CHESAPEAKE ENERGY CORP
Form 10-Q
August 09, 2011
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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 June 30, 2011

[ ] 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 August 3, 2011, there were 660,841,196 shares of our common stock, $0.01 par value, outstanding.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2011	December 31, 2010
	($ in millions)	
CURRENT ASSETS:		
Cash and cash equivalents	$ 109	$ 102
Accounts receivable	2,708	1,974
Short-term derivative instruments	169	947
Deferred income tax asset	15	139
Other current assets	125	104
Total Current Assets	3,126	3,266
PROPERTY AND EQUIPMENT:		
Natural gas and oil properties, at cost based on full-cost accounting:		
Evaluated natural gas and oil properties	38,318	38,952
Unevaluated properties	14,941	14,469
Natural gas gathering systems and treating plants	1,452	1,545
Other property and equipment	4,461	3,726
Total Property and Equipment, at Cost	59,172	58,692
Less: accumulated depreciation, depletion and amortization	(27,120)	(26,314)
Total Property and Equipment, Net	32,052	32,378
OTHER ASSETS:		
Investments	1,105	1,208
Long-term derivative instruments	7	
Other long-term assets	366	327
Total Other Assets	1,478	1,535
TOTAL ASSETS	$ 36,656	$ 37,179
CURRENT LIABILITIES:		
Accounts payable	$ 2,600	$ 2,069
Short-term derivative instruments	133	15
Accrued interest	180	191
Other current liabilities	2,815	2,215
Total Current Liabilities	5,728	4,490
LONG-TERM LIABILITIES:		
Long-term debt, net	10,047	12,640

Deferred income tax liabilities	2,482	2,384
Long-term derivative instruments	2,138	1,693
Asset retirement obligations	305	301
Other long-term liabilities	473	407
Total Long-Term Liabilities	15,445	17,425
CONTINGENCIES AND COMMITMENTS (Note 3)		
STOCKHOLDERS EQUITY:		
Preferred Stock, $0.01 par value, 20,000,000 shares authorized: 7,254,515 shares issued and outstanding	3,065	3,065
Common stock, $0.01 par value, 1,000,000,000 shares authorized, 659,107,987 and 655,251,275 shares issued	7	7
Paid-in capital	12,125	12,194
Retained earnings	411	190
Accumulated other comprehensive income (loss), net of tax of $61 million and $102 million	(99)	(168)
Less: treasury stock, at cost; 1,282,300 and 1,221,299 common shares	(26)	(24)
Total Stockholders Equity	15,483	15,264
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$ 36,656	$ 37,179

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 June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	($ in millions, except per share data)			
REVENUES:				
Natural gas and oil sales	$ 1,792	$ 1,161	$ 2,286	$ 3,059
Marketing, gathering and compression sales	1,404	793	2,421	1,637
Service operations revenue	122	58	223	114
Total Revenues	3,318	2,012	4,930	4,810
OPERATING COSTS:				
Production expenses	262	213	500	421
Production taxes	46	37	91	85
General and administrative expenses	130	106	259	215
Marketing, gathering and compression expenses	1,366	763	2,352	1,578
Service operations expense	92	53	169	102
Natural gas and oil depreciation, depletion and amortization	366	340	724	647
Depreciation and amortization of other assets	63	53	131	103
(Gains) losses on sales of other property and equipment	4		(1)	
Other impairments	4		4	
Total Operating Costs	2,333	1,565	4,229	3,151
INCOME FROM OPERATIONS	985	447	701	1,659
OTHER INCOME (EXPENSE):				
Interest (expense) income	(25)	16	(33)	(9)
Earnings from equity investees	47	27	72	39
Losses on purchases or exchanges of debt	(174)	(69)	(176)	(71)
Other income (expense)	2	(7)	5	(4)
Total Other Income (Expense)	(150)	(33)	(132)	(45)
INCOME BEFORE INCOME TAXES	835	414	569	1,614

INCOME TAX EXPENSE:				
Current income taxes	6	5	12	5
Deferred income taxes	319	154	210	616
Total Income Tax Expense	325	159	222	621
NET INCOME	510	255	347	993
Preferred stock dividends	(43)	(20)	(85)	(25)
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	$ 467	$ 235	$ 262	$ 968
EARNINGS PER COMMON SHARE:				
Basic	$ 0.74	$ 0.37	$ 0.41	$ 1.54
Diluted	$ 0.68	$ 0.37	$ 0.41	$ 1.49
CASH DIVIDEND DECLARED PER COMMON SHARE	$ 0.0875	$ 0.075	$ 0.1625	$ 0.15
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING (in millions):				
Basic	635	631	635	630
Diluted	751	635	645	665

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

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	($ in millions)			
Net income	$ 510	$ 255	$ 347	$ 993
Other comprehensive income, net of income tax:				
Change in fair value of derivative instruments, net of income taxes of $87 million, ($38) million, $89 million and $114 million	141	(62)	146	187
Reclassification of gain on settled contracts, net of income taxes of ($11) million, ($82) million, ($39) million and ($135) million	(18)	(134)	(64)	(221)
Ineffective portion of derivatives qualifying for cash flow hedge accounting, net of income taxes of ($3) million, $7 million, ($7) million and $9 million	(5)	11	(11)	15
Unrealized gain (loss) on marketable securities, net of income taxes of ($3) million, ($3) million, ($1) million and ($5) million	(5)	(5)	(2)	(8)
Comprehensive income	$ 623	$ 65	$ 416	$ 966

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 CASH FLOWS

(Unaudited)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
	($ in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME	$ 347	$ 993
ADJUSTMENTS TO RECONCILE NET INCOME TO CASH PROVIDED BY OPERATING ACTIVITIES:		
Depreciation, depletion and amortization	855	750
Deferred income tax expense	210	616
Unrealized losses on derivatives	1,087	5
Stock-based compensation	79	67
Accretion of discount on contingent convertible notes		38
(Gains) losses on equity investments	(23)	35
Losses on purchases or exchanges of debt	33	39
Other		21
Change in assets and liabilities	(495)	414
Cash provided by operating activities	2,093	2,978
CASH FLOWS FROM INVESTING ACTIVITIES:		
Exploration and development of natural gas and oil properties	(3,395)	(2,331)
Acquisitions of proved and unproved properties	(2,529)	(2,855)
Proceeds from divestitures of proved and unproved properties	6,173	1,933
Additions to other property and equipment	(863)	(679)
Proceeds from sales of other assets	526	306
Proceeds from (additions to) investments	212	(109)
Acquisition of drilling company	(339)	
Other	(25)	3
Cash used in investing activities	(240)	(3,732)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from credit facilities borrowings	8,343	7,044
Payments on credit facilities borrowings	(10,235)	(7,415)
Proceeds from issuance of senior notes, net of offering costs	977	
Proceeds from issuance of preferred stock, net of offering costs		2,562
Cash paid to purchase debt	(2,032)	(1,334)
Cash paid for common stock dividends	(95)	(95)
Cash paid for preferred stock dividends	(86)	(11)
Cash received on financing derivatives	882	271
Net increase in outstanding payments in excess of cash balance	448	47
Other	(48)	(21)

Cash provided by (used in) financing activities		(1,846)		1,048
Net increase in cash and cash equivalents		7		294
Cash and cash equivalents, beginning of period		102		307
Cash and cash equivalents, end of period	$	109	$	601

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 CASH FLOWS (Continued)

(Unaudited)

	Six Months Ended June 30,	
	2011	**2010**
	($ in millions)	
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION OF NET CASH PAYMENTS (REFUNDS) FOR:		
Interest, net of capitalized interest	$	$ 57
Income taxes, net of refunds received	$ (25)	$ (291)

SUPPLEMENTAL SCHEDULE OF SIGNIFICANT NON-CASH INVESTING AND FINANCING ACTIVITIES:

As of June 30, 2011 and 2010, dividends payable on our common and preferred stock were $99 million and $90 million, respectively.

For the six months ended June 30, 2011 and 2010, natural gas and oil properties were adjusted by $92 million and $64 million, respectively, as a result of an increase in accrued costs.

For the six months ended June 30, 2011 and 2010, other property and equipment were adjusted by $37 million and $2 million, respectively, as a result of an increase in accrued costs.

As of June 30, 2011 and 2010, we had recorded $206 million and $178 million, respectively, as a result of various accrued liabilities related to the purchase of proved and unproved properties and other assets.

During the six months ended June 30, 2010, holders of our 2.25% Contingent Convertible Senior Notes due 2038 exchanged approximately $11 million in aggregate principal amount for an aggregate of 298,500 shares of our common stock in privately negotiated exchanges.

On May 3, 2010, we converted all 5,000 shares of our outstanding 5.00% Cumulative Convertible Preferred Stock (Series 2005) into 20,774 shares of common stock pursuant to the company s mandatory conversion rights.

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 STOCKHOLDERS EQUITY

(Unaudited)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
	($ in millions)	
PREFERRED STOCK:		
Balance, beginning of period	$ 3,065	$ 466
Issuance of 0 and 1,500,000 shares of 5.75% preferred stock		1,500
Issuance of 0 and 1,100,000 shares of 5.75% preferred stock (series A)		1,100
Exchange of 0 and 5,000 shares of 5% preferred stock (series 2005) for common stock		(1)
Balance, end of period	3,065	3,065
COMMON STOCK:		
Balance, beginning of period	7	6
Exchange of convertible notes for 0 and 298,500 shares of common stock		
Exchange of preferred stock for 0 and 20,774 shares of common stock		
Stock-based compensation		1
Balance, end of period	7	7
PAID-IN CAPITAL:		
Balance, beginning of period	12,194	12,146
Stock-based compensation	114	116
Purchase of contingent convertible notes	(123)	
Exchange of convertible notes for 0 and 298,500 shares of common stock		8
Exchange of 0 and 5,000 shares of preferred stock for common stock		1
Exercise of stock options	1	2
Offering expenses		(38)
Tax benefit from stock-based compensation	2	
Dividends on common stock	(48)	(95)
Dividends on preferred stock	(15)	(44)
Balance, end of period	12,125	12,096
RETAINED EARNINGS (DEFICIT):		
Balance, beginning of period	190	(1,261)
Net income	347	993
Cumulative effect of accounting change, net of income taxes of $89 million		(142)
Dividends on common stock	(56)	
Dividends on preferred stock	(70)	

Balance, end of period	411	(410)
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):		
Balance, beginning of period	(168)	102
Hedging activity	71	(19)
Investment activity	(2)	(8)
Balance, end of period	(99)	75
TREASURY STOCK COMMON:		
Balance, beginning of period	(24)	(15)
Purchase of 134,300 and 123,579 shares for company benefit plans	(4)	(3)
Release of 73,299 and 6,818 shares for company benefit plans	2	
Balance, end of period	(26)	(18)
NONCONTROLLING INTEREST:		
Balance, beginning of period		897
Deconsolidation of investment in Chesapeake Midstream Partners		(897)
Balance, end of period		
TOTAL STOCKHOLDERS EQUITY	$ 15,483	$ 14,815

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

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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). Chesapeake s annual report on Form 10-K for the year ended December 31, 2010 (2010 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 statement 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. All significant intercompany accounts and transactions have been eliminated. The results for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the full year. This Form 10-Q relates to the three and six months ended June 30, 2011 (the Current Quarter and the Current Period , respectively) and the three and six months ended June 30, 2010 (the Prior Quarter and the Prior Period , respectively).

Cumulative Effect of Accounting Change

Effective January 1, 2010, in accordance with new authoritative guidance for variable interest entities, we ceased consolidating our 50/50 midstream joint venture with Global Infrastructure Partners within our financial statements and began to account for the joint venture under the equity method (see Note 9). Adoption of this new guidance resulted in an after-tax cumulative effect charge to retained earnings of $142 million, which is reflected in our condensed consolidated statement of equity for the Prior Period. This charge reflects the difference between the carrying value of our initial investment in the joint venture, which was recorded at carryover basis as an entity under common control, and the fair value of our equity in the joint venture as of the formation date.

Critical Accounting Policies

We consider accounting policies related to hedging, natural gas and oil properties and income taxes to be critical policies. These policies are summarized in Management s Discussion and Analysis of Financial Condition and Results of Operations in our 2010 Form 10-K.

2. Derivative and Hedging Activities

Natural Gas and Oil Derivatives

Our results of operations and cash flows are impacted by changes in market prices for natural gas and oil. To mitigate a portion of the exposure to adverse market changes, we have entered into various derivative instruments. These instruments allow us to predict with greater certainty the effective natural gas and oil prices to be received for our hedged production. Although derivatives often fail to achieve 100% effectiveness for accounting purposes, we believe our derivative instruments continue to be highly effective in achieving our risk management objectives. As of June 30, 2011 and December 31, 2010, 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.

Call Options: Chesapeake sells call options in exchange for a premium from the counterparty. At the time of settlement, if the market price exceeds the fixed price of the call option, Chesapeake pays the counterparty such excess and if the market price settles below the fixed price of the call option, no payment is due from either party.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Put Options: Chesapeake receives a premium from the counterparty in exchange for the sale of a put option. At the time of settlement, if the market price falls below the fixed price of the put option, Chesapeake pays the counterparty such shortfall, and if the market price settles above the fixed price of the put option, no payment is due from either party.

Knockout Swaps: Chesapeake receives a fixed price and pays a floating market price. The fixed price received by Chesapeake includes a premium in exchange for the possibility to reduce the counterparty s exposure to zero, in any given month, if the floating market price is lower than a certain pre-determined knockout price.

Basis Protection Swaps: These instruments are arrangements that guarantee a price differential to NYMEX for natural gas from a specified delivery point. For non-Appalachian Basin basis protection swaps, which 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. For Appalachian Basin basis protection swaps, which 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.

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.

The estimated fair values of our natural gas and oil derivative instruments as of June 30, 2011 and December 31, 2010 are provided below. The associated carrying values of these instruments are equal to the estimated fair values.

	June 30, 2011		December 31, 2010	
	Volume	**Fair Value ($ in millions)**	**Volume**	**Fair Value ($ in millions)**
Natural gas (bbtu):				
Fixed-price swaps	512,718	$ 346	1,035,134	$ 1,307
Call options	1,525,383	(769)	1,477,742	(701)
Put options	(33,120)	(35)	(51,220)	(59)
Basis protection swaps	130,684	(50)	173,691	(55)
Total natural gas	2,135,665	(508)	2,635,347	492
Oil (mbbl):				
Fixed-price swaps	2,202	4	4,385	(31)
Call options	77,489	(1,552)	64,226	(1,129)
Fixed-price knockout swaps	1,284	10	1,827	19
Total oil	80,975	(1,538)	70,438	(1,141)
		$ (2,046)		$ (649)

Total estimated fair value

Pursuant to accounting guidance for derivatives and hedging, 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, are recorded in accumulated other comprehensive income until the hedged item is recognized in earnings as the physical transactions being hedged occur. Any change in fair value resulting from ineffectiveness is currently recognized in natural gas and oil sales. Changes in the fair value of non-qualifying derivatives that occur prior to their maturity (i.e., temporary fluctuations in value) are reported currently in the condensed consolidated statements of operations within natural gas and oil sales.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	($ in millions)			
Natural gas and oil sales	$ 1,278	$ 984	$ 2,465	$ 2,169
Gains (losses) on natural gas and oil derivatives	506	195	(197)	914
Gains (losses) on ineffectiveness of cash flow hedges	8	(18)	18	(24)
Total natural gas and oil sales	$ 1,792	$ 1,161	$ 2,286	$ 3,059

Based upon the market prices at June 30, 2011, we expect to transfer approximately $75 million (net of income taxes) of gain included in accumulated other comprehensive income to net income (loss) during the next 12 months in the related month of production. All derivatives as of June 30, 2011 are expected to mature by December 31, 2022.

We have a multi-counterparty secured hedging facility with 17 counterparties that have committed to provide approximately 6.5 tcfe of hedging capacity for commodity price derivatives and 6.5 tcfe for basis derivatives with an aggregate mark-to-market capacity of $17.3 billion under the terms of the facility. As of June 30, 2011, we had hedged under the facility 2.5 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 natural gas liquids price and basis hedges 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, and guarantees by certain subsidiaries that also guarantee our corporate revolving bank credit facility and indentures. 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 hedging capacity under the facility is governed by the expected production of the pledged reserve collateral, and volume-based hedging limits are applied separately to price and basis hedges. In addition, there are volume-based sub-limits for natural gas, oil and natural gas liquids hedges. Chesapeake has significant flexibility with regard to releases and/or substitutions of pledged reserves, provided that certain collateral coverage and other requirements are met. The facility does not have a maturity date. Counterparties to the agreement have the right to cease entering into hedges 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 June 30, 2011 and December 31, 2010, our interest rate derivative instruments consisted of the following types of instruments:

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.

Call Options: Occasionally we sell call options for a premium when we think it is more likely that the option will expire unexercised. The option allows the counterparty to terminate a pre-determined open swap on a specific date.

Swaptions: Occasionally we sell an option to a counterparty for a premium which allows the counterparty to enter into a pre-determined swap with us on a specific date.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The notional amount of debt hedged and the estimated fair value of our interest rate derivatives outstanding as of June 30, 2011 and December 31, 2010 are provided below.

	June 30, 2011		December 31, 2010	
	Notional Amount	Fair Value	Notional Amount	Fair Value
	($ in millions)			
Interest rate:				
Swaps	$ 1,600	$ (48)	$ 1,900	$ (54)
Call options			250	(2)
Swaptions	450	(8)	500	(13)
Total	$ 2,050	$ (56)	$ 2,650	$ (69)

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. Our qualifying interest rate swaps are considered 100% effective and therefore no ineffectiveness was recorded for the periods presented above. Changes in the fair value of non-qualifying interest rate derivatives that occur prior to their maturity (i.e., temporary fluctuations in value) are currently reported in the condensed consolidated statements of operations within interest expense.

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 June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	($ in millions)			
Interest expense on senior notes	$ 164	$ 190	$ 342	$ 383
Interest expense on credit facilities	10	12	31	24
(Gains) losses on interest rate derivatives	19	(51)	18	(81)
Amortization of loan discount and other	8	12	23	23
Capitalized interest	(176)	(179)	(381)	(340)
Total interest expense (income)	$ 25	$ (16)	$ 33	$ 9

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 ten years, we will recognize $30 million in 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. As a result, we reclassified a loss of $38 million from accumulated other comprehensive income to the condensed consolidated statement of operations, $20 million of which related to the unwound notional amount and was included in losses on purchases or exchanges of debt, and $18 million of which related to future interest associated with the unwound principal and was included in interest expense. Under the terms of the remaining cross currency swaps, on each semi-annual interest payment date, the counterparties pay Chesapeake 11 million and Chesapeake pays the counterparties $17 million, which yields an annual dollar-equivalent interest rate of 7.491%. Upon maturity of the notes, the counterparties will pay Chesapeake 344 million and Chesapeake will pay the counterparties $459 million.

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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

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 Chesapeake s expected cash flows related to changes in foreign exchange rates and therefore the swaps qualify as cash flow hedges. The fair values of the cross currency swaps are recorded on the condensed consolidated balance sheet as an asset of $7 million at June 30, 2011. The euro-denominated debt in long-term debt has been adjusted to $500 million at June 30, 2011 using an exchange rate of $1.4523 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, Chesapeake nets the value of its 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 underlying hedged transaction occurs. Cash settlements of our derivative instruments are generally classified as operating cash flows unless the derivative contains 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.

The following table presents the fair value and location of each classification of derivative instrument as disclosed in the condensed consolidated balance sheets as of June 30, 2011 and December 31, 2010 on a gross basis without regard to same-counterparty netting:

		Fair Value	
	Balance Sheet Location	**June 30, 2011**	**December 31, 2010**
		($ in millions)	
Asset Derivatives:			
Derivatives designated as hedging instruments:			
Commodity contracts	Short-term derivative instruments	$ 168	$ 307
Commodity contracts	Long-term derivative instruments	1	12
Foreign currency contracts	Long-term derivative instruments	7	
Total		176	319
Derivatives not designated as hedging instruments:			
Commodity contracts	Short-term derivative instruments	198	921
Commodity contracts	Long-term derivative instruments	101	229
Total		299	1,150
Liability Derivatives:			
Derivatives designated as hedging instruments:			
Commodity contracts	Short-term derivative instruments	(17)	(59)
Interest rate contracts	Long-term derivative instruments	(11)	(25)
Foreign currency contracts	Long-term derivative instruments		(43)
Total		(28)	(127)

Derivatives not designated as hedging instruments:			
Commodity contracts	Short-term derivative instruments	(306)	(222)
Commodity contracts	Long-term derivative instruments	(2,191)	(1,837)
Interest rate contracts	Short-term derivative instruments	(8)	(15)
Interest rate contracts	Long-term derivative instruments	(37)	(29)
Total		(2,542)	(2,103)
Total derivative instruments		$ (2,095)	$ (761)

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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 non-qualifying derivatives.

Fair Value Hedges

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

Fair Value Derivatives	Location of Gain (Loss)	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Interest rate contracts	Interest expense[a]	$ 5	$ 5	$ 11	$ 13

(a) Interest expense on items hedged during the Current Quarter, the Prior Quarter, the Current Period and the Prior Period was $9 million, $5 million, $21 million and $15 million, respectively, which is included in interest expense on the condensed consolidated statements of operations.

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 June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Gain (Loss) Recognized in AOCI (Effective Portion)					
Commodity contracts	AOCI	$ 234	$ (41)	$ 250	$ 364
Foreign currency contracts	AOCI	(14)	(41)	(33)	(39)
		$ 220	$ (82)	$ 217	$ 325
Gain (Loss) Reclassified from AOCI (Effective Portion)					
Commodity contracts	Natural gas and oil sales	$ 67	$ 216	$ 141	$ 356
Foreign currency contracts	Interest expense	(18)		(18)	
Foreign currency contracts	Loss on purchase of debt	(20)		(20)	
		$ 29	$ 216	$ 103	$ 356

Gain (Loss) Recognized in Income					
Commodity contracts					
Ineffective portion	Natural gas and oil sales	$ 8	$ (18)	$ 18	$ (24)
Amount initially excluded from effectiveness testing	Natural gas and oil sales		36	22	72
		$ 8	$ 18	$ 40	$ 48

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Non-Qualifying Derivatives

The following table presents the gain (loss) recognized in the condensed consolidated statement of operations for instruments not qualifying as cash flow or fair value derivatives:

		Three Months Ended June 30,		Six Months Ended June 30,	
Derivative Contracts	**Location of Gain (Loss)**	**2011**	**2010**	**2011**	**2010**
Commodity contracts	Natural gas and oil sales	$ 439	$ (57)	$ (360)	$ 486
Interest rate contracts	Interest expense	(6)	46	(11)	68
	Total	$ 433	$ (11)	$ (371)	$ 554

Credit Risk

Derivative instruments that enable us to hedge a portion of our exposure to natural gas and oil prices and interest rate volatility expose us to credit risk from our counterparties. To mitigate this risk, we enter into derivative contracts only with investment-grade rated counterparties deemed by management to be competent and competitive market makers, and we attempt to limit our exposure to non-performance by any single counterparty. On June 30, 2011, our commodity and interest rate derivative instruments were spread among 14 counterparties. Additionally, our multi-counterparty secured hedging facility described above included 11 of our counterparties which are required to secure their natural gas and oil derivative obligations in excess of defined thresholds. We use this facility for all of our commodity derivatives.

3. Contingencies and Commitments

Litigation

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. Following the appointment of a lead plaintiff and counsel, 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. The defendants motion to dismiss was denied on September 2, 2010. A derivative action was also filed in the District Court of Oklahoma County, Oklahoma on March 10, 2009 against the company s directors and certain of its officers alleging breaches of fiduciary duties relating to the disclosure matters alleged in the securities case. The derivative action is stayed pursuant to stipulation. We are currently unable to assess the probability of loss or estimate a range of potential loss associated with the securities class action case, which is at an early stage.

Chesapeake is also involved in various other lawsuits and disputes incidental to its business operations, including commercial disputes, personal injury claims, claims for underpayment of royalties, property damage claims and contract actions. With regard to the latter, 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.

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The company records an associated liability when a loss is probable and the amount is reasonably estimable. Based on management s current assessment, we are of the opinion that no pending or threatened lawsuit or dispute incidental to its business operations is likely to have a material adverse effect on the company s 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

Due to the nature of the natural gas and oil business, Chesapeake and its subsidiaries are exposed to environmental risks. Chesapeake has implemented various policies and procedures to reduce and mitigate such environmental risks. Chesapeake conducts periodic reviews, on a company-wide basis, to identify changes in our environmental risk profile. These reviews evaluate whether there is a contingent liability, its amount, and the likelihood that the liability will be incurred. The amount of any potential liability is determined by considering, among other matters, incremental direct costs of any likely remediation and the proportionate cost of employees who are expected to devote a significant amount of time directly to any possible remediation effort. We manage our exposure to environmental liabilities on properties to be acquired by identifying existing problems and assessing the potential liability. Depending on the extent of an identified environmental problem, Chesapeake may exclude a property from the acquisition, require the seller to remediate the property to our satisfaction, or agree to assume liability for the remediation of the property. Chesapeake has historically not experienced any significant environmental liability and is not aware of any potential material environmental issues or claims at June 30, 2011. There is, however, pending against us an enforcement action related to compliance with Clean Water Act permitting requirements in West Virginia, as well as an investigation by the Pennsylvania Department of Environmental Protection of a recent well control incident. While these actions may result in monetary sanctions, we do not expect that they will have a material adverse effect on our operations.

Rig Leases

In a series of transactions since 2006, our drilling subsidiaries have sold 93 drilling rigs and related equipment for $802 million and entered into a master lease agreement under which we agreed to lease the rigs from the buyer for initial terms of five to ten years. The lease obligations are guaranteed by Chesapeake and certain of its subsidiaries. These transactions were recorded as sales and operating leasebacks and any related gain or loss is amortized to service operations expense 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 the 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 June 30, 2011, the minimum aggregate undiscounted future rig lease payments were approximately $506 million.

Compressor Leases

Through various transactions since 2007, our compression subsidiary has sold 2,234 compressors, a significant portion of its compressor fleet, for $517 million and entered into a master lease agreement. The term of the agreement varies by buyer ranging from four to ten years. The lease obligations are guaranteed by Chesapeake and certain of its subsidiaries. These transactions were recorded as sales and operating leasebacks and any related gain or loss is 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 the 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 June 30, 2011, the minimum aggregate undiscounted future compressor lease payments were approximately $391 million.

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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 from certain of our production. We have entered into these agreements to move our production to market. Working interest owners who are selling with us under our marketing agreements will reimburse us for some of these costs. While we expect to have sufficient production to fully utilize the committed capacity, we can pursue a release of any unused capacity to others, thus potentially reducing our future commitment.

The aggregate undiscounted commitments under our gathering, processing and transportation agreements, excluding any reimbursement from working interest owners, are presented below:

	June 30, 2011 ($ in millions)
2011	$ 440
2012	1,017
2013	1,153
2014	1,150
2015	1,195
2015 - 2099	6,767
Total	$ 11,722

Drilling Contracts

Currently, Chesapeake has contracts with various drilling contractors to lease approximately 55 rigs with terms ranging from four months to three years. These commitments are not recorded in the accompanying condensed consolidated balance sheets. As of June 30, 2011, the aggregate undiscounted minimum future drilling rig commitment was approximately $450 million.

Natural Gas and Oil Purchase Obligations

Our marketing segment regularly commits to purchase natural gas from other owners in our properties and such commitments typically are short-term in nature. We have also committed to purchase any natural gas and oil associated with certain volumetric production payment transactions. The purchase commitments are based on market prices at the time of production, and the purchased natural gas and oil is resold.

Net Acreage Maintenance Commitments

Under the terms of our joint venture agreements with our partners (Statoil, Total and CNOOC), 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 for certain designated time periods.

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4. Net Income Per Share

Accounting guidance for earnings per share (EPS) requires presentation of basic and diluted earnings per share on the face of the statements of operations for all entities with complex capital structures as well as a reconciliation of the numerator and denominator of the basic and diluted EPS computations.

For the Current Quarter and the Prior Period, all outstanding securities that were convertible into common stock were included in the calculation of diluted EPS. For the Prior Quarter and the Current Period, the following securities and associated adjustments to net income, consisting of dividends on our cumulative convertible preferred stock, were not included in the calculation of diluted EPS, as the effect was antidilutive.

	Net Income Adjustments ($ in millions)	Shares (in millions)
Three Months Ended June 30, 2010:		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$ 6	16
5.75% cumulative convertible preferred stock (series A)	$ 8	19
5.00% cumulative convertible preferred stock (series 2005B)	$ 3	5
4.50% cumulative convertible preferred stock	$ 3	6
Six Months Ended June 30, 2011:		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$ 43	56
5.75% cumulative convertible preferred stock (series A)	$ 31	39
5.00% cumulative convertible preferred stock (series 2005B)	$ 5	5
4.50% cumulative convertible preferred stock	$ 6	6

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A reconciliation of basic EPS and diluted EPS for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period is as follows:

	Income (Numerator)	Weighted Average Shares (Denominator)	Per Share Amount
	(in millions, except per share data)		
Three Months Ended June 30, 2011:			
Basic EPS	$ 467	635	$ 0.74
Effect of Dilutive Securities:			
Assumed conversion as of the beginning of the period of preferred shares outstanding during the period:			
Common shares assumed issued for 5.75% cumulative convertible preferred stock	21	56	
Common shares assumed issued for 5.75% cumulative convertible preferred stock (series A)	16	39	
Common shares assumed issued for 5.00% cumulative convertible preferred stock (series 2005B)	3	5	
Common shares assumed issued for 4.50% cumulative convertible preferred stock	3	6	
Unvested restricted stock		9	
Outstanding stock options		1	
Diluted EPS	$ 510	751	$ 0.68
Three Months Ended June 30, 2010:			
Basic EPS	$ 235	631	$ 0.37
Effect of Dilutive Securities:			
Unvested restricted stock		3	
Outstanding stock options		1	
Diluted EPS	$ 235	635	$ 0.37

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	Income (Numerator)	Weighted Average Shares (Denominator)	Per Share Amount
	(in millions, except per share data)		
Six Months Ended June 30, 2011:			
Basic EPS	$ 262	635	$ 0.41
Effect of Dilutive Securities:			
Unvested restricted stock		9	
Outstanding stock options		1	
Diluted EPS	$ 262	645	$ 0.41
Six Months Ended June 30, 2010:			
Basic EPS	$ 968	630	$ 1.54
Effect of Dilutive Securities:			
Assumed conversion as of the beginning of the period of preferred shares outstanding during the period:			
Common shares assumed issued for 5.75% cumulative convertible preferred stock	6	8	
Common shares assumed issued for 5.75% cumulative convertible preferred stock (series A)	8	10	
Common shares assumed issued for 5.00% cumulative convertible preferred stock (series 2005B)	5	6	
Common shares assumed issued for 4.50% cumulative convertible preferred stock	6	6	
Unvested restricted stock		4	
Outstanding stock options		1	
Diluted EPS	$ 993	665	$ 1.49

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5. Stockholders Equity, Restricted Stock and Stock Options

Common Stock

The following is a summary of the changes in our common shares outstanding for the six months ended June 30, 2011 and 2010:

	2011	2010
	(in thousands)	
Shares outstanding at January 1	655,251	648,549
Restricted stock issuances (net of forfeitures)	3,543	2,812
Stock option exercises	314	316
Convertible note exchanges		299
Preferred stock conversions/exchanges		21
Shares outstanding at June 30	659,108	651,997

In the Prior Period, we privately exchanged approximately $11 million in aggregate principal amount of our 2.25% Contingent Convertible Senior Notes due 2038 for an aggregate of 298,500 shares of our common stock valued at approximately $9 million. The difference between the allocated debt value of the notes that were exchanged and the fair value of the common stock issued resulted in a $2 million loss (including a nominal amount of deferred charges associated with the exchanges).

Preferred Stock

The following reflects our preferred shares outstanding for the six months ended June 30, 2011 and 2010:

	5.75%	5.75% (A)	4.50%	5.00% (2005B)	5.00% (2005)
			(in thousands)		
Shares outstanding at January 1, 2011 and June 30, 2011	1,500	1,100	2,559	2,096	
Shares outstanding at January 1, 2010			2,559	2,096	5
Preferred stock issuances	1,500	1,100			
Conversion of preferred into common stock					(5)
Shares outstanding at June 30, 2010	1,500	1,100	2,559	2,096	

On May 17, 2010, we issued 600,000 shares of 5.75% Cumulative Convertible Non-Voting Preferred Stock, par value $0.01 per share and liquidation preference $1,000 per share, in a private placement for net proceeds of approximately $594 million. We issued an additional 900,000 shares of 5.75% Cumulative Convertible Non-Voting Preferred Stock on June 18, 2010, upon the exercise of the purchasers option to place the additional shares, for net proceeds of approximately $877 million.

On May 17, 2010, we issued 1,100,000 shares of 5.75% Cumulative Convertible Non-Voting Preferred Stock (Series A), par value $0.01 per share and liquidation preference $1,000 per share, in a private placement for net proceeds of approximately $1.091 billion.

On May 3, 2010, we converted all 5,000 shares of our outstanding 5.00% Cumulative Convertible Preferred Stock (Series 2005) into 20,774 shares of common stock pursuant to the company s mandatory conversion rights.

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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% 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 programs consist of restricted stock and stock options issued to employees and non-employee directors. We recognize in our financial statements the cost of employee services received in exchange for awards of equity instruments based on the fair value at the date of the grant. To the extent compensation cost relates to employees directly involved in natural gas and oil acquisition, 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, production expenses, marketing, gathering and compression expenses or service operations expense. We recorded the following stock-based compensation during the Current Quarter, the Prior Quarter, the Current Period and the Prior Period:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	($ in millions)			
Natural gas and oil properties	$ 29	$ 28	$ 60	$ 66
General and administrative expenses	23	21	47	42
Production expenses	9	9	18	18
Marketing, gathering and compression expenses	4	4	9	9
Service operations expense	2	2	5	4
Total	$ 67	$ 64	$ 139	$ 139

Restricted Stock. Chesapeake began issuing shares of restricted common stock to employees in January 2004 and to non-employee directors in July 2005. The fair value of the awards issued is determined based on the fair market value of the shares on the date of grant. This value is amortized over the vesting period, which is generally four or five years from the date of grant for employees and three years for non-employee directors.

A summary of the changes in unvested shares of restricted stock for the six months ended June 30, 2011 is presented below:

	Number of Unvested Restricted Shares	Weighted Average Grant-Date Fair Value

	(in thousands)	
Unvested shares as of January 1, 2011	21,375	$ 28.68
Granted	4,989	$ 26.92
Vested	(3,208)	$ 27.59
Forfeited	(330)	$ 27.41
Unvested shares as of June 30, 2011	22,826	$ 28.47

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The aggregate intrinsic value of restricted stock vested during the Current Period was approximately $86 million based on the stock price at the time of vesting.

As of June 30, 2011, there was $350 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 two 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, we recognized excess tax benefits of a nominal amount which were recorded as an adjustment to additional paid-in-capital and deferred income taxes. A $1 million reduction in tax benefits related to restricted stock was recorded as an adjustment to additional paid-in-capital and deferred income taxes in the Prior Quarter, Current Period and the Prior Period.

Stock Options. We granted stock options prior to 2006 under several stock compensation plans. Outstanding options expire ten years from the date of grant and vested over a four-year period. All of our outstanding stock options are fully vested and exercisable.

The following table provides information related to stock option activity for the six months ended June 30, 2011:

	Number of Shares Underlying Options (in thousands)	Weighted Average Exercise Price Per Share	Weighted Average Contract Life in Years	Aggregate Intrinsic Value[a] ($ in millions)
Outstanding at January 1, 2011	1,808	$ 8.90	2.03	$ 31
Exercised	(400)	$ 6.86		
Outstanding and exercisable at June 30, 2011	1,408	$ 9.48	1.76	$ 28

(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.

There is no remaining unrecognized compensation cost related to unvested stock options.

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, $3 million and $1 million, respectfully, which were recorded as adjustments to additional paid-in capital and deferred income taxes with respect to such benefits.

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6. Debt

Our long-term debt consisted of the following at June 30, 2011 and December 31, 2010:

	June 30, 2011	December 31, 2010
	($ in millions)	
7.625% senior notes due 2013	$ 464	$ 500
9.5% senior notes due 2015	1,265	1,425
6.25% euro-denominated senior notes due 2017[a]	500	796
6.5% senior notes due 2017	660	1,100
6.875% senior notes due 2018	474	600
7.25% senior notes due 2018	669	800
6.625% senior notes due 2020	1,300	1,400
6.875% senior notes due 2020	500	500
6.125% senior notes due 2021	1,000	
2.75% contingent convertible senior notes due 2035[b]	396	451
2.5% contingent convertible senior notes due 2037[b]	1,168	1,378
2.25% contingent convertible senior notes due 2038[b]	346	752
Corporate revolving bank credit facility	1,710	3,612
Midstream revolving bank credit facility	104	94
Discount on senior notes[c]	(528)	(777)
Interest rate derivatives[d]	19	9
Total long-term debt	$ 10,047	$ 12,640

(a) The principal amount shown is based on the exchange rate of $1.4523 to 1.00 and $1.3269 to 1.00 as of June 30, 2011 and December 31, 2010, respectively. See Note 2 for information on our related foreign currency derivatives.

(b) 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 quarter by quarter. In the second quarter of 2011, 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 their notes into cash and common stock in the third quarter of 2011 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. 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:

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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	$ 48.62	May 14, 2016
2.5% due 2037	May 15, 2017, 2022, 2027, 2032	$ 64.16	November 14, 2017
2.25% due 2038	December 15, 2018, 2023, 2028, 2033	$ 107.36	June 14, 2019

(c) Included in this discount is $476 million at June 30, 2011 and $711 million at December 31, 2010 associated with the equity component of our contingent convertible senior notes. This discount is based on an effective yield method.

(d) See Note 2 for further discussion related to these instruments.

Senior Notes

Our senior notes are unsecured senior obligations of Chesapeake and rank equally in right of payment with all of our other existing and future senior 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. Our senior note obligations are guaranteed by certain of our wholly owned subsidiaries, excluding Chesapeake Midstream Development, L.P. (CMD) and its subsidiaries. See Note 11 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 limit our ability and our subsidiaries ability to incur certain secured indebtedness; enter into sale/leaseback transactions; and consolidate, merge or transfer assets.

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. These 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.

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In May 2011, we completed and settled tender offers to purchase the following senior notes and contingent convertible senior notes in order to reduce the amount of our outstanding indebtedness. We funded the purchase of the notes with a portion of the net proceeds we received from the sale of our Fayetteville Shale assets.

	Principal Amount Purchased ($ in millions)
7.625% senior notes due 2013	$ 36
9.5% senior notes due 2015	160
6.25% euro-denominated senior notes due 2017[(a)]	380
6.5% senior notes due 2017	440
6.875% senior notes due 2018	126
7.25% senior notes due 2018	131
6.625% senior notes due 2020	100
Total senior notes	1,373
2.75% contingent convertible senior notes due 2035	55
2.5% contingent convertible senior notes due 2037	210
2.25% contingent convertible senior notes due 2038	266
Total contingent convertible senior notes	531
Total	$ 1,904

(a) We purchased 256 million in aggregate principal amount of our euro-denominated senior notes which had a value of $380 million based on the exchange rate of $1.4821 to 1.00. Simultaneously with our purchase of the euro-denominated senior notes, we unwound cross currency swaps for the same principal amount. See Note 2 for additional information.

We paid $2.058 billion in cash for the tender offers described above and recorded associated losses of approximately $174 million. The losses included $154 million in cash premiums, $20 million of deferred charges, $160 million of note discounts and $2 million of interest rate hedging losses, offset by $162 million of the equity component of the contingent convertible notes.

During the Current Period, we issued $1.0 billion principal amount of 6.125% Senior Notes due 2021 in a registered public offering. We used the net proceeds of $977 million from the offering to repay indebtedness outstanding under our corporate revolving bank credit facility.

During the Current Period, we repurchased $140 million in aggregate principal amount of our 2.25% Contingent Convertible Senior Notes due 2038 for approximately $128 million. Associated with these repurchases, we recognized a loss of $2 million in the Current Period.

During the Prior Period, we redeemed in whole for an aggregate redemption price of approximately $1.366 billion, plus accrued interest, approximately $364 million in principal amount of our outstanding 7.50% Senior Notes due 2013, $300 million in principal amount of our

7.50% Senior Notes due 2014 and approximately $670 million in principal amount of our 6.875% Senior Notes due 2016. Associated with the redemptions, we recognized a loss of $69 million in the Prior Period.

During the Prior Period, holders of our 2.25% Contingent Convertible Senior Notes due 2038 exchanged approximately $11 million in aggregate principal amount for an aggregate of 298,500 shares of our common stock in privately negotiated exchanges. Associated with these exchanges, we recognized a loss of $2 million in the Prior Period.

No scheduled principal payments are required under our senior notes until 2013 when $464 million is due.

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Bank Credit Facilities

We utilize two revolving bank credit facilities, described below, as sources of liquidity.

	Corporate Credit Facility[a]	Midstream Credit Facility[b]
	($ in millions)	
Facility structure	Senior secured revolving	Senior secured revolving
Maturity date	December 2015	June 2016
Borrowing capacity	$ 4,000	$ 600[c]
Amount outstanding as of June 30, 2011	$ 1,710	$ 104
Letters of credit outstanding as of June 30, 2011	$ 56	$

(a) Borrower is Chesapeake Exploration, L.L.C.

(b) Borrower is Chesapeake Midstream Operating, L.L.C.

(c) The decrease in operating income following the sale of our Haynesville Springridge gathering system and the sale of our Fayetteville gathering system on March 31, 2011 caused the borrowing capacity under the facility to be limited to $350 million as of June 30, 2011.

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, neither of our credit facilities contains provisions which would trigger an acceleration of amounts due under the 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 natural gas and oil 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 the London Interbank Offered Rate (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.

The 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 the agreement at June 30, 2011. If we should fail to perform our obligations under these and other covenants, 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 indentures, which could in turn result in the acceleration of a significant portion of our senior note indebtedness. The credit facility 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.

The facility is fully and unconditionally guaranteed, on a joint and several basis, by Chesapeake and certain of our wholly owned subsidiaries.

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Midstream Credit Facility

On June 15, 2011, our midstream credit facility agreement was amended and restated to, among other things, increase the amount we can borrow under the facility from $300 million to $600 million, improve interest rates, extend the maturity by almost a year and favorably restructure covenants. We use the midstream syndicated revolving bank credit facility to fund capital expenditures to build natural gas gathering and other systems in support of our drilling program and for general corporate purposes associated with our midstream operations. Borrowings under the midstream credit facility are secured by all of the assets of the wholly owned subsidiaries (the restricted subsidiaries) of CMD, itself a wholly owned subsidiary of Chesapeake, and bear interest at our option at either (i) the greater of the reference rate of Wells Fargo Bank, National Association, the federal funds effective rate plus 0.50%, and the 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 the LIBOR plus a margin that varies from 2.00% to 2.75% per annum. The unused portion of the 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 midstream credit facility agreement contains various covenants and restrictive provisions which limit the ability of CMD and its restricted subsidiaries to incur additional indebtedness, make investments or loans and create liens. The agreement requires maintenance of a leverage ratio based on the ratio of indebtedness to EBITDA and an interest coverage ratio based on the ratio of EBITDA to interest expense, in each case as defined in the agreement. The leverage ratio increases during any three-quarter period, beginning in the quarter in which CMD makes a material disposition of assets to our master limited partnership midstream affiliate, Chesapeake Midstream Partners, L.P. As a result of the sale of our Springridge gathering system to Chesapeake Midstream Partners in December 2010, we were subject to a higher leverage ratio during the three quarters ended June 30, 2011. We were in compliance with all covenants under the agreement at June 30, 2011. If CMD or its restricted subsidiaries should fail to perform their obligations under these and other covenants, the revolving credit commitment could be terminated and any outstanding borrowings under the facility could be declared immediately due and payable. The midstream credit facility agreement also has cross default provisions that apply to other indebtedness CMD and its restricted subsidiaries may have from time to time with an outstanding principal amount in excess of $15 million.

Other Financings

In 2009, we financed 113 real estate surface assets in the Barnett Shale area for approximately $145 million and 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 two of the assets in 2010. As of June 30, 2011, we had 111 assets remaining and the obligation is recorded in other long-term liabilities on our condensed consolidated balance sheets.

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 has a floating rate of prime plus 275 basis points. At our option, we may prepay in full without penalty beginning in year four. This obligation is recorded in other long-term liabilities on our condensed consolidated balance sheets.

7. Segment Information

In accordance with accounting guidance for disclosures about segments of an enterprise and related information, we have two reportable operating segments. Our exploration and production operating segment and natural gas and oil marketing, gathering and compression operating segment are managed separately because of the nature of their products and services. The exploration and production operating segment is responsible for finding and producing natural gas and oil. The marketing, gathering and

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compression operating segment is responsible for marketing, gathering and compression of natural gas and oil primarily from Chesapeake-operated wells. We also have drilling rig, trucking and other oilfield service operations which are responsible for providing services for both Chesapeake-operated wells and wells operated by third parties. Our drilling rig, trucking and other oilfield service operations are included in Other Operations in the table below.

Management evaluates the performance of our segments based upon income (loss) before income taxes. Revenues from the sale of natural gas and oil related to Chesapeake s ownership interests by the marketing, gathering and compression operating segment are reflected as exploration and production revenues. Such amounts totaled $1.213 billion, $926 million, $2.417 billion and $1.933 billion for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, respectively. The following table presents selected financial information for Chesapeake s operating segments.

	Exploration and Production	Marketing, Gathering and Compression	Other Operations	Intercompany Eliminations	Consolidated Total
			($ in millions)		
Three Months Ended June 30, 2011:					
Revenues	$ 1,792	$ 2,617	$ 275	$ (1,366)	$ 3,318
Intersegment revenues		(1,213)	(153)	1,366	
Total revenues	$ 1,792	$ 1,404	$ 122	$	$ 3,318
Income (loss) before income taxes	$ 808	$ 75	$ 21	$ (69)	$ 835
Three Months Ended June 30, 2010:					
Revenues	$ 1,161	$ 1,719	$ 181	$ (1,049)	$ 2,012
Intersegment revenues		(926)	(123)	1,049	
Total revenues	$ 1,161	$ 793	$ 58	$	$ 2,012
Income (loss) before income taxes	$ 403	$ 23	$ (14)	$ 2	$ 414
Six Months Ended June 30, 2011:					
Revenues	$ 2,286	$ 4,838	$ 523	$ (2,717)	$ 4,930
Intersegment revenues		(2,417)	(300)	2,717	
Total revenues	$ 2,286	$ 2,421	$ 223	$	$ 4,930
Income (loss) before income taxes	$ 511	$ 160	$ 42	$ (144)	$ 569
Six Months Ended June 30, 2010:					

Revenues	$ 3,059	$ 3,570	$ 351	$ (2,170)	$ 4,810
Intersegment revenues		(1,933)	(237)	2,170	
Total revenues	$ 3,059	$ 1,637	$ 114	$	$ 4,810