CHESAPEAKE ENERGY CORP
Form 10-Q
August 05, 2015
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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, 2015
[ ] 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)

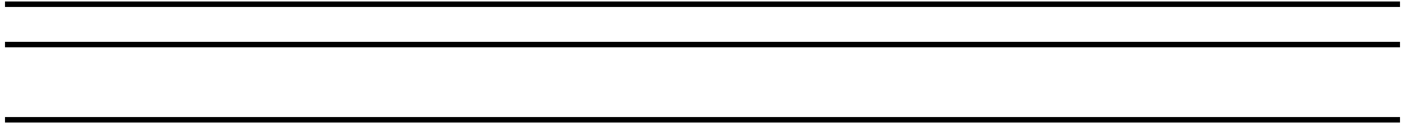
(405) 848-8000
(Registrant's telephone number, including area code)

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 July 31, 2015, there were 665,366,523 shares of our $0.01 par value common stock outstanding.



CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30, 2015	December 31, 2014
	($ in millions)	
CURRENT ASSETS:		
Cash and cash equivalents ($1 and $1 attributable to our VIE)	$2,051	$4,108
Restricted cash	38	38
Accounts receivable, net	1,501	2,236
Short-term derivative assets ($5 and $16 attributable to our VIE)	387	879
Other current assets	254	207
Total Current Assets	4,231	7,468
PROPERTY AND EQUIPMENT:		
Oil and natural gas properties, at cost based on full cost accounting:		
Proved oil and natural gas properties ($488 and $488 attributable to our VIE)	62,161	58,594
Unproved properties	8,625	9,788
Other property and equipment	3,038	3,083
Total Property and Equipment, at Cost	73,824	71,465
Less: accumulated depreciation, depletion and amortization (($361) and ($251) attributable to our VIE)	(50,302)	(39,043)
Property and equipment held for sale, net	93	93
Total Property and Equipment, Net	23,615	32,515
LONG-TERM ASSETS:		
Investments	255	265
Long-term derivative assets	186	6
Other long-term assets	311	497
TOTAL ASSETS	$28,598	$40,751

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

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

	June 30, 2015	December 31, 2014
	($ in millions)	
CURRENT LIABILITIES:		
Accounts payable	$1,284	$2,049
Current maturities of long-term debt, net	889	381
Accrued interest	153	150
Deferred income tax liabilities	126	207
Short-term derivative liabilities	27	15
Other current liabilities ($11 and $15 attributable to our VIE)	2,649	3,061
Total Current Liabilities	5,128	5,863
LONG-TERM LIABILITIES:		
Long-term debt, net	10,655	11,154
Deferred income tax liabilities	1,408	4,185
Long-term derivative liabilities	155	218
Asset retirement obligations, net of current portion	460	447
Other long-term liabilities	549	679
Total Long-Term Liabilities	13,227	16,683
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: 665,060,856 and 664,944,232 shares issued	7	7
Paid-in capital	12,420	12,531
Retained earnings (deficit)	(6,364)	1,483
Accumulated other comprehensive loss	(131)	(143)
Less: treasury stock, at cost; 1,586,305 and 1,614,312 common shares	(36)	(37)
Total Chesapeake Stockholders' Equity	8,958	16,903
Noncontrolling interests	1,285	1,302
Total Equity	10,243	18,205
TOTAL LIABILITIES AND EQUITY	$28,598	$40,751

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,	
	2015	2014	2015	2014
	($ in millions except per share data)			
REVENUES:				
Oil, natural gas and NGL	$728	$1,704	$1,813	$3,471
Marketing, gathering and compression	2,305	3,167	3,980	6,182
Oilfield services	—	281	—	545
Total Revenues	3,033	5,152	5,793	10,198
OPERATING EXPENSES:				
Oil, natural gas and NGL production	276	282	575	570
Production taxes	34	72	62	122
Marketing, gathering and compression	2,096	3,166	3,796	6,147
Oilfield services	—	212	—	431
General and administrative	69	90	125	169
Restructuring and other termination costs	(4)	33	(14)	26
Provision for legal contingencies	334	—	359	—
Oil, natural gas and NGL depreciation, depletion and amortization	601	661	1,285	1,288
Depreciation and amortization of other assets	34	79	69	157
Impairment of oil and natural gas properties	5,015	—	9,991	—
Impairments of fixed assets and other	84	40	88	60
Net (gains) losses on sales of fixed assets	1	(93)	4	(115)
Total Operating Expenses	8,540	4,542	16,340	8,855
INCOME (LOSS) FROM OPERATIONS	(5,507)	610	(10,547)	1,343
OTHER INCOME (EXPENSE):				
Interest expense	(71)	(27)	(122)	(66)
Losses on investments	(17)	(24)	(24)	(45)
Net gain on sales of investments	—	—	—	67
Losses on purchases of debt	—	(195)	—	(195)
Other income (expense)	(1)	7	5	13
Total Other Expense	(89)	(239)	(141)	(226)
INCOME (LOSS) BEFORE INCOME TAXES	(5,596)	371	(10,688)	1,117
INCOME TAX EXPENSE (BENEFIT):				
Current income taxes	(6)	5	(6)	8
Deferred income taxes	(1,500)	136	(2,872)	413
Total Income Tax Expense (Benefit)	(1,506)	141	(2,878)	421
NET INCOME (LOSS)	(4,090)	230	(7,810)	696
Net income attributable to noncontrolling interests	(18)	(39)	(37)	(80)
NET INCOME (LOSS) ATTRIBUTABLE TO CHESAPEAKE	(4,108)	191	(7,847)	616
Preferred stock dividends	(43)	(43)	(86)	(86)
Earnings allocated to participating securities	—	(3)	—	(12)
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	$(4,151)	$145	$(7,933)	$518

EARNINGS (LOSS) PER COMMON SHARE:				
Basic	$(6.27)	$0.22	$(11.99)	$0.79
Diluted	$(6.27)	$0.22	$(11.99)	$0.78
CASH DIVIDEND DECLARED PER COMMON SHARE	$—	$0.0875	$0.0875	$0.1750
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING (in millions):				
Basic	662	659	662	658
Diluted	662	659	662	760

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 June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	($ in millions)			
NET INCOME (LOSS)	$(4,090)	$230	$(7,810)	$696
OTHER COMPREHENSIVE INCOME (LOSS), NET OF INCOME TAX:				
Unrealized gains (losses) on derivative instruments, net of income tax expense (benefit) of $0 , $1, ($1) and $3	—	—	(1)	3
Reclassification of (gains) losses on settled derivative instruments, net of income tax expense (benefit) of $2, $4, $9 and $10	3	(1)	13	10
Reclassification of (gains) losses on investment, net of income tax expense (benefit) of $0, $0, $0 and ($3)	—	—	—	(5)
Other Comprehensive Income (Loss)	3	(1)	12	8
COMPREHENSIVE INCOME (LOSS)	(4,087)	229	(7,798)	704
COMPREHENSIVE INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(18)	(39)	(37)	(80)
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO CHESAPEAKE	$(4,105)	$190	$(7,835)	$624

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,	
	2015	2014
	($ in millions)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME (LOSS)	$(7,810)	$696
ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO CASH PROVIDED BY OPERATING ACTIVITIES:		
Depreciation, depletion and amortization	1,354	1,445
Deferred income tax expense (benefit)	(2,872)	413
Derivative (gains) losses, net	(344)	542
Cash receipts (payments) on derivative settlements, net	631	(323)
Stock-based compensation	43	40
Impairment of oil and natural gas properties	9,991	—
Net (gains) losses on sales of fixed assets	4	(115)
Impairments of fixed assets and other	81	51
Losses on investments	24	45
Net gains on sales of investments	—	(67)
Losses on purchases of debt	—	61
Restructuring and other termination costs	(14)	24
Provision for legal contingencies	359	—
Other	69	71
Changes in assets and liabilities	(779)	(240)
Net Cash Provided By Operating Activities	737	2,643
CASH FLOWS FROM INVESTING ACTIVITIES:		
Drilling and completion costs	(2,168)	(1,996)
Acquisitions of proved and unproved properties	(266)	(356)
Proceeds from divestitures of proved and unproved properties	14	248
Additions to other property and equipment	(93)	(620)
Proceeds from sales of other property and equipment	7	713
Additions to investments	(6)	(5)
Proceeds from sales of investments	—	239
Other	—	(3)
Net Cash Used In Investing Activities	(2,512)	(1,780)

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,	
	2015	2014
	($ in millions)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from credit facilities borrowings	—	857
Payments on credit facilities borrowings	—	(1,239)
Proceeds from issuance of senior notes, net of discount and offering costs	—	2,966
Proceeds from issuance of oilfield services senior notes, net of discount and offering costs	—	494
Proceeds from issuance of oilfield services term loan, net of issuance costs	—	394
Cash paid to purchase debt	—	(3,362)
Cash paid for common stock dividends	(118)	(117)
Cash paid for preferred stock dividends	(86)	(86)
Cash paid on financing derivatives	—	(32)
Cash held and retained by SSE at spin-off	—	(8)
Distributions to noncontrolling interest owners	(57)	(105)
Other	(21)	—
Net Cash Used In Financing Activities	(282)	(238)
Net increase (decrease) in cash and cash equivalents	(2,057)	625
Cash and cash equivalents, beginning of period	4,108	837
Cash and cash equivalents, end of period	$2,051	$1,462

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

SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid, net of capitalized interest	$65	$88
Income taxes paid, net of refunds received	$60	$13
SUPPLEMENTAL DISCLOSURE OF SIGNIFICANT NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Change in accrued drilling and completion costs	$(46)	$(125)
Change in accrued acquisitions of proved and unproved properties	$(31)	$(60)

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,	
	2015	2014
	($ 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	12,531	12,446
Stock-based compensation	40	23
Exercise of stock options	—	23
Dividends on common stock	(59)	—
Dividends on preferred stock	(86)	—
Increase (decrease) in tax benefit from stock-based compensation	(6)	3
Balance, end of period	12,420	12,495
RETAINED EARNINGS (DEFICIT):		
Balance, beginning of period	1,483	688
Net income (loss) attributable to Chesapeake	(7,847)	616
Dividends on common stock	—	(117)
Dividends on preferred stock	—	(86)
Spin-off of oilfield services business (Note 14)	—	(268)
Balance, end of period	(6,364)	833
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS):		
Balance, beginning of period	(143)	(162)
Hedging activity	12	13
Investment activity	—	(5)
Balance, end of period	(131)	(154)
TREASURY STOCK – COMMON:		
Balance, beginning of period	(37)	(46)
Purchase of 28,298 and 15,532 shares for company benefit plans	—	—
Release of 56,305 and 300,034 shares from company benefit plans	1	5
Balance, end of period	(36)	(41)
TOTAL CHESAPEAKE STOCKHOLDERS' EQUITY	8,958	16,202
NONCONTROLLING INTERESTS:		
Balance, beginning of period	1,302	2,145
Net income attributable to noncontrolling interests	37	80
Distributions to noncontrolling interest owners	(54)	(102)
Balance, end of period	1,285	2,123
TOTAL EQUITY	$10,243	$18,325

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

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Chesapeake Energy Corporation ("Chesapeake" or the "Company") and its subsidiaries were prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and include the accounts of our direct and indirect wholly owned subsidiaries and entities in which Chesapeake has a controlling financial interest. Intercompany accounts and balances have been eliminated. These financial statements were prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all disclosures required for financial statements prepared in conformity with U.S. GAAP. This Form 10-Q relates to the three and six months ended June 30, 2015 (the "Current Quarter" and the “Current Period”, respectively) and the three and six months ended June 30, 2014 (the "Prior Quarter" and the “Prior Period”, respectively). Chesapeake's annual report on Form 10-K for the year ended December 31, 2014 ("2014 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 results for the Current Quarter and the Current Period are not necessarily indicative of the results to be expected for the full year.

2. Earnings Per Share

Basic earnings per share (EPS) is calculated using the weighted average number of common shares outstanding during the period and includes the effect of any participating securities as appropriate. Participating securities consist of unvested restricted stock issued to our employees and non-employee directors that provide dividend rights.

Diluted EPS is calculated assuming the issuance of common shares for all potentially dilutive securities, provided the effect is not antidilutive. 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 EPS. See Note 3 for further discussion of our contingent convertible senior notes.

For the Current Quarter, the Prior Quarter, the Current Period and the Prior Period, shares of the following securities and associated adjustments to net income, representing dividends on preferred stock and allocated earnings on participating securities, were excluded from the calculation of diluted EPS as the effect was antidilutive.

	Net Income Adjustments ($ in millions)	Shares (in millions)
Three Months Ended June 30, 2015		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$21	59
5.75% cumulative convertible preferred stock (series A)	$16	42
5.00% cumulative convertible preferred stock (series 2005B)	$3	6
4.50% cumulative convertible preferred stock	$3	6
Participating securities	$—	1
Three Months Ended June 30, 2014		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$22	59
5.75% cumulative convertible preferred stock (series A)	$16	42

5.00% cumulative convertible preferred stock (series 2005B)	$3	6
4.50% cumulative convertible preferred stock	$3	6
Participating securities	$3	3

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	Net Income Adjustments ($ in millions)	Shares (in millions)
Six Months Ended June 30, 2015		
Common stock equivalent of our preferred stock outstanding:		
5.75% cumulative convertible preferred stock	$43	59
5.75% cumulative convertible preferred stock (series A)	$32	42
5.00% cumulative convertible preferred stock (series 2005B)	$5	6
4.50% cumulative convertible preferred stock	$6	6
Participating securities	$—	2
Six Months Ended June 30, 2014		
Common stock equivalent of our preferred stock outstanding:		
5.00% cumulative convertible preferred stock (series 2005B)	$5	6
4.50% cumulative convertible preferred stock	$6	6
Participating securities	$11	3

For the Prior Period, the following outstanding equity securities convertible into common stock were included in the calculation of diluted EPS. A reconciliation of basic EPS and diluted EPS for the Prior Period is as follows:

	Income (Numerator)	Weighted Average Shares (Denominator)	Per Share Amount
	(in millions, except per share data)		
Six Months Ended June 30, 2014			
Basic EPS	$518	658	$0.79
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	43	59	
Common shares assumed issued for 5.75% cumulative convertible preferred stock (series A)	32	42	
Outstanding stock options	—	1	
Diluted EPS	$593	760	$0.78

3. Debt

Our long-term debt consisted of the following as of June 30, 2015 and December 31, 2014:

	June 30, 2015	December 31, 2014
	($ in millions)	
3.25% senior notes due 2016	$500	$500
6.25% euro-denominated senior notes due 2017[(a)]	384	416
6.5% senior notes due 2017	660	660
7.25% senior notes due 2018	669	669
Floating rate senior notes due 2019	1,500	1,500
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	700
4.875% senior notes due 2022	1,500	1,500
5.75% senior notes due 2023	1,100	1,100
2.75% contingent convertible senior notes due 2035[(b)]	396	396
2.5% contingent convertible senior notes due 2037[(b)]	1,168	1,168
2.25% contingent convertible senior notes due 2038[(b)]	347	347
Revolving credit facility	—	—
Discount on senior notes[(c)]	(188)	(231)
Interest rate derivatives[(d)]	8	10
Total debt, net	11,544	11,535
Less current maturities of long-term debt, net[(e)]	(889)	(381)
Total long-term debt, net	$10,655	$11,154

(a) The principal amount shown is based on the exchange rate of $1.1147 to €1.00 and $1.2098 to €1.00 as of June 30, 2015 and December 31, 2014, respectively. See Note 8 for information on our related foreign currency derivatives.

(b) The repurchase, conversion, contingent interest and redemption provisions of our contingent convertible senior notes are as follows:

Holders' Demand Repurchase Rights. 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 holders of our 2.75% Contingent Convertible Senior Notes due 2035 could exercise their individual demand repurchase rights on November 15, 2015, which would require us to repurchase all or a portion of the principal amount of the notes.

Optional Conversion by Holders. At the holder's option, prior to maturity under certain circumstances, the notes are convertible into cash and, if applicable, shares of our common stock using a net share settlement process. One 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. During the specified period in the second quarter of 2015, the price of our common stock was below the threshold level for each series of the contingent convertible senior notes 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 2015 under this provision.

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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. The notes were not convertible under this provision during the Current Quarter or the Prior Quarter. 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 the principal amount.

Contingent Interest. We will pay contingent interest on the convertible senior notes after they have been outstanding at least ten years during certain periods if the average trading price of the notes exceeds the threshold defined in the indenture.

The holders' demand repurchase dates, the common stock price conversion threshold amounts (as adjusted to give effect to cash dividends on our common stock) 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	Holders' Demand Repurchase Dates	Common Stock Price Conversion Thresholds	Contingent Interest First Payable (if applicable)
2.75% due 2035	November 15, 2015, 2020, 2025, 2030	$45.14	May 14, 2016
2.5% due 2037	May 15, 2017, 2022, 2027, 2032	$59.44	November 14, 2017
2.25% due 2038	December 15, 2018, 2023, 2028, 2033	$100.35	June 14, 2019

Optional Redemption by the Company. We may redeem the contingent 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.

(c) Discount as of June 30, 2015 and December 31, 2014 included $181 million and $224 million, respectively, associated with the equity component of our contingent convertible senior notes. This discount is amortized based on an effective yield method.

(d) See Note 8 for further discussion related to these instruments.

(e) As of June 30, 2015, current maturities of long-term debt, net includes the carrying amount of our 3.25% Senior Notes due March 2016 and 2.75% Contingent Convertible Senior Notes due 2035. As discussed in footnote (b) above, the holders of our 2.75% Contingent Convertible Senior Notes due 2035 could exercise their individual demand repurchase rights on November 15, 2015, which would require us to repurchase all or a portion of the principal amount of the notes. As of June 30, 2015 and December 31, 2014, current maturities of long-term debt, net reflects $7 million and $15 million, respectively, of discount associated with the equity component of the 2.75% Contingent Convertible Senior Notes due 2035.

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, 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 100% owned subsidiaries. See Note 18 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 or $75 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.

In March 2013, the Company brought suit in the U.S. District Court for the Southern District of New York against The Bank of New York Mellon Trust Company, N.A., the indenture trustee for the 6.775% Senior Notes due 2019 (the 2019 Notes). The Company sought and ultimately obtained a judgment declaring 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 for that redemption pursuant to the special early redemption provision of the supplemental indenture governing the 2019 Notes. In May 2013, as a result of that ruling, the 2019 Notes were redeemed at par. In November 2014, the U.S. Court of Appeals for the Second Circuit, on appeal by the indenture trustee, reversed the District Court's declaratory judgment and held that the notice was not effective to redeem the 2019 Notes at par because it was not timely for that purpose. The Court of Appeals remanded the case to the District Court for a determination whether the redemption notice triggered a redemption at the make-whole price specified in the indenture, instead of at par. The Company sought a rehearing by the Court of Appeals en banc in December 2014, and that petition was denied on February 6, 2015. On February 13, 2015, the indenture trustee moved the District Court for entry of a judgment requiring the Company to pay the make-whole price, as defined in the indenture, less the par amount paid in the 2013 redemption plus prejudgment interest from the redemption date. On March 20, 2015, the Company filed its opposition to the Trustee's motion and cross-moved for a judgment requiring the Company to pay restitution in an amount that would disgorge the benefit the Company achieved from refinancing the 2019 Notes in 2013 and that would return the parties to the economic positions they would have been in if the par redemption had never taken place. The District Court held argument on the motion and cross-motion on May 1, 2015. On July 10, 2015, the District Court granted the Trustee's motion and denied the Company's cross-motion and entered an amended judgment on July 17, 2015 awarding the Trustee $380 million plus prejudgment interest in the amount of $59 million. The Company filed a notice of appeal on July 27, 2015 and posted a supersedeas bond to stay execution of the judgment while appellate proceedings are pending.

Revolving Credit Facility

In December 2014, we entered into a five-year $4.0 billion senior unsecured revolving credit facility to use for general corporate purposes. The credit facility replaced our then-existing $4.0 billion senior secured revolving credit facility. The aggregate commitments under the facility may be increased up to an additional $1.0 billion, and the December 2019 maturity date may be extended for two one-year periods at our request and with the consent of the participating lenders. As of June 30, 2015, we had no outstanding borrowings under the facility and utilized $15 million of the facility for various letters of credit. Borrowings under the facility are currently unsecured; however, we will be required to provide collateral and the facility will be subject to a borrowing base if our credit rating declines to Ba3 (Moody's Investors Services, Inc.) or BB- (Standard & Poor's Ratings Services) or lower.

Revolving loans under the credit facility bear interest at a fluctuating rate per annum equal to the highest of (i) the federal funds effective rate plus 0.5%, (ii) the administrative agent's prime rate or (iii) the London interbank offer rate (LIBOR) for a one-month interest period plus 1.0% (alternative base rate (ABR) loans), and/or LIBOR rates (LIBOR loans), at our election, plus an applicable margin rate depending on our credit rating (currently 0.625% per annum for ABR loans and 1.625% per annum for LIBOR loans). The terms of the credit facility include covenants limiting, among other things, the ability of the Company and its restricted subsidiaries to incur additional indebtedness, make investments or loans, create liens, consummate mergers and similar fundamental changes, make restricted payments, make investments in unrestricted subsidiaries and enter into transactions with affiliates. In addition, the credit facility

requires us to maintain, as of the last day of each fiscal quarter, (i) a net debt to capitalization ratio (as defined in the credit agreement) that does not exceed 65%; and (ii) a leverage ratio (net debt to consolidated EBITDA, as defined in the credit agreement) that does not exceed 4.0 to 1.0; provided, however, that the leverage ratio will not apply during any period in which our credit rating, as determined by either Moody's Investors Services, Inc. or Standard & Poor's Rating Services, meets certain investment grade thresholds, as defined in the credit agreement.

Our credit facility is fully and unconditionally guaranteed, on a joint and several basis, by certain of our material subsidiaries. The credit agreement includes events of default relating to customary matters, including, among other things, nonpayment of principal, interest or other amounts; violation of covenants; incorrectness of representations and warranties in any material respect; cross-payment default and cross acceleration with respect to indebtedness in an aggregate principal amount of $125 million or more; bankruptcy; judgments involving liability of $125 million or more that are not paid; and ERISA events. Many events of default are subject to customary notice and cure periods.

Spin-Off Debt Transactions

On June 30, 2014, we completed the spin-off of our oilfield services business, which we previously conducted through our indirect, wholly owned subsidiary Chesapeake Oilfield Operating, L.L.C. (COO), into an independent, publicly traded company called Seventy Seven Energy Inc. (SSE). In the Prior Quarter, COO or its subsidiaries completed the following debt transactions:

- Entered into a five-year senior secured revolving credit facility with total commitments of $275 million and incurred approximately $3 million in financing costs related to entering into the facility.
- Entered into a $400 million seven-year secured term loan and used the net proceeds of approximately $394 million and borrowings under the new revolving credit facility to repay and terminate COO’s then-existing credit facility.
- Issued $500 million in aggregate principal amount of 6.5% Senior Notes due 2022 in a private placement and used the net proceeds of approximately $494 million to make a cash distribution of approximately $391 million to us, to repay a portion of outstanding indebtedness under the new revolving credit facility discussed above and for general corporate purposes.

All deferred charges and debt balances related to these transactions were removed from our consolidated balance sheet as of June 30, 2014. See Note 14 for further discussion of the spin-off.

Fair Value of Debt

We estimate the fair value of our exchange-traded debt using quoted market prices (Level 1). The fair value of all other debt, which would include borrowings under our revolving credit facility (which was undrawn as of June 30, 2015 and December 31, 2014), is estimated using our credit default swap rate (Level 2). Fair value is compared to the carrying value, excluding the impact of interest rate derivatives, in the table below.

	June 30, 2015		December 31, 2014	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
		($ in millions)		
Short-term debt (Level 1)	$889	$892	$381	$396
Long-term debt (Level 1)	$10,647	$10,286	$11,144	$11,656

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 or may seek damages and penalties, the amount of which is indeterminate. 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 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. 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. On appeal, the U.S. Court of Appeals for the Tenth Circuit affirmed the dismissal on August 8, 2014 and denied the plaintiffs’ petition for rehearing on November 12, 2014. On April 10, 2015, the plaintiffs filed a writ of certiorari with the United States Supreme Court.
Shareholder Derivative Litigation. A federal consolidated derivative action and an Oklahoma state court derivative action were stayed in 2012 pending resolution of a related, previously reported putative federal securities class action. The shareholder derivative actions allege breaches of fiduciary duty, among other things, related to the former CEO’s personal financial practices and purported conflicts of interest, and the Company’s accounting for volumetric production payments. With the dismissal of the federal securities class action now affirmed (in July 2014), the parties stipulated to continue the stay of the Oklahoma state court derivative action while the plaintiffs pursue their claims in the federal consolidated derivative action. The plaintiffs filed a consolidated derivative complaint on October 31, 2014 and an amended consolidated derivative complaint on February 12, 2015. Chesapeake filed its motion to dismiss on February 23, 2015.
Regulatory Proceedings. The Company has received, from the U.S. Department of Justice (DOJ) and certain state governmental agencies and authorities, subpoenas and demands for documents, information and testimony in connection with investigations into possible violations of federal and state antitrust laws relating to our purchase and lease of oil and gas rights in various states. The Company also has received DOJ and state subpoenas seeking information on the Company’s royalty payment practices. Chesapeake has engaged in discussions with the DOJ and state agency representatives and continues to respond to such subpoenas and demands.
On March 5, 2014, the Attorney General of the State of Michigan filed a criminal complaint against Chesapeake in Michigan state court alleging misdemeanor antitrust violations and attempted antitrust violations under state law arising out of the Company’s leasing activities in Michigan during 2010. On July 9, 2014, following a preliminary hearing on the complaint, as amended, the 89th District Court for Cheboygan County, Michigan ruled that one count alleging a bid-rigging conspiracy between Chesapeake and Encana Oil & Gas USA, Inc. regarding the October 2010 state lease auction would proceed to trial and dismissed claims alleging a second antitrust violation and an attempted antitrust violation. The Michigan Attorney General filed a second criminal complaint against Chesapeake in the same court on June 5, 2014 which, as amended, alleged that Chesapeake’s conduct in canceling lease offers to Michigan landowners in 2010 violated the state’s criminal enterprises and false pretenses felony statutes. In resolution of both criminal complaints and with no admission of wrongdoing, on April 24, 2015, the Company entered a plea of no contest to one count of misdemeanor attempted antitrust violation and one count of misdemeanor false pretenses. The plea has been taken under advisement for a period of 11 months by the Court and will be dismissed if Chesapeake fulfills the terms of a settlement agreement with the Attorney General. As part of the settlement, Chesapeake will contribute no more than $25 million to a compensation fund established to compensate Michigan landowners for unfunded oil and gas leases in 2010.
Redemption of 2019 Notes. See Note 3 for a description of pending litigation regarding our redemption in May 2013 of our 2019 Notes. As a result of the reversal of the trial court’s decision in our declaratory judgment action against the indenture trustee, we accrued a loss contingency of $100 million for this matter in the 2014 fourth quarter, and we accrued an additional $339 million in the Current Quarter as a result of the judgment on remand entered on July 17, 2015.
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 oil and natural gas 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 failure-to-close cases in various courts, has settled and resolved other such cases and disputes and believes that its remaining loss exposure for these claims will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.
Regarding royalty claims, Chesapeake and other natural gas producers have been named in various lawsuits alleging royalty underpayment. The suits against us allege, among other things, 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 natural gas liquids (NGL). The Company has resolved a number of these claims through negotiated settlements of past and future royalties and has prevailed in various other lawsuits. We are currently defending lawsuits seeking damages for royalty underpayment in various states, including, but not limited to, Oklahoma, Texas, Pennsylvania, Ohio, Louisiana and Arkansas. These lawsuits include cases filed by individual royalty owners and putative class actions, some of which seek to certify a statewide class. The Company also has received DOJ and state subpoenas seeking information on the Company's royalty payment practices.
Plaintiffs have varying royalty provisions in their respective leases and oil and gas law varies from state to state. Royalty owners and producers differ in their interpretation of the legal effect of lease provisions governing royalty calculations, an issue in a putative class action filed in November 2010 in the District Court of Beaver County, Oklahoma on behalf of Oklahoma royalty owners asserting claims dating back to 2004. In July 2014, this case was remanded to the trial court for further proceedings following the reversal on appeal of certification of a statewide class. We and the named plaintiff participated in mediation concerning the claims asserted in the putative class action litigation, and in the Current Period we negotiated a settlement requiring the Company to pay $119 million cash to compensate the putative settlement class for alleged past royalty underpayments in exchange for the release of claims for the ten-year period ended December 31, 2014. Following a fairness hearing, the District Court certified the settlement class and approved the $119 million settlement on July 3, 2015. The Company reduced its prior settlement accrual to $114 million in the Current Quarter to reflect potential claimants that have opted out of the settlement. Although Chesapeake believes its royalty calculation and payment methodologies are appropriate under Oklahoma oil and gas law and denies that it committed any acts or omissions giving rise to any liability, it also believes that settlement is in the best interest of the Company considering the questions of law and fact involved and the uncertainty of continued litigation.
Chesapeake is also defending lawsuits alleging royalty underpayment with respect to properties in Texas. On April 8, 2015, Chesapeake obtained a transfer order from the Texas Multidistrict Litigation Panel to transfer a substantial portion of these lawsuits filed since June 2014 to the 348th District Court of Tarrant County for pre-trial purposes. These lawsuits, which are primarily related to the Barnett Shale, generally allege that Chesapeake underpaid royalties by making improper deductions and using incorrect production volumes. In addition to allegations of breach of contract, a number of these lawsuits allege fraud, conspiracy, joint venture and antitrust violations by Chesapeake. Chesapeake expects that additional lawsuits will be filed by new plaintiffs making similar allegations. The lawsuits seek direct damages in varying amounts, together with exemplary damages, attorneys' fees, costs and interest. Chesapeake believes its royalty calculations and payment practices were appropriate and has not accrued a loss contingency with respect to the multidistrict litigation.
Putative statewide class actions in Pennsylvania and Ohio and purported class arbitrations in Pennsylvania have been filed on behalf of royalty owners asserting various claims for damages related to alleged underpayment of royalties as a result of the Company's divestiture of substantially all of its midstream business and most of its gathering assets in 2012 and 2013. These cases include claims for violation of and conspiracy to violate the federal Racketeer Influenced and Corrupt Organizations Act and one of the cases includes claims of intentional interference with contractual relations and violations of antitrust laws.
We believe losses are reasonably possible in certain of the other pending royalty cases for which we have not accrued a loss contingency, but we are currently unable to estimate an amount or range of loss or the impact the actions could have on our future results of operations or cash flows. Uncertainties in pending royalty cases generally include the complex nature of the claims and defenses, the potential size of the class in class actions, the scope and types of the properties and agreements involved, and the applicable production years. 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 future 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 Contingencies

The nature of the oil and gas 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 established 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 address 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.

Commitments

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 oil, natural gas and NGL sales prices used in our proved reserves estimates.

In addition, we have entered into long-term agreements for certain natural gas gathering and related services within specified acreage dedication areas in exchange for cost-of-service based fees redetermined annually or tiered fees based on volumes delivered relative to scheduled volumes. Future gathering fees will vary depending on the applicable agreement. Two of these agreements, one for production in the Anadarko Basin in northwestern Oklahoma and the Texas panhandle and the other for production in the Haynesville/Bossier Shales in northwestern Louisiana, contain cost-of-service based fees that are redetermined annually through 2019 and 2020, respectively. The annual upward or downward fee adjustment for these two contracts is capped at 15% of the then-current fees at the time of redetermination. To the extent the actual rate of return on capital expended by the counterparty over the term of the agreement differs from the applicable rate of return, a payment is due to (from) the midstream service company.

The aggregate undiscounted commitments under our gathering, processing and transportation agreements, excluding any reimbursement from working interest and royalty interest owners, credits for third-party volumes or future costs under cost-of-service agreements discussed above, are presented below.

	June 30, 2015
	($ in millions)
2015	$914
2016	1,936
2017	1,941
2018	1,723
2019	1,437
2020 – 2099	6,227
Total	$14,178

Drilling Contracts

We have contracts with various drilling contractors, including those entered into with SSE in connection with the spin-off of our oilfield services business in June 2014, to utilize drilling services with terms ranging from three months to three years at market-based pricing. These commitments are not recorded in the accompanying condensed consolidated balance sheets. As of June 30, 2015, the aggregate undiscounted minimum future payments under these drilling service commitments were approximately $353 million.

Pressure Pumping Contracts

In connection with the spin-off of our oilfield services business in June 2014, we entered into an agreement with a subsidiary of SSE for pressure pumping services. The services agreement requires us to utilize, at market-based pricing, the lesser of (i) seven, five and three pressure pumping crews in years one, two and three of the agreement, respectively, or (ii) 50% of the total number of all pressure pumping crews working for us in all of our operating regions during the respective year. We are also required to utilize SSE pressure pumping services for a minimum number of fracture stages as set forth in the agreement. We are entitled to terminate the agreement in certain situations, including if SSE fails to provide the overall quality of service provided by similar service providers. As of June 30, 2015, the aggregate undiscounted minimum future payments under this agreement were approximately $185 million.

Drilling Commitments

We have committed to drill wells for the benefit of Chesapeake Granite Wash Trust. See Noncontrolling Interests in Note 6 for discussion of this commitment.

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 volumetric production payment (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 9 for further discussion of our VPP transactions.

Net Acreage Maintenance Commitments

Under the terms of our joint venture agreements with Total S.A. (see Note 9), we are required to extend, renew or replace expiring joint leasehold, at our cost, to ensure that the net acreage is maintained in certain designated areas as of future measurement dates.

Other Commitments

In July 2011, we agreed to invest $155 million in preferred equity securities of Sundrop Fuels, Inc. (Sundrop), a privately held cellulosic biofuels company based in Longmont, Colorado. We also provided Sundrop with a one-time option to require us to purchase up to $25 million in additional preferred equity securities following the full payment of the initial investment, subject to the occurrence of specified milestones. As of June 30, 2015, we had funded our $155 million commitment in full and the milestones related to Sundrop’s preferred equity call option had not been met. See Note 10 for further discussion of this investment.

As part of our normal course of business, we enter into various agreements providing, or otherwise arranging for, 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 and/or other specified matters. 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 entering into or consummating a particular transaction. For divestitures of oil and gas properties, our purchase and sale agreements may require the return of a portion of the proceeds we receive as a result of uncured title defects.

Certain of our oil and natural gas 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 these interests have been created, we have the responsibility to bear the cost of developing and producing the reserves attributable to these interests. See Note 9 for further discussion of our VPP

transactions.

While executing our strategic priorities, we have incurred certain cash charges, including contract termination charges, financing extinguishment costs and charges for unused natural gas transportation and gathering capacity. As we continue to focus on our strategic priorities, we may take certain actions that reduce financial leverage and complexity, and we may incur additional cash and noncash charges.

5. Other Liabilities

Other current liabilities as of June 30, 2015 and December 31, 2014 are detailed below.

	June 30, 2015	December 31, 2014
	($ in millions)	
Revenues and royalties due others	$757	$1,176
Accrued drilling and production costs	327	385
Joint interest prepayments received	202	189
Accrued compensation and benefits	237	344
Other accrued taxes	130	55
Accrued dividends	43	101
Bank of New York Mellon legal accrual	439	100
Oklahoma royalty settlement	114	119
Other	400	592
Total other current liabilities	$2,649	$3,061

Other long-term liabilities as of June 30, 2015 and December 31, 2014 are detailed below.

	June 30, 2015	December 31, 2014
	($ in millions)	
CHK Utica ORRI conveyance obligation[a]	$205	$220
CHK C-T ORRI conveyance obligation[b]	128	135
Financing obligations	29	30
Unrecognized tax benefits	46	45
Other	141	249
Total other long-term liabilities	$549	$679

(a) $20 million and $14 million of the total $225 million and $234 million obligations are recorded in other current liabilities as of June 30, 2015 and December 31, 2014, respectively. See Noncontrolling Interests in Note 6 for further discussion of the conveyance obligation.

(b) $28 million and $23 million of the total $156 million and $158 million obligations are recorded in other current liabilities as of June 30, 2015 and December 31, 2014, respectively. See Noncontrolling Interests in Note 6 for further discussion of the conveyance obligation.

6. Equity

Common Stock

The following is a summary of the changes in our common shares issued for the Current Period and the Prior Period:

	Six Months Ended June 30,	
	2015	2014
	(in thousands)	
Shares issued as of January 1	664,944	666,192
Restricted stock issuances (net of forfeitures and cancellations)[a]	103	(2,019)
Stock option exercises	14	1,268
Shares issued as of June 30	665,061	665,441

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

Preferred Stock

The following reflects the shares outstanding of our preferred stock for the Current Period and the Prior Period:

	5.75%	5.75% (A)	4.50%	5.00% (2005B)
	(in thousands)			
Shares outstanding as of January 1, 2015 and 2014 and shares outstanding as of June 30, 2015 and 2014	1,497	1,100	2,559	2,096

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 exists after giving effect to the dividends. To the extent retained earnings are insufficient to fund the distributions, dividend declarations are accounted for as a reduction to paid-in capital.

In July 2015, our Board of Directors determined to eliminate quarterly cash dividends on our common stock.

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.

Accumulated Other Comprehensive Income (Loss)

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

	Cash Flow Hedges	Investments	Net Change
	($ in millions)		
Balance, December 31, 2014	$(143)	$—	$(143)
Other comprehensive income before reclassifications	(1)	—	(1)
Amounts reclassified from accumulated other comprehensive income	13	—	13
Net other comprehensive income	12	—	12
Balance, June 30, 2015	$(131)	$—	$(131)
Balance, December 31, 2013	$(167)	$5	$(162)
Other comprehensive income before reclassifications	3	—	3
Amounts reclassified from accumulated other comprehensive income	10	(5)	5
Net other comprehensive income	13	(5)	8
Balance, June 30, 2014	$(154)	$—	$(154)

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

Details About Accumulated Other Comprehensive Income (Loss) Components	Affected Line Item in the Statement Where Net Income is Presented	Amounts Reclassified
		($ in millions)
Three Months Ended June 30, 2015		
Net losses on cash flow hedges:		
Commodity contracts	Oil, natural gas and NGL revenues	$3
Total reclassifications for the period, net of tax		$3
Three Months Ended June 30, 2014		
Net gains on cash flow hedges:		
Commodity contracts	Oil, natural gas and NGL revenues	$(1)
Total reclassifications for the period, net of tax		$(1)
Six Months Ended June 30, 2015		
Net losses on cash flow hedges:		
Commodity contracts	Oil, natural gas and NGL revenues	$13
Total reclassifications for the period, net of tax		$13
Six Months Ended June 30, 2014		
Net losses on cash flow hedges:		

Commodity contracts	Oil, natural gas and NGL revenues	$10	
Investments:			
Sale of investment	Net gain on sale of investment	(5	)
Total reclassifications for the period, net of tax		$5	

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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 oil and natural gas assets in our Cleveland and Tonkawa plays. CHK C-T is an unrestricted subsidiary under our revolving 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, 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. Dividends on the preferred shares are payable on a quarterly basis at a rate of 6% per annum based on $1,000 per share. CHK C-T is required to retain an amount of cash equal to the next two quarters of preferred dividend payments. The amount reserved, approximately $38 million as of June 30, 2015 and December 31, 2014, was reflected as restricted cash on our condensed consolidated balance sheets. We initially 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. In April 2014, the drilling commitment was amended to require us to drill and complete a minimum cumulative total of (i) 162.5 net wells by June 30, 2014 and (ii) 175 net wells by December 31, 2014. The drilling commitment was suspended in January 2015.

The CHK C-T investors’ right to receive, proportionately, a 3.75% ORRI in CHK C-T wells 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. We did not meet the 2014 ORRI conveyance commitment. However, in no event are we required to deliver to investors more than a total ORRI of 3.75% in the contributed wells and 1,000 future net wells. As of June 30, 2015, we had drilled 190 net wells. The obligation to deliver future ORRIs, which runs through the first quarter of 2025, has been recorded as a liability that 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 oil and natural gas properties.

As of June 30, 2015 and December 31, 2014, $1.015 billion of noncontrolling interests on our condensed consolidated balance sheets was attributable to CHK C-T. For the Current Quarter and the Prior Quarter, income of $19 million was attributable to the noncontrolling interests of CHK C-T and for the Current Period and the Prior Period, income of $38 million was attributable to the noncontrolling interests of CHK C-T.

On June 30, 2015, we entered into an agreement to sell all of the properties held by CHK C-T to FourPoint Energy, LLC (FourPoint) for approximately $575 million. We will use the consideration from the sale and cash held by CHK C-T, to repurchase the outstanding preferred shares in CHK C-T, subject to customary adjustments to the purchase price and certain indemnity obligations in connection with the sale. Upon closing of the transaction, we will eliminate the noncontrolling interest and ORRI obligation on our condensed consolidated balance sheet, approximately $75

million in annual preferred dividend payments and all related future drilling and ORRI commitments attributable to CHK C-T. We expect this transaction to close in the 2015 third quarter.
Utica Financial Transaction. We formed CHK Utica, L.L.C. (CHK Utica) in October 2011 to develop a portion of our Utica Shale oil and natural gas assets. 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.

In July 2014, we repurchased all of the outstanding preferred shares of CHK Utica from third-party preferred shareholders for approximately $1.254 billion, or approximately $1,189 per share including accrued dividends. The $447 million difference between the cash paid for the preferred shares and the carrying value of the noncontrolling interest acquired was reflected in retained earnings and as a reduction to net income available to common stockholders for purposes of our EPS computations. Pursuant to the transaction, our obligation to pay quarterly dividends to third-party preferred shareholders was eliminated. In addition, the development agreement was terminated pursuant to the transaction, which eliminated our obligation to drill and complete a minimum number of wells within a specified period for the benefit of CHK Utica. Our repurchase of the outstanding preferred shares in CHK Utica did not affect our obligation to deliver a 3% ORRI in 1,500 net wells on certain Utica Shale leasehold.

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 through 2023. However, in no event are we required to 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 the 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 the remaining ORRIs once we have drilled a minimum of 1,300 net wells. As of June 30, 2015, we had drilled 463 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 oil and natural gas properties. Because 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. We met our ORRI conveyance commitments as of December 31, 2013 and 2014.

In the Prior Quarter and the Prior Period, income of approximately $19 million and $37 million, respectively, was attributable to the noncontrolling interests of CHK Utica.

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 Trust's initial public offering, 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 is not 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 recoverable by the Trust under the lien was limited to $263 million initially and is proportionately reduced as we fulfill our drilling obligation over time. As of June 30, 2015 and 2014, we had drilled or caused to be drilled approximately 104 and 93 development wells, respectively, as calculated under the development

agreement, and the maximum amount recoverable under the drilling support lien was approximately $32 million and $55 million, respectively.

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 the quarter. If there is not sufficient cash to fund a distribution on all of the Trust units, the distribution to be made with respect to the subordinated units is reduced or eliminated for the quarter in order to make a distribution, to the extent possible, of up to the subordination threshold amount on the common units. The distribution made with respect to the subordinated units to Chesapeake was either reduced or eliminated for each of the most recent 12 quarters. 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 the quarter. The remaining 50% of cash available for distribution in excess of the applicable incentive threshold is to be paid to Trust unitholders, including Chesapeake, on a pro rata basis. Through June 30, 2015, no incentive distributions had been made. 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 this 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 the Prior Period, the Trust declared and paid the following distributions:

Production Period	Distribution Date	Cash Distribution per Common Unit	Cash Distribution per Subordinated Unit
December 2014 – February 2015	June 1, 2015	$0.3899	$—
September 2014 – November 2014	March 2, 2015	$0.4496	$—
December 2013 – February 2014	May 30, 2014	$0.6454	$—
September 2013 – November 2013	March 3, 2014	$0.6624	$—

We have determined that the Trust is a variable interest entity (VIE) and that Chesapeake is the primary beneficiary. As a result, the Trust is consolidated in our condensed consolidated financial statements. As of June 30, 2015 and December 31, 2014, $271 million and $287 million, respectively, of noncontrolling interests on our condensed consolidated balance sheets were attributable to the Trust. Net income (loss) attributable to the Trust's noncontrolling interests is presented in our condensed consolidated statements of operations as a loss of approximately $1 million in the Current Quarter, income of approximately $2 million in the Prior Quarter, a loss of approximately $1 million in the Current Period and income of approximately $7 million in the Prior Period. See Note 11 for further discussion of VIEs.

7. Share-Based Compensation

Chesapeake's share-based compensation program consists of restricted stock, stock options and performance share units (PSUs) granted to employees and common stock and restricted stock granted to non-employee directors under our long term incentive plans. The restricted stock and stock options are equity-classified awards and the PSUs are liability-classified awards.

Equity-Classified Awards

Restricted Stock. We grant restricted stock to employees and non-employee directors. Restricted stock vests over a minimum of three years and the holder receives dividends, if paid, on unvested shares. A summary of the changes in unvested restricted stock during the Current Period is presented below.

	Shares of Unvested Restricted Stock (in thousands)	Weighted Average Grant Date Fair Value
Unvested restricted stock as of January 1, 2015	10,091	$21.20
Granted	6,918	$14.03
Vested	(2,651)	$16.79
Forfeited	(374)	$15.28
Unvested restricted stock as of June 30, 2015	13,984	$18.65

The aggregate intrinsic value of restricted stock that vested during the Current Period was approximately $45 million based on the stock price at the time of vesting.

As of June 30, 2015, there was approximately $180 million of total unrecognized compensation expense related to unvested restricted stock. The expense is expected to be recognized over a weighted average period of approximately 2.21 years.

The vesting of certain restricted stock grants may result in state and federal income tax benefits, or reductions in these 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 and the Current Period, we recognized reductions in tax benefits related to restricted stock of a nominal amount and $6 million, respectively, and during the Prior Quarter and the Prior Period, we recognized excess tax benefits related to restricted stock of a nominal amount and $3 million, respectively. Each adjustment was recorded to additional paid-in capital and deferred income taxes.

Stock Options. In the Current Period and the Prior Period, we granted members of senior management stock options that vest ratably over a three-year period. In January 2013, we also granted retention awards of stock options to certain officers that vest one-third on each of the third, fourth and fifth anniversaries of the grant date. Each stock option award has an exercise price equal to the closing price of the Company's common stock on the grant date. Outstanding options generally expire ten years from the date of grant.

We utilize the Black-Scholes option pricing model to measure the fair value of stock options. The expected life of an option is determined using the simplified method, as there is no adequate historical exercise behavior available. Volatility assumptions are estimated based on an average of historical volatility of Chesapeake stock over the expected life of an option. The risk-free interest rate is based on the U.S. Treasury rate in effect at the time of the grant over the expected life of the option. The dividend yield is based on an annual dividend yield, taking into account the Company's dividend policy, over the expected life of the option. The Company used the following weighted average assumptions to estimate the grant date fair value of the stock options granted in the Current Period:

Expected option life – years	4.5
Volatility	39.91 %

Risk-free interest rate	1.33	%
Dividend yield	1.91	%

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The following table provides information related to stock option activity for the Current Period:

	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, 2015	4,599	$19.55	7.03	$5
Granted	1,208	$18.37		
Exercised	(14)	$18.13		$—
Expired	(213)	$18.54		
Forfeited	—	$—		
Outstanding at June 30, 2015	5,580	$19.33	6.39	$—
Exercisable at June 30, 2015	2,169	$19.44	5.59	$—

(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 June 30, 2015, there was $13 million of total unrecognized compensation expense related to stock options. The expense is expected to be recognized over a weighted average period of approximately 2.02 years.

The vesting of certain stock option grants may result in state and federal income tax benefits, or reductions in these 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 and the Current Period, we recognized a reduction in tax benefits related to stock options of nominal amounts, and during the Prior Quarter and the Prior Period, we recognized nominal amounts of excess tax benefits related to stock options. Each adjustment was recorded to additional paid-in capital and deferred income taxes.

Restricted Stock and Stock Option Compensation. We recognized the following compensation costs related to restricted stock and stock options for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	($ in millions)			
General and administrative expenses	$12	$11	$24	$24
Oil and natural gas properties	8	9	15	16
Oil, natural gas and NGL production expenses	6	5	10	8
Marketing, gathering and compression expenses	2	1	3	3
Oilfield services expenses	—	3	—	5
Total	$28	$29	$52	$56

Liability-Classified Awards

Performance Share Units. In 2013, 2014 and 2015, we granted PSUs to senior management that vest ratably over their respective terms and are settled in cash on the third anniversary of the awards. The ultimate amount earned is based on achievement of performance metrics established by the Compensation Committee of the Board of Directors, which include total shareholder return (TSR) and, for certain of the awards, operational performance goals such as finding and development costs and production and proved reserve growth.

For PSUs granted in 2013, the TSR component can range from 0% to 125% of base salary, and each of the two operational components can range from 0% to 62.5%; however, the maximum total payout is capped at 200%. For PSUs granted in 2014, the TSR component can range from 0% to 200%, with no operational components. For PSUs granted in 2015, the TSR component can range from 0% to 100%, and each of the two operational components can range from 0% to 50% resulting in a maximum total payout of 200%. The payout percentage for these PSUs is capped at 100% if the Company's absolute TSR is less than zero. Compensation expense associated with PSU grants is recognized over the service period based on the graded-vesting method. The number of units settled is dependent upon the Company's estimates of the underlying performance measures. The Company utilized the Monte Carlo simulation for the TSR performance measure and the following assumptions to determine the grant date fair value of the PSUs:

Volatility	40.12	%
Risk-free interest rate	0.95	%
Dividend yield for value of awards	1.91	%

The following table presents a summary of our 2013, 2014 and 2015 PSU awards:

	Units	Fair Value as of Grant Date	Fair Value[(a)]	Liability for Vested Amount[(a)]
		($ in millions)		
2013 Awards:				
Payable 2016	1,701,941	$35	$13	$12
2014 Awards:				
Payable 2017	609,637	$16	$1	$1
2015 Awards:				
Payable 2018	696,683	$13	$5	$2

(a) As of June 30, 2015.

PSU Compensation. We recognized the following compensation costs (credits) related to PSUs for the Current Quarter, the Prior Quarter, the Current Period and the Prior Period:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
	($ in millions)			
General and administrative expenses	$(4)	$11	$(14)	$10
Restructuring and other termination costs	(5)	15	(15)	6
Marketing, gathering and compression	—	1	(1)	1
Oil and natural gas properties	—	2	(1)	3

Total	$(9)	$29	$(31)	$20

Effect of the Spin-off on Share-Based Compensation

The employee matters agreement entered into in connection with the spin-off of our oilfield services business (see Note 14) addresses the treatment of holders of Chesapeake stock options, restricted stock and PSUs. Unvested equity-based compensation awards held by COO employees were canceled and replaced with new awards of SSE, and unvested equity-based compensation awards held by Chesapeake employees were adjusted to account for the spin-off, each as of the spin-off date. The employee matters agreement provides that employees of SSE ceased to participate in benefit plans sponsored or maintained by Chesapeake as of the spin-off date. In addition, the employee matters agreement provides that as of the spin-off date, each party is responsible for the compensation of its current employees and for all liabilities relating to its former employees, as determined by their respective employer on the date of termination.

8. Derivative and Hedging Activities

Chesapeake uses commodity derivative instruments to secure attractive pricing and margins on its share of expected production, to reduce its exposure to fluctuations in future commodity prices and to protect its expected operating cash flow against significant market movements or volatility. Chesapeake also uses derivative instruments to mitigate a portion of its exposure to interest rate and foreign currency exchange rate fluctuations. All of our commodity 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.

Oil and Natural Gas Derivatives

As of June 30, 2015 and December 31, 2014, our oil and natural gas 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.
- 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 prices, 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 call option. This eliminates the counterparty's downside exposure below the second put option strike price.
- 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 the excess on sold call options, and Chesapeake receives the 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.
- Basis Protection Swaps: These instruments are arrangements that guarantee a fixed price differential to NYMEX from a specified delivery point. Chesapeake receives the fixed price differential and pays the floating market price differential to the counterparty for the hedged commodity.

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The estimated fair values of our oil and natural gas derivative instrument assets (liabilities) as of June 30, 2015 and December 31, 2014 are provided below.

	June 30, 2015		December 31, 2014	
	Volume	Fair Value ($ in millions)	Volume	Fair Value ($ in millions)
Oil (mmbbl):				
Fixed-price swaps	7.4	$196	12.5	$471
Three-way collars	2.2	21	4.4	40
Call options	27.9	(26)	35.8	(89)
Basis protection swaps	4.5	4	—	—
Total oil	42.0	$195	52.7	$422
Natural gas (tbtu):				
Fixed-price swaps	260	$135	275	$281
Three-way collars	71	51	207	165
Call options	193	(128)	193	(170)
Basis protection swaps	80	5	60	23
Total natural gas	604	$63	735	$299
Total estimated fair value		$258		$721

We have terminated certain commodity derivative contracts that were previously designated as cash flow hedges for which the hedged production is still expected to occur. See further discussion below under Effect of Derivative Instruments – Accumulated Other Comprehensive Income (Loss).

Interest Rate Derivatives

As of June 30, 2015 and December 31, 2014, our interest rate derivative instruments consisted of swaps. We enter 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 facility borrowings.

The notional amount of our interest rate derivatives associated with our long-term debt as of June 30, 2015 and December 31, 2014 was $400 million and $850 million, respectively. The estimated fair value of our interest rate derivative liabilities as of June 30, 2015 and December 31, 2014 was a nominal amount and $17 million, respectively.

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 six years, we will recognize $8 million in net gains related to these transactions.

Foreign Currency Derivatives

We are party to cross currency swaps to mitigate our exposure to foreign currency exchange rate fluctuations that may result from the €344 million principal amount of our euro-denominated senior notes. 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. Under the terms of the cross currency swaps we currently hold, 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 swaps are designated as cash flow hedges and, because they are entirely effective in having eliminated any potential variability in our expected cash flows related to changes in foreign exchange rates, changes in their fair

value do not impact earnings. The fair values of the cross currency swaps are recorded on the condensed consolidated balance sheets as liabilities of $88 million and $53 million as of June 30, 2015 and December 31, 2014, respectively. The euro-denominated debt in long-term debt has been adjusted to $384 million as of June 30, 2015, using an exchange rate of $1.1147 to €1.00.

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Supply Contract Derivatives

From time to time and in the normal course of business, our marketing subsidiary enters into supply contracts under which we commit to deliver a predetermined quantity of natural gas to certain counterparties in an attempt to earn attractive margins. Under certain contracts, we receive a sales price that is based on the price of a product other than natural gas thereby creating an embedded derivative requiring bifurcation. As of June 30, 2015, two supply contracts comprise our supply contract derivatives.

In the Current Quarter, we were required to bifurcate a derivative embedded within one of our supply contracts. Under this contract, we are committed to supply approximately 90,000 mmbtu per day of natural gas through March 2025. In the Current Quarter and the Current Period, we recorded revenues of approximately $27 million for settlements of this embedded derivative. As of June 30, 2015, the bifurcated derivative was measured to fair value, which resulted in a $221 million unrealized gain. Both settlements and mark-to market gains (losses) are included in marketing, gathering and compression revenues in our condensed consolidated statements of operations.

Effect of Derivative Instruments – Condensed Consolidated Balance Sheets

The following table presents the fair value and location of each classification of derivative instrument included in the condensed consolidated balance sheets as of June 30, 2015 and December 31, 2014 on a gross basis and after same-counterparty netting:

Balance Sheet Classification	Gross Fair Value	Amounts Netted in Condensed Consolidated Balance Sheet	Net Fair Value Presented in Condensed Consolidated Balance Sheet
	($ in millions)		
As of June 30, 2015			
Commodity Contracts:			
Short-term derivative asset	$426	$(74)	$352
Short-term derivative liability	(101)	74	(27)
Long-term derivative liability	(67)	—	(67)
Total commodity contracts	258	—	258
Interest Rate Contracts:			
Short-term derivative liability	—	—	—
Total interest rate contracts	—	—	—
Foreign Currency Contracts:[a]			
Long-term derivative liability	(88)	—	(88)
Total foreign currency contracts	(88)	—	(88)
Supply Contracts:			
Short-term derivative asset	35	—	35
Long-term derivative asset	186	—	186
Total supply contracts	221	—	221

Total derivatives	$391	$—	$391

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Balance Sheet Classification	Gross Fair Value	Amounts Netted in Condensed Consolidated Balance Sheet	Net Fair Value Presented in Condensed Consolidated Balance Sheet
As of December 31, 2014			
Commodity Contracts:			
Short-term derivative asset	$974	$(95)	$879
Long-term derivative asset	16	(10)	6
Short-term derivative liability	(105)	95	(10)
Long-term derivative liability	(163)	10	(153)
Total commodity contracts	722	—	722
Interest Rate Contracts:			
Short-term derivative liability	(5)	—	(5)
Long-term derivative liability	(12)	—	(12)
Total interest rate contracts	(17)	—	(17)
Foreign Currency Contracts:[a]			
Long-term derivative liability	(53)	—	(53)
Total foreign currency contracts	(53)	—	(53)
Total derivatives	$652	$—	$652

(a) Designated as cash flow hedging instruments.

As of June 30, 2015 and December 31, 2014, we did not have any cash collateral balances for these derivatives.

Effect of Derivative Instruments – Condensed Consolidated Statements of Operations

The components of oil, natural gas and NGL sales for the Current Quart