 2013 and 2012 (in thousands)	1,497	1,100	2,559	2,096	7,252
Liquidation preference per share	$1,000	$1,000	$100	$100	

Dividends
Dividends declared on our common stock and preferred stock are reflected as adjustments to retained earnings to the extent a surplus of retained earnings will exist after giving effect to the dividends. To the extent retained earnings are insufficient to fund the distributions, such payments constitute a return of contributed capital rather than earnings and are accounted for as a reduction to paid-in capital.
Dividends on our outstanding preferred stock are payable quarterly. We may pay dividends on our 5.00% Cumulative Convertible Preferred Stock (Series 2005B) and our 4.50% Cumulative Convertible Preferred Stock in cash, common stock or a combination thereof, at our option. Dividends on both series of our 5.75% Cumulative Convertible Non-Voting Preferred Stock are payable only in cash.
Stock-Based Compensation
Chesapeake's stock-based compensation program consists of restricted stock and stock options granted to employees and restricted stock granted to non-employee directors under our Long Term Incentive Plan. We recognize in our financial statements the cost of employee services received in exchange for awards of equity instruments, including restricted stock and stock options, based on the fair value of the equity instruments at the date of the grant. For employees, this value is amortized over the vesting period, which is generally three or four years from the date of grant. For directors, although restricted stock grants vest over three years, this value is expensed immediately as there is a non-substantive service condition for vesting. To the extent compensation cost relates to employees directly involved in the acquisition of natural gas and oil leasehold and exploration and development activities, such amounts are capitalized to natural gas and oil properties. Amounts not capitalized to natural gas and oil properties are recognized as general and administrative expenses, natural gas, oil and NGL production expenses, marketing, gathering and compression expenses or oilfield services expenses. We recorded the following stock-based compensation during the Current Quarter, the Prior Quarter, the Current Period and the Prior Period:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	($ in millions)			
Natural gas and oil properties	$12	$18	$45	$55
General and administrative expenses	13	17	48	55
Natural gas, oil and NGL production expenses	5	6	17	18
Marketing, gathering and compression expenses	2	4	5	12
Oilfield services expenses	3	2	8	8
Total	$35	$47	$123	$148

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Restricted Stock

In the Current Period, we granted restricted stock to employees and non-employee directors. Restricted stock vests over a minimum of three years and the holder receives dividends or dividend equivalents on unvested shares. A summary of the changes in unvested shares during the nine months ended September 30, 2013 is presented below.

	Number of Unvested Restricted Shares (in thousands)	Weighted Average Grant-Date Fair Value
Unvested shares as of January 1, 2013	18,899	$23.72
Granted	9,053	$19.44
Vested	(9,553)	$23.31
Forfeited	(1,353)	$21.61
Unvested shares as of September 30, 2013	17,046	$21.85

The aggregate intrinsic value of restricted stock that vested during the Current Period was approximately $187 million based on the stock price at the time of vesting.

As of September 30, 2013, there was $244 million of total unrecognized compensation cost related to unvested restricted stock. The cost is expected to be recognized over a weighted average period of approximately 2.6 years.

The vesting of certain restricted stock grants could result in state and federal income tax benefits related to the difference between the market price of the common stock at the date of vesting and the date of grant. During the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, we recognized reductions in tax benefits related to restricted stock of a nominal amount, $14 million, $12 million and $19 million, respectively, which were recorded as adjustments to additional paid-in capital and deferred income taxes.

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Stock Options

In the Current Period, we granted members of our senior management team stock options that will vest ratably over a three-year period. We also granted retention awards to certain officers of stock options that will vest one-third on each of the third, fourth and fifth anniversaries of the grant date. The stock option awards have an exercise price equal to the closing price of the Company's common stock on the grant date. Prior to 2006, we had granted stock options under several stock compensation plans which vested over a four-year period. Outstanding options expire ten years from the date of grant.

The following table provides information related to stock option activity for the nine months ended September 30, 2013:

	Number of Shares Underlying Options	Weighted Average Exercise Price Per Share	Weighted Average Contract Life in Years	Aggregate Intrinsic Value[(a)]
	(in thousands)			($ in millions)
Outstanding at January 1, 2013	481	$12.69	0.96	$2
Granted	5,264	$19.32		
Exercised	(345)	$10.81		
Expired	(94)	$19.43		
Outstanding at September 30, 2013	5,306	$19.27	7.18	$35
Exercisable at September 30, 2013	1,386	$18.79	2.34	$10

(a) The intrinsic value of a stock option is the amount by which the current market value or the market value upon exercise of the underlying stock exceeds the exercise price of the option.

As of September 30, 2013, there was $19 million of total unrecognized compensation cost related to stock options. The cost is expected to be recognized over a weighted average period of approximately 2.8 years.

During the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, we recognized excess tax benefits related to stock options of $2 million, a nominal amount, $2 million and $1 million, respectively. All amounts were recorded as adjustments to additional paid-in capital and deferred income taxes.

Performance Share Units

In January 2012 and 2013, we granted performance share units (PSUs) to senior management under our Long Term Incentive Plan that vest ratably over a three-year period. The 2012 awards are settled in cash on the first, second and third anniversary dates of the awards, and the 2013 awards are settled in cash on the third anniversary of the awards. The PSU awards include both an internal operational performance condition and an external market condition. The operational performance condition is a function of internal proved reserves growth and production growth. The market condition is a function of total shareholder return (TSR), and generally requires a Monte Carlo simulation to determine the fair value.

For PSUs granted in 2012, each of the TSR and operational payout components can range from 0% to 125% resulting in a maximum total payout of 250%. For PSUs granted in 2013, the TSR component can range from 0% to 125% and each of the two operational components can range from 0% to 62.5%; however, the maximum total payout is capped at 200% in all cases and at 100% in situations where the Company's absolute TSR is less than zero. The PSUs can only be settled in cash, so they are classified as a liability in our condensed consolidated financial statements and are measured at fair value as of the grant date and re-measured at fair value at the end of each reporting period. This fair value adjustment is recognized as compensation expense in the condensed consolidated statements of operations.

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The following table presents a summary of our PSU awards as of September 30, 2013:

	Units	Fair Value as of Grant-Date	Fair Value	Liability for Vested Amount
		($ in millions)		
2012 Awards [(a)]				
Payable 2014	278,084	$8	$10	$10
Payable 2015	834,246	23	29	28
Total 2012 Awards	1,112,330	$31	$39	$38
2013 Awards				
Payable 2016	1,637,601	$37	$54	$40

(a) In the Current Period, we paid $2 million related to 2012 PSU awards.

Noncontrolling Interests

Cleveland Tonkawa Financial Transaction. We formed CHK Cleveland Tonkawa, L.L.C. (CHK C-T) in March 2012 to continue development of a portion of our natural gas and oil assets in our Cleveland and Tonkawa plays. CHK C-T is an unrestricted subsidiary under our corporate credit facility agreement and is not a guarantor of, or otherwise liable for, any of our indebtedness or other liabilities, including indebtedness under our indentures. In exchange for all of the common shares of CHK C-T, we contributed to CHK C-T approximately 245,000 net acres of leasehold and the existing wells within an area of mutual interest in the plays between the top of the Tonkawa and the top of the Big Lime formations covering Ellis and Roger Mills counties in western Oklahoma. In March 2012, in a private placement, third-party investors contributed $1.25 billion in cash to CHK C-T in exchange for (i) 1.25 million preferred shares, and (ii) our obligation to deliver a 3.75% overriding royalty interest (ORRI) in the existing wells and up to 1,000 future net wells to be drilled on the contributed play leasehold. Subject to customary minority interest protections afforded the investors by the terms of the CHK C-T limited liability company agreement (the CHK C-T LLC Agreement), as the holder of all the common shares and the sole managing member of CHK C-T, we maintain voting and managerial control of CHK C-T and therefore include it in our condensed consolidated financial statements. Of the $1.25 billion of investment proceeds, we allocated $225 million to the ORRI obligation and $1.025 billion to the preferred shares based on estimates of fair values. The remaining ORRI obligation is included in other current and long-term liabilities and the preferred shares are included in noncontrolling interests on our condensed consolidated balance sheets. Pursuant to the CHK C-T LLC Agreement, CHK C-T is currently required to retain an amount of cash (measured quarterly) equal to (i) the next two quarters of preferred dividend payments plus (ii) its projected operating funding shortfall for the next six months (projected operating funding shortfall requirement ends on December 31, 2013). The amount so retained, approximately $38 million as of September 30, 2013, is reflected as restricted cash on our condensed consolidated balance sheet.

Dividends on the preferred shares are payable on a quarterly basis at a rate of 6% per annum based on $1,000 per share. This dividend rate is subject to increase in limited circumstances in the event that, and only for so long as, any dividend amount is not paid in full for any quarter. As the managing member of CHK C-T, we may, at our sole discretion and election at any time after March 31, 2014, distribute certain excess cash of CHK C-T, as determined in accordance with the CHK C-T LLC Agreement. Any such optional distribution of excess cash is allocated 75% to the preferred shares (which is applied toward redemption of the preferred shares) and 25% to the common shares unless we have not met our drilling commitment at such time, in which case an optional distribution would be allocated 100% to the preferred shares (and applied toward redemption thereof). We may also, at our sole discretion and election, in accordance with the CHK C-T LLC Agreement, cause CHK C-T to redeem all or a portion of the CHK C-T preferred shares for cash. The preferred shares may be redeemed at a valuation equal to the greater of a 9%

internal rate of return or a return on investment of 1.35x, in each case inclusive of dividends paid through redemption at the rate of 6% per annum and optional distributions made through the applicable redemption date. In the event that redemption does not occur on or prior to March 31, 2019, the optional redemption valuation will increase to provide a 15% internal rate of return to the investors. The preferred shares can be redeemed on a pro-rata basis in accordance with the then-applicable redemption valuation formula. As of September 30, 2013, the redemption price and the liquidation preference were each $1,260 per preferred share.

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We have committed to drill and complete, for the benefit of CHK C-T in the area of mutual interest, a minimum of 37.5 net wells per six-month period through 2013, inclusive of wells drilled in 2012, and 25 net wells per six-month period in 2014 through 2016, up to a minimum cumulative total of 300 net wells. If we fail to meet the then-current cumulative drilling commitment in any six-month period, any optional cash distributions would be distributed 100% to the investors. If we fail to meet the then-current cumulative drilling commitment in two consecutive six-month periods, the then-applicable internal rate of return to investors at redemption would increase by 3% per annum. In addition, if we fail to meet the then-current cumulative drilling commitment in four consecutive six-month periods, the then-applicable internal rate of return to investors at redemption would be increased by an additional 3% per annum. Any such increase in the internal rate of return would be effective only until the end of the first succeeding six-month period in which we have met our then-current cumulative drilling commitment. CHK C-T is responsible for all capital and operating costs of the wells drilled for the benefit of the entity. Under the development agreement, approximately 73 and 58 qualified net wells were added in the Current Period and the Prior Period, respectively. As of September 30, 2013, we had met our 2013 drilling commitment associated with the CHK C-T transaction.
The CHK C-T investors' right to receive, proportionately, a 3.75% ORRI in the contributed wells and up to 1,000 future net wells on our contributed leasehold is subject to an increase to 5% on net wells earned in any year following a year in which we do not meet our net well commitment under the ORRI obligation, which runs from 2012 through the first quarter of 2025. However, in no event would we deliver to investors more than a total ORRI of 3.75% in existing wells and 1,000 future net wells. If at any time CHK C-T holds fewer net acres than would enable us to drill all then-remaining net wells on 160-acre spacing, the investors have the right to require us to repurchase their right to receive ORRIs in the remaining net wells at the then-current fair market value of such remaining ORRIs. We retain the right to repurchase the investors' right to receive ORRIs in the remaining net wells at the then-current fair market value of such remaining ORRIs once we have drilled a minimum of 867 net wells. The obligation to deliver future ORRIs has been recorded as a liability which will be settled through the conveyance of the underlying ORRIs to the investors on a net-well basis, at which time the associated liability will be reversed and the sale of the ORRIs reflected as an adjustment to the capitalized cost of our natural gas and oil properties. Under the ORRI obligation, we delivered an ORRI in approximately 80 net wells in the Current Period and 50 net wells in the Prior Period. While operations began on April 1, 2012, all wells completed since January 1, 2012 are credited to the ORRI obligation of 1,000 future net wells. Through September 30, 2013, we were on target to meet the 2013 ORRI conveyance commitment associated with the CHK C-T transaction.
As of September 30, 2013 and December 31, 2012, $1.015 billion of noncontrolling interests on our condensed consolidated balance sheets was attributable to CHK C-T. In the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, income of $19 million, $19 million, $56 million and $38 million, respectively, was attributable to the noncontrolling interests of CHK C-T.
Utica Financial Transaction. We formed CHK Utica, L.L.C. (CHK Utica) in October 2011 to develop a portion of our Utica Shale natural gas and oil assets. CHK Utica is an unrestricted subsidiary under our corporate credit facility agreement and is not a guarantor of, or otherwise liable for, any of our indebtedness or other liabilities, including indebtedness under our indentures. In exchange for all of the common shares of CHK Utica, we contributed to CHK Utica approximately 700,000 net acres of leasehold and the existing wells within an area of mutual interest in the Utica Shale play covering 13 counties located primarily in eastern Ohio. During November and December 2011, in private placements, third-party investors contributed $1.25 billion in cash to CHK Utica in exchange for (i) 1.25 million preferred shares, and (ii) our obligation to deliver a 3% ORRI in 1,500 net wells to be drilled on certain of our Utica Shale leasehold. Subject to customary minority interest protections afforded the investors by the terms of the CHK Utica limited liability company agreement (the CHK Utica LLC Agreement), as the holder of all the common shares and the sole managing member of CHK Utica, we maintain voting and managerial control of CHK Utica and therefore include it in our condensed consolidated financial statements. Of the $1.25 billion of investment proceeds, we allocated $300 million to the ORRI obligation and $950 million to the preferred shares based on estimates of fair

values. The remaining ORRI obligation is included in other current and long-term liabilities and the preferred shares are included in noncontrolling interests on our condensed consolidated balance sheets. Pursuant to the CHK Utica LLC Agreement, CHK Utica is required to retain a cash balance equal to the next two quarters of preferred dividend payments. The amount reserved for paying such dividends, approximately $37 million, was reflected as restricted cash on our condensed consolidated balance sheet as of September 30, 2013. In addition, pursuant to the CHK Utica LLC Agreement, with respect to any divestiture proceeds as defined by the agreement, CHK Utica is required to separately account for, and dedicate all of such divestiture proceeds to either (i) capital expenditures made by CHK Utica in connection with its assets or (ii) the redemption of CHK Utica preferred shares. As of December 31, 2012, we held $155 million received from divestitures defined by the agreement as restricted cash in other long-term assets on our condensed consolidated balance sheet. In the Current Period, we used all of the $155 million for CHK Utica capital expenditures.

Dividends on the preferred shares are payable on a quarterly basis at a rate of 7% per annum based on $1,000 per share. This dividend rate is subject to increase in limited circumstances in the event that, and only for so long as, any dividend amount is not paid in full for any quarter. As the managing member of CHK Utica, we may, at our sole discretion and election at any time after December 31, 2013, distribute certain excess cash of CHK Utica, as determined in accordance with the CHK Utica LLC Agreement. Any such optional distribution of excess cash is allocated 70% to the preferred shares (which is applied toward redemption of the preferred shares) and 30% to the common shares. We may also, at our sole discretion and election, in accordance with the CHK Utica LLC Agreement, cause CHK Utica to redeem the CHK Utica preferred shares for cash, in whole or in part. The preferred shares may be redeemed at a valuation equal to the greater of a 10% internal rate of return or a return on investment of 1.4x, in each case inclusive of dividends paid at the rate of 7% per annum and optional distributions made through the applicable redemption date. In the event that redemption does not occur on or prior to October 31, 2018, the optional redemption valuation will increase to provide the investors the greater of a 17.5% internal rate of return or a return on investment of 2.0x. The preferred shares can be redeemed on a pro-rata basis in accordance with the then-applicable redemption valuation formula. As of September 30, 2013, the redemption price and the liquidation preference were each approximately $1,270 per preferred share.

We have committed to drill and complete, for the benefit of CHK Utica in the area of mutual interest, a minimum of 50 net wells per year from 2012 through 2016, up to a minimum cumulative total of 250 net wells. CHK Utica is responsible for all capital and operating costs of the wells drilled for the benefit of the entity. If we fail to meet the then-current drilling commitment in any year, we must pay CHK Utica $5 million for each well we are short of such drilling commitment. CHK Utica also receives its proportionate share of the benefit of the drilling carry associated with our joint venture with Total in the Utica Shale. See Note 8 for further discussion of the joint venture. Under the development agreement, approximately 86 and 40 qualified net wells were added in the Current Period and Prior Period, respectively. As of September 30, 2013, we had met our 2013 drilling commitment associated with the CHK Utica transaction.

The CHK Utica investors' right to receive, proportionately, a 3% ORRI in the first 1,500 net wells drilled on our Utica Shale leasehold is subject to an increase to 4% on net wells earned in any year following a year in which we do not meet our net well commitment under the ORRI obligation, which runs from 2012 through 2023. However, in no event would we deliver to investors more than a total ORRI of 3% in 1,500 net wells. If at any time we hold fewer net acres than would enable us to drill all then-remaining net wells on 150-acre spacing, the investors have the right to require us to repurchase their right to receive ORRIs in the remaining net wells at the then-current fair market value of such remaining ORRIs. We retain the right to repurchase the investors' right to receive ORRIs in the remaining net wells at the then-current fair market value of such remaining ORRIs once we have drilled a minimum of 1,300 net wells. The obligation to deliver future ORRIs has been recorded as a liability which will be settled through the future conveyance of the underlying ORRIs to the investors on a net-well basis, at which time the associated liability will be reversed and the sale of the ORRIs reflected as an adjustment to the capitalized cost of our natural gas and oil properties. Under the ORRI obligation, we delivered an ORRI in approximately 100 new net wells in the Current Period and 31 net wells in the Prior Period. We did not meet our ORRI commitment in 2012. The ORRI increased to 4% for wells earned in 2013, and the ultimate number of wells in which we must assign an interest will be reduced accordingly. Through September 30, 2013, we were on target to meet the 2013 ORRI conveyance commitment associated with the CHK Utica transaction.

As of September 30, 2013 and December 31, 2012, $807 million and $950 million of noncontrolling interests on our condensed consolidated balance sheets, respectively, were attributable to CHK Utica. For the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, income of approximately $18 million, $22 million, $60 million and $66 million, respectively, was attributable to the noncontrolling interests of CHK Utica. In the Current Period, we purchased approximately 190,000 preferred shares of CHK Utica from existing investors for approximately $212 million, or approximately $1,115 per share plus accrued dividends, reducing the amount of outstanding preferred shares held by third-party investors by approximately 15%. The difference between the cash paid for the preferred shares and the carrying value of the noncontrolling interest acquired of $69 million is reflected in retained earnings and as a reduction to net income available to common stockholders for purposes of our EPS computations.

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Chesapeake Granite Wash Trust. In November 2011, Chesapeake Granite Wash Trust (the "Trust") sold 23,000,000 common units representing beneficial interests in the Trust at a price of $19.00 per common unit in its initial public offering. The common units are listed on the New York Stock Exchange and trade under the symbol "CHKR". We own 12,062,500 common units and 11,687,500 subordinated units, which in the aggregate represent an approximate 51% beneficial interest in the Trust. The Trust has a total of 46,750,000 units outstanding.

In connection with the initial public offering of the Trust, we conveyed royalty interests to the Trust that entitle the Trust to receive (i) 90% of the proceeds (after deducting certain post-production expenses and any applicable taxes) that we receive from the production of hydrocarbons from 69 producing wells, and (ii) 50% of the proceeds (after deducting certain post-production expenses and any applicable taxes) in 118 development wells that have been or will be drilled on approximately 45,400 gross acres (29,000 net acres) in the Colony Granite Wash play in Washita County in the Anadarko Basin of western Oklahoma. Pursuant to the terms of a development agreement with the Trust, we are obligated to drill, or cause to be drilled, the development wells at our own expense prior to June 30, 2016, and the Trust will not be responsible for any costs related to the drilling of the development wells or any other operating or capital costs of the Trust properties. In addition, we granted to the Trust a lien on our remaining interests in the undeveloped properties that are subject to the development agreement in order to secure our drilling obligation to the Trust, although the maximum amount that may be recovered by the Trust under such lien could not exceed $263 million initially and is proportionately reduced as we fulfill our drilling obligation over time. As of September 30, 2013, we had drilled or caused to be drilled approximately 80 development wells, as calculated under the development agreement, and the maximum amount recoverable under the drilling support lien was approximately $85 million.

The subordinated units we hold in the Trust are entitled to receive pro rata distributions from the Trust each quarter if and to the extent there is sufficient cash to provide a cash distribution on the common units that is not less than the applicable subordination threshold for such quarter. If there is not sufficient cash to fund such a distribution on all of the Trust units, the distribution to be made with respect to the subordinated units will be reduced or eliminated for such quarter in order to make a distribution, to the extent possible, of up to the subordination threshold amount on the common units. In exchange for agreeing to subordinate a portion of our Trust units, and in order to provide additional financial incentive to us to satisfy our drilling obligation and perform operations on the underlying properties in an efficient and cost-effective manner, Chesapeake is entitled to receive incentive distributions equal to 50% of the amount by which the cash available for distribution on the Trust units in any quarter exceeds the applicable incentive threshold for such quarter. The remaining 50% of cash available for distribution in excess of the applicable incentive threshold will be paid to Trust unitholders, including Chesapeake, on a pro rata basis. At the end of the fourth full calendar quarter following our satisfaction of our drilling obligation with respect to the development wells, the subordinated units will automatically convert into common units on a one-for-one basis and our right to receive incentive distributions will terminate. After such time, the common units will no longer have the protection of the subordination threshold, and all Trust unitholders will share in the Trust's distributions on a pro rata basis.

For the Current Period and Prior Period, the Trust declared and paid the following distributions:

Production Period	Distribution Date	Cash Distribution per Common Unit	Cash Distribution per Subordinated Unit
March 2013 - May 2013	August 29, 2013	$0.6900	$0.1432
December 2012 - February 2013	May 31, 2013	$0.6900	$0.3010
September 2012 - November 2012	March 1, 2013	$0.6700	$0.3772
March 2012 - May 2012	August 30, 2012	$0.6100	$0.4819
December 2011 - February 2012	May 31, 2012	$0.6588	$0.6588
September 2011 - November 2011	March 1, 2012	$0.7277	$0.7277

We have determined that the Trust constitutes a VIE and that Chesapeake is the primary beneficiary. As a result, the Trust is included in our condensed consolidated financial statements. As of September 30, 2013 and December 31, 2012, $323 million and $356 million of noncontrolling interests on our condensed consolidated balance sheets, respectively, were attributable to the Trust. For the Current Quarter, Prior Quarter, Current Period and Prior Period, income of approximately $2 million, $1 million, $14 million and $28 million, respectively, was attributable to the Trust’s noncontrolling interests in our condensed consolidated statements of operations. See Note 10 for further discussion of VIEs.

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Wireless Seismic, Inc. We have a controlling 51% equity interest in Wireless Seismic, Inc. (Wireless), a privately owned company engaged in research, development and eventual production of wireless seismic systems and any related technology that deliver seismic information obtained from standard geophones in real time to laptop and desktop computers. As of September 30, 2013 and December 31, 2012, $7 million and $5 million of noncontrolling interests on our condensed consolidated balance sheets, respectively, were attributable to Wireless. In the Current Quarter and Current Period, losses of $1 million and $3 million, respectively, were attributable to noncontrolling interests of Wireless in our condensed consolidated statement of operations.

7. Derivative and Hedging Activities

Natural Gas, Oil and NGL Derivatives

Our results of operations and cash flows are impacted by changes in market prices for natural gas, oil and NGL. To mitigate a portion of our exposure to adverse price changes, we have entered into various derivative instruments. These instruments allow us to predict with greater certainty the effective prices to be received for our production. We believe our derivative instruments continue to be highly effective in achieving our risk management objectives. As of September 30, 2013 and December 31, 2012, our natural gas and oil derivative instruments consisted of the following types of instruments:

- Swaps: Chesapeake receives a fixed price and pays a floating market price to the counterparty for the hedged commodity.
- Options: Chesapeake sells, and occasionally buys, call options in exchange for a premium. At the time of settlement, if the market price exceeds the fixed price of the call option, Chesapeake pays the counterparty such excess on sold call options, and Chesapeake receives such excess on bought call options. If the market price settles below the fixed price of the call option, no payment is due from either party.
- Swaptions: Chesapeake sells call swaptions in exchange for a premium that allows a counterparty, on a specific date, to enter into a fixed-price swap for a certain period of time.
- Basis Protection Swaps: These instruments are arrangements that guarantee a price differential to NYMEX from a specified delivery point. Our natural gas basis protection swaps typically have negative differentials to NYMEX. Chesapeake receives a payment from the counterparty if the price differential is greater than the stated terms of the contract and pays the counterparty if the price differential is less than the stated terms of the contract. Our oil basis protection swaps typically have positive differentials to NYMEX. Chesapeake receives a payment from the counterparty if the price differential is less than the stated terms of the contract and pays the counterparty if the price differential is greater than the stated terms of the contract.
- Collars: These instruments contain a fixed floor price (put) and ceiling price (call). If the market price exceeds the call strike price or falls below the put strike price, Chesapeake receives the fixed price and pays the market price. If the market price is between the put and the call strike price, no payments are due from either party. Three-way collars include an additional put option in exchange for a more favorable strike price on the collar. This eliminates the counterparty's downside exposure below the second put option strike price.

All of our derivative instruments are net settled based on the difference between the fixed-price payment and the floating-price payment, resulting in a net amount due to or from the counterparty.

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The estimated fair values of our natural gas and oil derivative instrument assets (liabilities) as of September 30, 2013 and December 31, 2012 are provided below.

	September 30, 2013		December 31, 2012	
	Volume	Fair Value ($ in millions)	Volume	Fair Value ($ in millions)
Natural gas (tbtu):				
Fixed-price swaps	341	$96	49	$24
Call options	193	(219)	193	(240)
Call swaptions	12	—	—	—
Basis protection swaps	79	(2)	111	(15)
Three-way collars	36	4	—	—
Total natural gas	661	(121)	353	(231)
Oil (mmbbl):				
Fixed-price swaps	31.6	(94)	28.1	68
Call options	65.6	(368)	73.8	(748)
Call swaptions	5.3	(1)	5.3	(13)
Basis protection swaps	0.5	1	5.5	—
Total oil	103.0	(462)	112.7	(693)
Total estimated fair value		$(583)		$(924)

Pursuant to accounting guidance, certain derivatives qualify for designation as cash flow hedges. Following this guidance, changes in the fair value of derivative instruments designated as cash flow hedges, to the extent they are effective in offsetting cash flows attributable to the hedged risk and locked-in gains and losses of settled designated derivative contracts, are recorded in accumulated other comprehensive income until the hedged item is recognized in earnings. Any change in fair value resulting from ineffectiveness is recognized in natural gas, oil and NGL sales. Changes in the fair value of derivatives not designated as cash flow hedges that occur prior to their maturity (i.e., temporary fluctuations in value) are reported in the condensed consolidated statements of operations within natural gas, oil and NGL sales. As of September 30, 2013, we did not have any natural gas or oil derivatives that were designated as cash flow hedges. Therefore, changes in the fair value of these derivatives are reported in the condensed consolidated statement of operations. See further discussion below under Cash Flow Hedges.

The components of natural gas, oil and NGL sales for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period are presented below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	($ in millions)			
Natural gas, oil and NGL sales	$1,839	$1,464	$5,303	$3,798
Gains (losses) on natural gas, oil and NGL derivatives	(253)	(27)	141	824
Total natural gas, oil and NGL sales	$1,586	$1,437	$5,444	$4,622

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Hedging Facility

We have a multi-counterparty secured hedging facility with 16 counterparties that have committed to provide approximately 6.4 tcfe of hedging capacity for natural gas, oil and NGL price derivatives and 6.4 tcfe for basis derivatives with an aggregate mark-to-market capacity of $17.0 billion under the terms of the facility. As of September 30, 2013, we had hedged under the facility 1.2 tcfe of our future production with price derivatives and 0.1 tcfe with basis derivatives. The multi-counterparty facility allows us to enter into cash-settled natural gas, oil and NGL price and basis derivatives with the counterparties. Our obligations under the multi-counterparty facility are secured by proved reserves, the value of which must cover the fair value of the transactions outstanding under the facility by at least 1.65 times at semi-annual collateral dates and 1.30 times in between those dates, and guarantees by certain subsidiaries that also guarantee our corporate revolving bank credit facility, indentures, term loan and equipment master lease agreements. The counterparties' obligations under the facility must be secured by cash or short-term U.S. Treasury instruments to the extent that any mark-to-market amounts they owe to Chesapeake exceed defined thresholds. The maximum volume-based trading capacity under the facility is governed by the expected production of the pledged reserve collateral, and volume-based trading limits are applied separately to price and basis derivatives. In addition, there are volume-based sub-limits for natural gas, oil and NGL derivative instruments. Chesapeake has significant flexibility with regard to releases and/or substitutions of pledged reserves, provided that certain requirements are met including maintaining specified collateral coverage ratios as well as maintaining credit ratings with either of the designated rating agencies at or above current levels. The facility does not have a maturity date. Counterparties to the agreement have the right to cease entering into derivative instruments with the Company on a prospective basis as long as obligations associated with any existing transactions in the facility continue to be satisfied in accordance with the terms of the agreement.

Interest Rate Derivatives

To mitigate a portion of our exposure to volatility in interest rates related to our senior notes and bank credit facilities, we enter into interest rate derivatives. As of September 30, 2013 and December 31, 2012, our interest rate derivative instruments consisted of swaps. Chesapeake enters into fixed-to-floating interest rate swaps (we receive a fixed interest rate and pay a floating market rate) to mitigate our exposure to changes in the fair value of our senior notes. We enter into floating-to-fixed interest rate swaps (we receive a floating market rate and pay a fixed interest rate) to manage our interest rate exposure related to our bank credit facilities borrowings.

The notional amount and the estimated fair value of our interest rate derivative liabilities as of September 30, 2013 and December 31, 2012 are provided below.

	September 30, 2013		December 31, 2012	
	Notional Amount	Fair Value	Notional Amount	Fair Value
	($ in millions)			
Interest rate swaps	$2,500	$(88)	$1,050	$(35)

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
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Realized and unrealized gains or losses from interest rate derivative transactions are reflected as adjustments to interest expense in the condensed consolidated statements of operations. The components of interest expense for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period are presented below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	($ in millions)			
Interest expense on senior notes	$180	$187	$560	$546
Interest expense on credit facilities	8	13	30	51
Interest expense on term loans	29	112	87	173
(Gains) losses on interest rate derivatives	(3)	(2)	51	(4)
Amortization of loan discount, issuance costs and other	21	24	70	67
Capitalized interest	(195)	(298)	(634)	(770)
Total interest expense	$40	$36	$164	$63

We have terminated certain fair value hedges related to senior notes. Gains and losses related to these terminated hedges will be amortized as an adjustment to interest expense over the remaining term of the related senior notes. Over the next seven years, we will recognize $14 million in net gains related to such transactions.

Foreign Currency Derivatives

In December 2006, we issued €600 million of 6.25% Euro-denominated Senior Notes due 2017. Concurrent with the issuance of the euro-denominated senior notes, we entered into cross currency swaps to mitigate our exposure to fluctuations in the euro relative to the dollar over the term of the notes. In May 2011, we purchased and subsequently retired €256 million in aggregate principal amount of these senior notes following a tender offer, and we simultaneously unwound the cross currency swaps for the same principal amount. Under the terms of the remaining cross currency swaps, on each semi-annual interest payment date, the counterparties pay us €11 million and we pay the counterparties $17 million, which yields an annual dollar-equivalent interest rate of 7.491%. Upon maturity of the notes, the counterparties will pay us €344 million and we will pay the counterparties $459 million. The terms of the cross currency swaps were based on the dollar/euro exchange rate on the issuance date of 1.3325 to €1.00. Through the cross currency swaps, we have eliminated any potential variability in our expected cash flows related to changes in foreign exchange rates and therefore the swaps are designated as cash flow hedges. The fair values of the cross currency swaps are recorded on the condensed consolidated balance sheet as a liability of $5 million as of September 30, 2013. The euro-denominated debt in long-term debt has been adjusted to $465 million as of September 30, 2013 using an exchange rate of $1.3527 to €1.00.

Additional Disclosures Regarding Derivative Instruments and Hedging Activities

In accordance with accounting guidance for derivatives and hedging, to the extent that a legal right of set-off exists, we net the value of our derivative arrangements with the same counterparty in the accompanying condensed consolidated balance sheets. Derivative instruments reflected as current in the condensed consolidated balance sheets represent the estimated fair value of derivatives scheduled to settle over the next twelve months based on market prices/rates as of the respective balance sheet dates. The derivative settlement amounts are not due until the month in which the related hedged transaction occurs. Cash settlements of our derivative instruments are generally classified as operating cash flows unless the derivative is deemed to contain, for accounting purposes, a significant financing element at contract inception, in which case these cash settlements are classified as financing cash flows in the accompanying condensed consolidated statements of cash flows.

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The following table presents the fair value and location of each classification of derivative instrument disclosed in the condensed consolidated balance sheets as of September 30, 2013 and December 31, 2012 on a gross basis without regard to same-counterparty netting:

	Balance Sheet Location	Fair Value September 30, 2013 ($ in millions)	December 31, 2012
Asset Derivatives:			
Not designated as hedging instruments:			
Commodity contracts	Short-term derivative instruments	$115	$110
Commodity contracts	Long-term derivative instruments	11	5
Total		126	115
Liability Derivatives:			
Designated as hedging instruments:			
Foreign currency contracts	Long-term derivative instruments	(5)	(20)
Total		(5)	(20)
Not designated as hedging instruments:			
Commodity contracts	Short-term derivative instruments	(265)	(157)
Commodity contracts	Long-term derivative instruments	(444)	(882)
Interest rate contracts	Short-term derivative instruments	(9)	—
Interest rate contracts	Long-term derivative instruments	(79)	(35)
Total		(797)	(1,074)
Total derivative instruments		$(676)	$(979)

All of the Company’s derivative positions are subject to netting arrangements which provide for offsetting of asset and liability positions, as well as related cash collateral if applicable. Such netting arrangements generally do not have restrictions. Under such netting arrangements, the Company offsets the fair value of derivative instruments with cash collateral received or paid for those contracts executed with the same counterparty, which reduces the Company’s total assets and liabilities. As of September 30, 2013 and December 31, 2012, we did not have any cash collateral balances for these derivatives.

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The following tables present the netting offsets of derivative assets and liabilities as of September 30, 2013 and December 31, 2012:

	September 30, 2013			
	Derivative Assets		Derivative Liabilities	
	Short-Term	Long-Term	Short-Term	Long-Term
	($ in millions)			
Commodity Contracts:				
Gross amounts of recognized assets (liabilities)	$115	$11	$(265)	$(444)
Gross amounts offset in the condensed consolidated balance sheet	(104)	(9)	104	9
Net amounts of assets (liabilities) presented in the condensed consolidated balance sheet	11	2	(161)	(435)
Interest Rate Contracts:				
Gross amounts of recognized assets (liabilities)	—	—	(9)	(79)
Gross amounts offset in the condensed consolidated balance sheet	—	—	—	—
Net amounts of assets (liabilities) presented in the condensed consolidated balance sheet	—	—	(9)	(79)
Foreign Currency Contracts:				
Gross amounts of recognized assets (liabilities)	—	—	—	(5)
Gross amounts offset in the condensed consolidated balance sheet	—	—	—	—
Net amounts of assets (liabilities) presented in the condensed consolidated balance sheet	—	—	—	(5)
Total derivatives as reported	$11	$2	$(170)	$(519)

	December 31, 2012			
	Derivative Assets		Derivative Liabilities	
	Short-Term	Long-Term	Short-Term	Long-Term
	($ in millions)			
Commodity Contracts:				
Gross amounts of recognized assets (liabilities)	$110	$5	$(157)	$(882)
Gross amounts offset in the consolidated balance sheet	(52)	(3)	52	3
Net amounts of assets (liabilities) presented in the consolidated balance sheet	58	2	(105)	(879)
Interest Rate Contracts:				
Gross amounts of recognized assets (liabilities)	—	—	—	(35)
Gross amounts offset in the consolidated balance sheet	—	—	—	—
Net amounts of assets (liabilities) presented in the consolidated balance sheet	—	—	—	(35)
Foreign Currency Contracts:				
Gross amounts of recognized assets (liabilities)	—	—	—	(20)
Gross amounts offset in the consolidated balance sheet	—	—	—	—

Net amounts of assets (liabilities) presented in the consolidated balance sheet	—	—	—	(20)
Total derivatives as reported	$58	$2	$(105)	$(934)

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A consolidated summary of the effect of derivative instruments on the condensed consolidated statements of operations for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period is provided below, separating fair value, cash flow and undesignated derivatives.

Fair Value Hedges

For interest rate derivative instruments designated as fair value hedges, the fair values of the hedges are recorded on the condensed consolidated balance sheets as assets or liabilities, with corresponding offsetting adjustments to the debt's carrying value. We have elected not to designate any of our qualifying interest rate derivatives as fair value hedges. Therefore, changes in the fair value of all of our interest rate derivatives that occur prior to their maturity (i.e., temporary fluctuations in value) are reported in the condensed consolidated statements of operations within interest expense.

The following table presents the gain (loss) recognized in the condensed consolidated statements of operations for terminated instruments that were designated as fair value derivatives:

		Three Months Ended September 30,		Nine Months Ended September 30,	
Fair Value Derivatives	Location of Gain (Loss)	2013	2012	2013	2012
		($ in millions)			
Interest rate contracts	Interest expense	$1	$2	$4	$6

Cash Flow Hedges

A reconciliation of the changes of accumulated other comprehensive income (loss) in the condensed consolidated statements of stockholders' equity related to our cash flow hedges is presented below.

	Three Months Ended September 30,			
	2013		2012	
	Before Tax	After Tax	Before Tax	After Tax
	($ in millions)			
Balance, beginning of period	$(286)	$(178)	$(306)	$(190)
Net change in fair value	3	2	4	3
(Gains) losses reclassified to income	3	2	(9)	(6)
Balance, end of period	$(280)	$(174)	$(311)	$(193)

	Nine Months Ended September 30,			
	2013		2012	
	Before Tax	After Tax	Before Tax	After Tax
	($ in millions)			
Balance, beginning of period	$(304)	$(189)	$(287)	$(178)
Net change in fair value	3	2	4	3
(Gains) losses reclassified to income	21	13	(28)	(18)
Balance, end of period	$(280)	$(174)	$(311)	$(193)

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Approximately $166 million of the $174 million of accumulated other comprehensive loss as of September 30, 2013 represents the net deferred loss associated with commodity derivative contracts that were previously designated as cash flow hedges for which the hedged production is still expected to occur. These amounts will be recognized in earnings in the month in which the originally forecasted hedged production occurs. As of September 30, 2013, we expect to transfer approximately $22 million of net loss included in accumulated other comprehensive income to net income (loss) during the next 12 months. The remaining amount will be transferred by December 31, 2022. As of September 30, 2013, none of our open commodity derivative instruments were designated as cash flow hedges.
The following table presents the pre-tax gain (loss) recognized in, and reclassified from, accumulated other comprehensive income (AOCI) related to instruments designated as cash flow derivatives:

Cash Flow Derivatives	Location of Gain (Loss)	Three Months Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
		($ in millions)			
Gain (Loss) Recognized in AOCI (Effective Portion):					
Foreign currency contracts	AOCI	$3	$4	$3	$4
		$3	$4	$3	$4
Gain (Loss) Reclassified from AOCI (Effective Portion):					
Commodity contracts	Natural gas, oil and NGL sales	$(3)	$9	$(21)	$28
		$(3)	$9	$(21)	$28

Undesignated Derivatives
The following table presents the gain (loss) recognized in the condensed consolidated statements of operations for instruments not designated as either cash flow or fair value hedges:

Derivative Contracts	Location of Gain (Loss)	Three Months Ended September 30, 2013	2012	Nine Months Ended September 30, 2013	2012
		($ in millions)			
Commodity contracts	Natural gas, oil and NGL sales	$(250)	$(36)	$162	$796
Interest rate contracts	Interest expense	2	—	(55)	(2)
Total		$(248)	$(36)	$107	$794

Credit Risk
Derivative instruments that enable us to manage our exposure to natural gas, oil and NGL prices and interest rate volatility expose us to credit risk from our counterparties. To mitigate this risk, we enter into derivative contracts only with counterparties that are rated investment-grade and deemed by management to be competent and competitive market makers, and we attempt to limit our exposure to non-performance by any single counterparty. As of September 30, 2013, our natural gas, oil and interest rate derivative instruments were spread among 15 counterparties. Additionally, counterparties to our multi-counterparty secured hedging facility described previously are required to secure their obligations in excess of defined thresholds. We use this facility for substantially all of our natural gas, oil and NGL derivatives.

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8. Divestitures

Natural Gas and Oil Properties

Under full cost accounting rules, we account for the sale of natural gas and oil properties as an adjustment to capitalized costs, with no recognition of gain or loss as the sales typically do not involve a significant change in proved reserves or significantly alter the relationship between costs and proved reserves. In conjunction with certain sales, affiliates of our former Chief Executive Officer, Aubrey K. McClendon, have sold interests in the same properties and on the same terms as those that applied to the interests sold by the Company, and the net proceeds were paid to the sellers based on their respective ownership. These interests were acquired through the Founder Well Participation Program, which provides Mr. McClendon a contractual right to participate and invest as a working interest owner (with up to a 2.5% working interest) in new wells drilled on the Company's leasehold through June 2014.

In the Current Quarter, we sold assets in the Haynesville Shale to EXCO Operating Company, LP (EXCO) for net proceeds of approximately $257 million. We may receive up to an additional $32 million of net proceeds pursuant to customary post-closing adjustments. The assets sold included our operated and non-operated interests in approximately 9,600 net acres in DeSoto and Caddo parishes, Louisiana.

In the Current Quarter, we sold assets in the northern Eagle Ford Shale to EXCO for net proceeds of approximately $617 million. In the Current Quarter, we received approximately $4 million of net proceeds for customary post-closing adjustments and may receive up to an additional $64 million of net proceeds pursuant to further customary post-closing adjustments. The assets sold included approximately 55,000 net acres in Zavala, Dimmit, La Salle and Frio counties, Texas.

In the Prior Quarter, we sold producing assets in the Midland Basin portion of the Permian Basin to affiliates of Houston-based EnerVest, Ltd. for approximately $376 million in cash

In the Prior Quarter, we sold approximately 72,000 net acres of noncore leasehold in the Utica Shale play in Ohio to affiliates of EnerVest, Ltd. for approximately $358 million in cash.

In the Prior Period, we sold approximately 60,000 net acres of leasehold in the Texoma Woodford play in Bryan, Carter, Johnston and Marshall counties, Oklahoma to XTO Energy Inc., a subsidiary of Exxon Mobil Corporation (NYSE:XOM), for net proceeds of approximately $572 million.

During the Current Period and the Prior Period, we received proceeds of approximately $800 million and $180 million, respectively, from various other divestitures of natural gas and oil properties.

Joint Ventures

On June 28, 2013, we completed a strategic joint venture with Sinopec International Petroleum Exploration and Production Corporation (Sinopec) in which Sinopec purchased a 50% undivided interest in approximately 850,000 acres in the Mississippi Lime play in northern Oklahoma (425,000 acres net to Sinopec). The total consideration for the transaction was approximately $1.020 billion in cash, of which approximately $949 million of net proceeds, or 93%, was received upon closing. We also received an additional $90 million at closing related to closing adjustments for activity between the effective date and closing date of the transaction. We may receive up to an additional $71 million of net proceeds pursuant to customary post-closing adjustments. All future exploration and development costs in the joint venture will be shared proportionately between the parties with no drilling carries involved.

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As of September 30, 2013, we had entered into eight significant joint ventures with other leading energy companies pursuant to which we sold a portion of our leasehold, producing properties and other assets located in eight different resource plays and received cash of $8.0 billion and commitments by our counterparties to pay our share of future drilling and completion costs of $9.0 billion. In each of these joint ventures, Chesapeake serves as the operator and conducts all drilling, completion and operations, the majority of leasing and, in certain transactions, marketing activities for the project. The carries paid by a joint venture partner are for a specified percentage of our drilling and completion costs. In addition, a joint venture partner is responsible for its proportionate share of drilling and completion costs as a working interest owner. We bill our joint venture partners for their drilling carries at the same time we bill them and other joint working interest owners for their share of drilling costs as they are incurred. For accounting purposes, initial cash proceeds from these joint venture transactions were reflected as a reduction of natural gas and oil properties with no gain or loss recognized. The transactions are detailed below.

Primary Play	Joint Venture Partner[a]	Joint Venture Date	Interest Sold	Initial Proceeds[b]		Total Drilling Carries		Total Initial Proceeds and Drilling Carries	Drilling Carries Remaining[c]
				($ in millions)					
Mississippi Lime	Sinopec	June 2013	50.0%	$949	(d)	$—		$949	$—
Utica	TOT	December 2011	25.0%	610		1,422	(e)	2,032	714
Niobrara	CNOOC	February 2011	33.3%	570		697	(f)	1,267	233
Eagle Ford	CNOOC	November 2010	33.3%	1,120		1,080		2,200	—
Barnett	TOT	January 2010	25.0%	800		1,403		2,203	—
Marcellus	STO	November 2008	32.5%	1,250		2,125		3,375	—
Fayetteville	BP	September 2008	25.0%	1,100		800		1,900	—
Haynesville & Bossier	FCX	July 2008	20.0%	1,650		1,508		3,158	—
				$8,049		$9,035		$17,084	$947

(a) Joint venture partners include Sinopec International Petroleum Exploration and Production (Sinopec), Total S.A. (TOT), CNOOC Limited (CNOOC), Statoil (STO), BP America (BP) and Freeport-McMoRan Copper & Gold (FCX), formerly known as Plains Exploration & Production Company.
(b) Excludes closing and post-closing adjustments.
(c) As of September 30, 2013.
(d) Excludes $71 million of net proceeds (or 7% of the total transaction) expected to be received pursuant to certain customary post-closing adjustments and approximately $90 million received at closing for closing adjustments.
(e) The Utica drilling carries cover 60% of our drilling and completion costs for Utica wells drilled and must be used by December 2018. We expect to fully utilize these drilling carry commitments prior to expiration. See Note 4 for further discussion of the Utica drilling carries.
(f) The Niobrara drilling carries cover 67% of our drilling and completion costs for Niobrara wells drilled and must be used by December 2014. We expect to fully utilize these drilling carry commitments prior to expiration.

During the Current Period and the Prior Period, our drilling and completion costs included the benefit of approximately $669 million and $655 million, respectively, in drilling and completion carries paid by our joint venture partners.

During the Current Period and the Prior Period, we sold interests in additional leasehold we acquired in the Marcellus, Barnett and Utica Shale plays to our joint venture partners TOT and STO for approximately $48 million and $228 million, respectively.

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Volumetric Production Payments

From time to time, we have sold certain of our producing assets which are located in more mature producing regions through the sale of VPPs. A VPP is a limited-term overriding royalty interest in natural gas and oil reserves that (i) entitles the purchaser to receive scheduled production volumes over a period of time from specific lease interests; (ii) is free and clear of all associated future production costs and capital expenditures; (iii) is nonrecourse to the seller (i.e., the purchaser's only recourse is to the reserves acquired); (iv) transfers title of the reserves to the purchaser; and (v) allows the seller to retain all production beyond the specified volumes, if any, after the scheduled production volumes have been delivered. For all of our VPP transactions, we have novated hedges to each of the respective VPP buyers and such hedges covered all VPP volumes sold. If contractually scheduled volumes exceed the actual volumes produced from the VPP wellbores that are attributable to the ORRI conveyed, either the shortfall will be made up from future production from these wellbores (or, at our option, from our retained interest in the wellbores) through an adjustment mechanism or the initial term of the VPP will be extended until all scheduled volumes, to the extent produced, are delivered from the VPP wellbores to the VPP buyer. We retain drilling rights on the properties below currently producing intervals and outside of producing wellbores.

As the operator of the properties from which the VPP volumes have been sold, we have the responsibility to bear the cost of producing the reserves attributable to such interests, which we include as a component of production expenses and production taxes in our condensed consolidated statements of operations in the periods such costs are incurred. As with all non-expense-bearing royalty interests, volumes conveyed in a VPP transaction are excluded from our estimated proved reserves; however, the estimated production expenses and taxes associated with VPP volumes expected to be delivered in future periods are included as a reduction of the future net cash flows attributable to our proved reserves for purposes of determining the cost center ceiling for impairment purposes and in determining our standardized measure. Pursuant to SEC guidelines, the estimates used for purposes of determining the cost center ceiling and the standardized measure are based on current costs. Our commitment to bear the costs on any future production of VPP volumes is not reflected as a liability on our balance sheet. The costs that will apply in the future will depend on the actual production volumes as well as the production costs and taxes in effect during the periods in which such production actually occurs, which could differ materially from our current and historical costs, and production may not occur at the times or in the quantities projected, or at all.

For accounting purposes, cash proceeds from the sale of VPPs were reflected as a reduction of natural gas and oil properties with no gain or loss recognized, and our proved reserves were reduced accordingly. We have also committed to purchase natural gas and liquids associated with our VPP transactions. Production purchased under these arrangements is based on market prices at the time of production, and the purchased natural gas and liquids are resold at market prices.

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Our outstanding VPPs consist of the following:

VPP #	Date of VPP	Division	Proceeds	Volume Sold Natural Gas	Oil	NGL	Total
			($ in millions)	(bcf)	(mmbbl)	(mmbbl)	(bcfe)
10	March 2012	Anadarko Basin Granite Wash	$744	87	3.0	9.2	160
9	May 2011	Mid-Continent	853	138	1.7	4.8	177
8	September 2010	Barnett Shale	1,150	390	—	—	390
6	February 2010	East Texas and Texas Gulf Coast	180	44	0.3	—	46
5	August 2009	South Texas	370	67	0.2	—	68
4	December 2008	Anadarko and Arkoma Basins	412	95	0.5	—	98
3	August 2008	Anadarko Basin	600	93	—	—	93
2	May 2008	Texas, Oklahoma and Kansas	622	94	—	—	94
1	December 2007	Kentucky and West Virginia	1,100	208	—	—	208
			$6,031	1,216	5.7	14.0	1,334

The volumes produced on behalf of our VPP buyers for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period were as follows:

VPP #	Three Months Ended September 30, 2013 Natural Gas	Oil	NGL	Total
	(bcf)	(mbbl)	(mbbl)	(bcfe)
10	3.7	131.0	371.9	6.7
9	4.1	52.3	140.3	5.2
8	16.6	—	—	16.6
6	1.2	6.0	—	1.2
5	1.9	6.7	—	1.9
4	2.4	13.9	—	2.6
3	2.0	—	—	2.0
2	2.6	—	—	2.6
1	3.5	—	—	3.5
	38.0	209.9	512.2	42.3

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	Three Months Ended September 30, 2012			
VPP #	Natural Gas (bcf)	Oil (mbbl)	NGL (mbbl)	Total (bcfe)
10	5.3	206.0	503.7	9.5
9	4.5	60.8	158.0	5.8
8	19.4	—	—	19.4
7	0.2			