

CHESAPEAKE ENERGY CORP

Form 10-Q

May 02, 2018

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended March 31, 2018

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  NO

]

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

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

company" and  
"emerging growth  
company" in Rule  
12b-2 of the  
Exchange Act.

Large  
Accelerated  
Filer   
Accelerated  
Filer   
Non-accelerated  
Filer   
Smaller  
Reporting  
Company   
Emerging  
Growth  
Company

If an emerging  
growth  
company,  
indicate by  
check mark if  
the registrant has  
elected not to  
use the extended  
transition period  
for complying  
with any new or  
revised financial  
accounting  
standards  
provided  
pursuant to  
Section 13(a) of  
the Exchange  
Act.

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

As of April 23, 2018, there were 911,815,100 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

## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2018	December 31, 2017
	(\$ in millions)	
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents (\$1 and \$2 attributable to our VIE)	\$4	\$5
Accounts receivable, net	1,082	1,322
Short-term derivative assets	3	27
Other current assets	135	171
Total Current Assets	1,224	1,525
<b>PROPERTY AND EQUIPMENT:</b>		
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)	69,284	68,858
Unproved properties	3,326	3,484
Other property and equipment	1,869	1,986
Total Property and Equipment, at Cost	74,479	74,328
Less: accumulated depreciation, depletion and amortization ((\$462) and (\$461) attributable to our VIE)	(63,903 )	(63,664 )
Property and equipment held for sale, net	16	16
Total Property and Equipment, Net	10,592	10,680
<b>LONG-TERM ASSETS:</b>		
Other long-term assets	270	220
<b>TOTAL ASSETS</b>	<b>\$12,086</b>	<b>\$12,425</b>

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)

	March 31, 2018	December 31, 2017
	(\$ in millions)	
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$657	\$ 654
Current maturities of long-term debt, net	52	52
Accrued interest	139	137
Short-term derivative liabilities	149	58
Other current liabilities (\$3 and \$3 attributable to our VIE)	1,357	1,455
Total Current Liabilities	2,354	2,356
<b>LONG-TERM LIABILITIES:</b>		
Long-term debt, net	9,325	9,921
Long-term derivative liabilities	6	4
Asset retirement obligations, net of current portion	153	162
Other long-term liabilities	345	354
Total Long-Term Liabilities	9,829	10,441
<b>CONTINGENCIES AND COMMITMENTS (Note 4)</b>		
<b>EQUITY:</b>		
Chesapeake Stockholders' Equity:		
Preferred stock, \$0.01 par value, 20,000,000 shares authorized: 5,603,458 shares outstanding	1,671	1,671
Common stock, \$0.01 par value, 2,000,000,000 shares authorized: 911,794,424 and 908,732,809 shares issued	9	9
Additional paid-in capital	14,419	14,437
Accumulated deficit	(16,240 )	(16,525 )
Accumulated other comprehensive loss	(47 )	(57 )
Less: treasury stock, at cost; 3,416,465 and 2,240,394 common shares	(32 )	(31 )
Total Chesapeake Stockholders' Equity (Deficit)	(220 )	(496 )
Noncontrolling interests	123	124
Total Equity (Deficit)	(97 )	(372 )
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$12,086</b>	<b>\$12,425</b>

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

TABLE OF CONTENTSCHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended March 31, 2018 2017 (\$ in millions except per share data)	
REVENUES:		
Oil, natural gas and NGL	\$1,243	\$1,469
Marketing	1,246	1,284
Total Revenues	2,489	2,753
OPERATING EXPENSES:		
Oil, natural gas and NGL production	147	135
Oil, natural gas and NGL gathering, processing and transportation	356	355
Production taxes	31	22
Marketing	1,268	1,328
General and administrative	72	65
Restructuring and other termination costs	38	—
Provision for legal contingencies, net	5	(2 )
Oil, natural gas and NGL depreciation, depletion and amortization	268	197
Depreciation and amortization of other assets	18	21
Other operating expense	—	391
Net losses on sales of fixed assets	8	—
Total Operating Expenses	2,211	2,512
INCOME FROM OPERATIONS	278	241
OTHER INCOME (EXPENSE):		
Interest expense	(123 )	(95 )
Gains on investments	139	—
Losses on purchases or exchanges of debt	—	(7 )
Other income	—	3
Total Other Income (Expense)	16	(99 )
INCOME BEFORE INCOME TAXES	294	142
Income tax expense	—	1
NET INCOME	294	141
Net income attributable to noncontrolling interests	(1 )	(1 )
NET INCOME ATTRIBUTABLE TO CHESAPEAKE	293	140
Preferred stock dividends	(23 )	(23 )
Loss on exchange of preferred stock	—	(41 )
Earnings allocated to participating securities	(2 )	(1 )
NET INCOME AVAILABLE TO COMMON STOCKHOLDERS	\$268	\$75
EARNINGS PER COMMON SHARE:		
Basic	\$0.30	\$0.08
Diluted	\$0.29	\$0.08
WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING (in millions):		
Basic	907	906

Diluted

1,053 907

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

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

	Three Months Ended March 31, 2018 2017 (\$ in millions)	
NET INCOME	\$294	\$141
OTHER COMPREHENSIVE INCOME, NET OF INCOME TAX:		
Unrealized gains on derivative instruments, net of income tax expense of \$0 and \$0	—	4
Reclassification of losses on settled derivative instruments, net of income tax expense of \$0 and \$0	10	10
Other Comprehensive Income	10	14
COMPREHENSIVE INCOME	304	155
COMPREHENSIVE INCOME ATTRIBUTABLE TO NONCONTROLLING INTERESTS	(1 )	(1 )
COMPREHENSIVE INCOME ATTRIBUTABLE TO CHESAPEAKE	\$303	\$154

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

	Three Months Ended March 31, 2018 2017 (\$ in millions)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
NET INCOME	\$294	\$141
<b>ADJUSTMENTS TO RECONCILE NET INCOME (LOSS) TO CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES:</b>		
Depreciation, depletion and amortization	286	218
Derivative (gains) losses, net	117	(322 )
Cash receipts (payments) on derivative settlements, net	13	(34 )
Stock-based compensation	9	11
Net losses on sales of fixed assets	8	—
Gains on investments	(139 )	—
Losses on purchases or exchanges of debt	—	6
Other	(36 )	(34 )
Changes in assets and liabilities	104	113
Net Cash Provided By Operating Activities	656	99
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Drilling and completion costs	(442 )	(433 )
Acquisitions of proved and unproved properties	(63 )	(95 )
Proceeds from divestitures of proved and unproved properties	319	892
Additions to other property and equipment	(3 )	(3 )
Proceeds from sales of other property and equipment	68	19
Proceeds from sales of investments	74	—
Net Cash Provided By (Used In) Investing Activities	(47 )	380
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from revolving credit facility borrowings	2,904	50
Payments on revolving credit facility borrowings	(3,485)	(50 )
Cash paid to purchase debt	—	(982 )
Cash paid for preferred stock dividends	(23 )	(114 )
Distributions to noncontrolling interest owners	(2 )	(2 )
Other	(4 )	(14 )
Net Cash Used In Financing Activities	(610 )	(1,112)
Net decrease in cash and cash equivalents	(1 )	(633 )
Cash and cash equivalents, beginning of period	5	882
Cash and cash equivalents, end of period	\$4	\$249

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)

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

	Three Months Ended March 31, 2018 2017 (\$ in millions)	
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Interest paid, net of capitalized interest	\$ 131	\$ 92
Income taxes paid, net of refunds received	\$—	\$ 1
<b>SUPPLEMENTAL DISCLOSURE OF SIGNIFICANT NON-CASH INVESTING AND FINANCING ACTIVITIES:</b>		
Change in accrued drilling and completion costs	\$ 103	\$ 68
Change in accrued acquisitions of proved and unproved properties	\$—	\$ 8
Change in divested proved and unproved properties	\$(12 )	\$(8 )

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

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CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
(Unaudited)

	Three Months Ended March 31, 2018    2017 (\$ in millions)	
<b>PREFERRED STOCK:</b>		
Balance, beginning of period	\$1,671	\$1,771
Exchange/conversions of 0 and 236,048 shares of preferred stock for common stock	—	(100 )
Balance, end of period	1,671	1,671
<b>COMMON STOCK:</b>		
Balance, beginning and end of period	9	9
<b>ADDITIONAL PAID-IN CAPITAL:</b>		
Balance, beginning of period	14,437	14,486
Stock-based compensation	5	10
Exchange of preferred stock for 0 and 9,965,835 shares of common stock	—	100
Equity component of contingent convertible notes repurchased, net of tax	—	(20 )
Dividends on preferred stock	(23 )	(137 )
Balance, end of period	14,419	14,439
<b>RETAINED EARNINGS (ACCUMULATED DEFICIT):</b>		
Balance, beginning of period	(16,525)	(17,603 )
Net income attributable to Chesapeake	293	140
Cumulative effect of accounting change	(8 )	—
Balance, end of period	(16,240)	(17,463 )
<b>ACCUMULATED OTHER COMPREHENSIVE LOSS:</b>		
Balance, beginning of period	(57 )	(96 )
Hedging activity	10	14
Balance, end of period	(47 )	(82 )
<b>TREASURY STOCK – COMMON:</b>		
Balance, beginning of period	(31 )	(27 )
Purchase of 1,451,478 and 1,185,517 shares for company benefit plans	(4 )	(7 )
Release of 275,407 and 38,013 shares from company benefit plans	3	1
Balance, end of period	(32 )	(33 )
<b>TOTAL CHESAPEAKE STOCKHOLDERS' EQUITY (DEFICIT)</b>	<b>(220 )</b>	<b>(1,459 )</b>
<b>NONCONTROLLING INTERESTS:</b>		
Balance, beginning of period	124	257
Net income attributable to noncontrolling interests	1	1
Distributions to noncontrolling interest owners	(2 )	(2 )
Balance, end of period	123	256
<b>TOTAL EQUITY (DEFICIT)</b>	<b>\$(97 )</b>	<b>\$(1,203 )</b>

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

Basis of Presentation

The accompanying condensed consolidated financial statements of Chesapeake were prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and the rules and regulations of the SEC. Pursuant to such rules and regulations, certain disclosures have been condensed or omitted.

This Form 10-Q relates to the three months ended March 31, 2018 (the “Current Quarter”) and the three months ended March 31, 2017 (the “Prior Quarter”). Our annual report on Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”) should be read in conjunction with this Form 10-Q. The accompanying condensed consolidated financial statements reflect all normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of our condensed consolidated financial statements and accompanying notes and include the accounts of our direct and indirect wholly owned subsidiaries and entities in which we have a controlling financial interest.

Intercompany accounts and balances have been eliminated.

Recently Issued Accounting Standards

The Financial Accounting Standards Board (FASB) issued Revenue from Contracts with Customers (Topic 606) superseding virtually all existing revenue recognition guidance. We adopted this new standard in the first quarter of 2018 using the modified retrospective approach. We applied the new standard to all contracts that were not completed as of January 1, 2018 and reflected the aggregate effect of all modifications in determining and allocating the transaction price. See Note 10 for further details regarding our adoption of Topic 606.

In February 2018, the FASB issued Accounting Standards Update (ASU) 2018-02, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The new standard allows for stranded tax effects resulting from the Tax Cuts and Jobs Act (the “Tax Act”) previously recognized in accumulated other comprehensive income to be reclassified to retained earnings. For public business entities, the amendments are effective for annual periods, including interim periods within the annual periods, beginning after December 15, 2018. Early adoption is permitted in any interim or annual period, but we do not plan to early adopt. We are currently evaluating the impact of this standard on our consolidated financial statements and related disclosures.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815), which makes significant changes to the current hedge accounting guidance. The new standard eliminates the requirement to separately measure and report hedge ineffectiveness and generally requires the entire change in the fair value of a hedging instrument to be presented in the same income statement line as the hedged item. The new standard also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. The new standard update is effective for annual and interim periods beginning after December 15, 2018, including interim periods within those annual periods. Early adoption is permitted, but we do not plan to early adopt. We are currently evaluating the impact of this standard on our consolidated financial statements and related disclosures.



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CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842), which updated lease accounting guidance requiring lessees to recognize most leases, including operating leases, on the balance sheet as a right-of-use asset and lease liability for leases with terms in excess of 12 months. In January 2018, the FASB issued an update permitting an entity to elect an optional transition practical expedient to not evaluate land easements that existed or expired before the adoption of Topic 842 and were not previously accounted for as leases. Currently the guidance would be applied using a modified retrospective transition method, which requires applying the new guidance to leases that exist or are entered into after the beginning of the earliest period in the financial statements. However, the FASB recently issued Proposed ASU No. 2018-200, Leases (Topic 842), Targeted Improvements which would allow entities to apply the transition provisions of the new standard at its adoption date instead of at the earliest comparative period presented in the consolidated financial statements. The proposed ASU will allow entities to continue to apply the legacy guidance in Topic 840, including its disclosure requirements, in the comparative periods presented in the year the new leases standard is adopted. Entities that elect this option would still adopt the new leases standard using a modified retrospective transition method, but would recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption rather than in the earliest period presented. Early adoption is permitted, but we do not plan to early adopt. The standard will not apply to our leases of mineral rights. We are continuing to evaluate the impact of this standard on our consolidated financial statements and related disclosures.

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## 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 all periods presented, 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 convertible senior notes and contingent convertible senior notes.

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

	Three Months Ended March 31, 2018 2017 (in millions, except per share data)	
Net income available to common stockholders	\$268	\$75
Effect of dilutive securities	36	—
Diluted income per share	\$304	\$75
Weighted average common and common equivalent shares outstanding - basic	907	906
Effect of dilutive securities	146	1
Weighted average common and common equivalent shares outstanding - diluted	1,053	907
Net income per share attributable to Chesapeake:		
Basic	\$0.30	\$0.08
Diluted	\$0.29	\$0.08

Shares of common stock for the following dilutive securities were excluded from the calculation of diluted EPS as the effect was antidilutive:

Common stock equivalent of our preferred stock outstanding	60	60
Common stock equivalent of our convertible senior notes outstanding	—	146
Common stock equivalent of our preferred stock outstanding prior to exchange	—	1
Participating securities	—	1

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## 3. Debt

Our long-term debt consisted of the following as of March 31, 2018 and December 31, 2017:

	March 31, 2018		December 31, 2017	
	Principal Amount	Carrying Amount	Principal Amount	Carrying Amount
	(\$ in millions)			
7.25% senior notes due 2018	\$44	\$44	\$44	\$44
Floating rate senior notes due 2019	380	380	380	380
6.625% senior notes due 2020	437	437	437	437
6.875% senior notes due 2020	227	227	227	227
6.125% senior notes due 2021	548	548	548	548
5.375% senior notes due 2021	267	267	267	267
4.875% senior notes due 2022	451	451	451	451
8.00% senior secured second lien notes due 2022	1,416	1,870	1,416	1,895
5.75% senior notes due 2023	338	338	338	338
8.00% senior notes due 2025	1,300	1,290	1,300	1,290
5.5% convertible senior notes due 2026 <sup>(a)(b)</sup>	1,250	844	1,250	837
8.00% senior notes due 2027	1,300	1,298	1,300	1,298
2.25% contingent convertible senior notes due 2038 <sup>(a)</sup>	9	8	9	8
Term loan due 2021	1,233	1,233	1,233	1,233
Revolving credit facility	200	200	781	781
Debt issuance costs	—	(60)	—	(63)
Interest rate derivatives	—	2	—	2
Total debt, net	9,400	9,377	9,981	9,973
Less current maturities of long-term debt, net <sup>(c)</sup>	(53)	(52)	(53)	(52)
Total long-term debt, net	\$9,347	\$9,325	\$9,928	\$9,921

We are required to account for the liability and equity components of our convertible debt instruments separately and to reflect interest expense through the first demand repurchase date, as applicable, at the interest rate of similar nonconvertible debt at the time of issuance. The applicable rates for our 2.25% Contingent Convertible Senior Notes due 2038 and our 5.5% Convertible Senior Notes due 2026 are 8.0% and 11.5%, respectively.

Prior to maturity under certain circumstances and at the holder's option, the notes are convertible. During the first quarter of 2018, the price of our common stock was below the threshold level for conversion and, as a result, the holders do not have the option to convert their notes in the second quarter of 2018.

As of March 31, 2018, current maturities of long-term debt, net includes our 7.25% Senior Notes due December 2018 and our 2.25% Contingent Convertible Notes due December 2038.

## Debt Retirements

In the Prior Quarter, we retired \$908 million principal amount of our outstanding senior notes and contingent convertible notes through purchases in the open market, tender offers or repayment upon maturity for \$982 million. For the open market repurchases and tender offers, we recorded an aggregate net loss of approximately \$7 million.

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## Revolving Credit Facility

We have a senior secured revolving credit facility currently subject to a \$3.8 billion borrowing base that matures in December 2019. As of March 31, 2018, we had outstanding borrowings of \$200 million under the revolving credit facility and had used \$157 million of the revolving credit facility for various letters of credit. Borrowings under the revolving credit facility bear interest at a variable rate. The terms of the revolving credit facility include covenants limiting, among other things, our ability 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. Our next borrowing base redetermination is scheduled for the second quarter of 2018.

Our revolving credit facility is subject to various financial and other covenants. As of March 31, 2018, we were in compliance with all applicable financial covenants under the credit agreement and we were able to borrow up to the full availability under the revolving credit facility.

## Fair Value of Debt

We estimate the fair value of our senior notes based on the market value of our publicly traded debt as determined based on the yield of our senior notes (Level 1). The fair value of all other debt is based on a market approach using estimates provided by an independent investment financial data services firm (Level 2). Fair value is compared to the carrying value, excluding the impact of interest rate derivatives, in the table below:

	March 31, 2018		December 31, 2017	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(\$ in millions)			
Short-term debt (Level 1)	\$52	\$53	\$52	\$ 53
Long-term debt (Level 1)	\$2,635	\$2,603	\$2,633	\$ 2,629
Long-term debt (Level 2)	\$6,690	\$6,582	\$7,286	\$ 7,301

## 4. Contingencies and Commitments

There have been no material developments in previously reported legal or environmental contingencies or commitments other than the items discussed below. For a discussion of commitments and contingencies, see “Contingencies and Commitments,” Note 4 to the Consolidated Financial Statements in our 2017 Form 10-K.

## Contingencies

**Regulatory and Related Proceedings.** We have previously disclosed receiving U.S. Postal Service and state subpoenas seeking information on our royalty payment practices. The U.S. Postal Service inquiry and all outstanding state subpoenas have been resolved.

We have also previously disclosed defending lawsuits alleging various violations of the Sherman Antitrust Act and state antitrust laws. In 2016, putative class action lawsuits were filed in the U.S. District Court for the Western District of Oklahoma and in Oklahoma state courts, and an individual lawsuit was filed in the U.S. District Court of Kansas, in each case against us and other defendants. The lawsuits generally allege that, since 2007 and continuing through April 2013, the defendants conspired to rig bids and depress the market for the purchases of oil and natural gas leasehold interests and properties in the Anadarko Basin containing producing oil and natural gas wells. The lawsuits seek damages, attorney’s fees, costs and interest, as well as enjoinder from adopting practices or plans that would restrain competition in a similar manner as alleged in the lawsuits. On April 12, 2018, we reached a tentative settlement to resolve substantially all Oklahoma civil class action antitrust cases for an immaterial amount.

We recently received a demand letter from the Healthcare of Ontario Pension Plan (HOOPP) regarding HOOPP’s purchase of our interest in Chaparral Energy, Inc. stock for \$215 million on January 5, 2014. HOOPP claims that the Company engaged in material misrepresentations and fraud, and that we violated the Exchange Act and Oklahoma

Uniform Securities Act. HOOPP seeks \$215 million in monetary damages, plus interest, attorney's fees, disgorgement and punitive damages. We expect a lawsuit will be filed, and we intend to vigorously defend it.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## Commitments

## Gathering, Processing and Transportation Agreements

We have contractual commitments with midstream service companies and pipeline carriers for future gathering, processing and transportation of oil, natural gas and NGL 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 as obligations in the accompanying consolidated balance sheets; however, they are reflected in our estimates of proved reserves.

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, are presented below:

	March 31, 2018 (\$ in millions)
2018	\$ 815
2019	1,052
2020	980
2021	884
2022	772
2023 – 2035	4,406
Total	\$ 8,909

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 may vary with the applicable agreement.

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## 5. Other Liabilities

Other current liabilities as of March 31, 2018 and December 31, 2017 are detailed below:

	March	December
	31,	31,
	2018	2017
	(\$ in millions)	
Revenues and royalties due others	\$584	\$ 612
Accrued drilling and production costs	297	216
Joint interest prepayments received	76	74
Accrued compensation and benefits	125	214
Accrued restructuring and other termination costs	27	—
Other accrued taxes	41	43
Other	207	296
Total other current liabilities	\$1,357	\$ 1,455

Other long-term liabilities as of March 31, 2018 and December 31, 2017 are detailed below:

	March	December
	31,	31,
	2018	2017
	(\$ in millions)	
CHK Utica ORRI conveyance obligation <sup>(a)</sup>	\$153	\$ 156
Unrecognized tax benefits	98	101
Other	94	97
Total other long-term liabilities	\$345	\$ 354

The CHK Utica, L.L.C. investors' right to receive proportionately an overriding royalty interest (ORRI) in the first 1,500 net wells drilled on certain of our Utica Shale leasehold runs through 2023. We have the right to repurchase the ORRIs in the remaining net wells once we have drilled a minimum of 1,300 net wells. As of March 31, 2018, (a) we had drilled 584 net wells. The obligation to deliver future ORRIs, which has been recorded as a liability, will be settled through the future conveyance of the underlying ORRIs to the investors on a net-well basis. As of March 31, 2018 and December 31, 2017, approximately \$30 million of the total ORRI obligations are recorded in other current liabilities.

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## 6. Income Taxes

We estimate our annual effective tax rate for continuing operations in recording our quarterly income tax provision (or benefit) for the various jurisdictions in which we operate. The tax effects of statutory rate changes, significant unusual or infrequent items, and certain changes in the assessment of the realizability of deferred tax assets are excluded from the determination of our annual effective tax rate as such items are recognized as discrete items in the quarter in which they occur.

For the Current Quarter, our effective tax rate remains nominal as a result of maintaining a valuation allowance against substantially all of our net deferred tax asset. Based on our projected operating results for the subsequent 2018 quarters, we project remaining in a net deferred tax asset position as of December 31, 2018. Based on all available positive and negative evidence, including estimates of future taxable income, we believe it is more-likely-than-not that these deferred tax assets will not be realized. A significant piece of objective negative evidence evaluated is the projected cumulative loss incurred over the rolling three-year period ending March 31, 2018, which limits our ability to consider other subjective positive evidence, such as our projections for future growth and earnings. A valuation allowance was recorded against substantially all of our net deferred tax asset as of both December 31, 2017 and March 31, 2018.

We are subject to U.S. federal income tax as well as income and capital taxes in various state jurisdictions. During the Current Quarter, the federal tax examination by the Internal Revenue Service (IRS) of taxable years 2010 through 2013 was settled. Based on new information available in the Current Quarter and the expectation that certain statute of limitations should expire during 2018, we anticipate a \$14 million estimated reduction to the liability for state unrecognized tax benefits resulting in an \$11 million estimated income tax benefit being recorded as early as the next quarter.

On December 22, 2017, the President of the United States signed into law the Tax Act, which substantially revised numerous areas of U.S. federal income tax law, including reducing the tax rate for corporations from a maximum rate of 35% to a flat rate of 21% and eliminating the corporate alternative minimum tax (AMT). The various estimates included in determining our tax provision as of December 31, 2017 remain provisional through the three months ended March 31, 2018 and may be adjusted through subsequent events such as the filing of the 2017 consolidated federal income tax return and the issuance of additional guidance such as new Treasury Regulations. Moreover, we are still in the process of evaluating the full impact of the Tax Act both at the federal and state level.

## 7. Share-Based Compensation

Our share-based compensation program consists of restricted stock, stock options, performance share units (PSUs) and cash restricted stock units (CRSUs) granted to employees 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 and CRSUs are liability-classified awards.

## Equity-Classified Awards

Restricted Stock. We grant restricted stock units to employees and non-employee directors. A summary of the changes in unvested restricted stock during the Current Quarter is presented below:

	Shares of Unvested Restricted Stock (in thousands)	Weighted Average Grant Date Fair Value
Unvested restricted stock as of January 1, 2018	13,178	\$ 6.37
Granted	2,805	\$ 3.02
Vested	(4,651 )	\$ 7.64
Forfeited	(465 )	\$ 6.24



Unvested restricted stock as of March 31, 2018 10,867 \$ 4.97

The aggregate intrinsic value of restricted stock that vested during the Current Quarter was approximately \$15 million based on the stock price at the time of vesting.

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

As of March 31, 2018, there was approximately \$40 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 2.02 years.

**Stock Options.** In the Current Quarter and the Prior Quarter, we granted members of management stock options that vest ratably over a three-year period. Each stock option award has an exercise price equal to the closing price of our common stock on the grant date. Outstanding options expire seven years to 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. 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 our dividend policy, over the expected life of the option. We used the following weighted average assumptions to estimate the grant date fair value of the stock options granted in the Current Quarter:

Expected option life – years	6.0
Volatility	63.55 %
Risk-free interest rate	2.72 %
Dividend yield	— %

The following table provides information related to stock option activity in the Current Quarter:

	Number of Shares Underlying Options  (in thousands)	Weighted Average Exercise Price Per Share	Weighted Average Contract Life in Years	Aggregate Intrinsic Value <sup>(a)</sup>  (\$ in millions)
Outstanding as of January 1, 2018	16,285	\$ 8.25	7.73	\$ 1
Granted	3,611	\$ 3.01		
Exercised	—	\$ —		\$ —
Expired	(64 )	\$ 20.77		
Forfeited	(267 )	\$ 5.45		
Outstanding as of March 31, 2018	19,565	\$ 7.28	7.93	\$ —
Exercisable as of March 31, 2018	8,776	\$ 10.88	6.52	\$ —

<sup>(a)</sup> 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 March 31, 2018, there was \$23 million of total unrecognized compensation expense related to stock options. The expense is expected to be recognized over a weighted average period of approximately 2.14 years.

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

Three  
Months  
Ended  
March 31,  
2018 2017  
(\$ in  
millions)

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General and administrative expenses	\$7	\$8
Oil and natural gas properties	2	4
Oil, natural gas and NGL production expenses	2	3
Total restricted stock and stock option compensation	\$11	\$15

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## Liability-Classified Awards

Performance Share Units. We granted PSUs to senior management that vest ratably over a three-year performance period and are settled in cash. The ultimate amount earned is based on achievement of performance metrics established by the Compensation Committee of the Board of Directors. Compensation expense associated with PSU awards is recognized over the service period based on the graded-vesting method. The value of the PSU awards at the end of each reporting period is dependent upon our estimates of the underlying performance measures.

For PSUs granted in 2017 and 2016, performance metrics include a total shareholder return (TSR) component, which can range from 0% to 100% and an operational performance component based on finding and development costs, which can range from 0% to 100%, resulting in a maximum payout of 200%. The payout percentage for the 2016 and 2017 PSU awards is capped at 100% if our absolute TSR is less than zero. The PSUs are settled in cash on the third anniversary of the awards. We utilized a Monte Carlo simulation for the TSR performance measure and the following assumptions to determine the grant date fair value of the PSUs.

## Grant Date Assumptions

Assumption	2017	2016
	Awards	Awards
Volatility	80.65 %	49.74 %
Risk-free interest rate	1.54 %	1.13 %
Dividend yield for value of awards	— %	— %

## Reporting Period Assumptions

Assumption	2017	2016
	Awards	Awards
Volatility	55.89 %	53.77 %
Risk-free interest rate	2.23 %	2.01 %
Dividend yield for value of awards	— %	— %

The PSUs are subsequently adjusted, based on adjustments to the above assumptions through the end of each subsequent reporting period, through the end of the performance period.

For PSUs granted in 2018, performance metrics include an operational performance component based on a ratio of cumulative earnings before interest expense, income taxes, and depreciation, depletion and amortization expense (EBITDA) to capital expenditures, for which payout can range from 0% to 200%. The vested PSUs are settled in cash on each of the three annual vesting dates. We used the closing price of our common stock on the grant date to determine the grant date fair value of the PSUs. The PSUs are subsequently adjusted, based on changes in our stock price through the end of each subsequent reporting period, through the end of the performance period.

Cash Restricted Stock Units. We granted CRSUs to employees that vest straight-line over a three-year period and are settled in cash on each of the three annual vesting dates. The ultimate amount earned is based on the closing price of our common stock on each of the vesting dates. We used the closing price of our common stock on the grant date to determine the grant date fair value of the CRSUs. The CRSUs are subsequently adjusted, based on changes in our stock price through the end of each subsequent reporting period, through the end of each vesting period.

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The following table presents a summary of our liability-classified awards:

	Units	Grant Date Fair Value (\$ in millions)	March 31, 2018 Fair Vested Value Liability (\$ in millions)	
2018 PSU Awards:				
Payable 2019, 2020 and 2021	4,031,011	\$ 12	\$ 12	\$ —
2017 PSU Awards:				
Payable 2020	1,217,774	\$ 8	\$ 4	\$ 2
2016 PSU Awards:				
Payable 2019	2,348,893	\$ 10	\$ 8	\$ 7
2018 CRSU Awards:				
Payable 2019, 2020 and 2021	16,976,014	\$ 52	\$ 52	\$ —

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(Unaudited)

**8. Derivative and Hedging Activities**

We use derivative instruments to reduce our exposure to fluctuations in future commodity prices and to protect our expected operating cash flow against significant market movements or volatility. All of our oil, natural gas and NGL 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. None of our oil, natural gas and NGL derivative instruments were designated for hedge accounting as of March 31, 2018 or December 31, 2017.

**Oil, Natural Gas and NGL Derivatives**

As of March 31, 2018 and December 31, 2017, our oil, natural gas and NGL derivative instruments consisted of the following types of instruments:

**Swaps:** We receive a fixed price and pay a floating market price to the counterparty for the hedged commodity. In exchange for higher fixed prices on certain of our swap trades, we may sell call options and call swaptions.

**Options:** We sell, and occasionally buy, call options in exchange for a premium. At the time of settlement, if the market price exceeds the fixed price of the call option, we pay the counterparty the excess on sold call options and we receive 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.

**Call Swaptions:** We sell call swaptions to counterparties that allow the counterparty, on a specific date, to extend an existing fixed-price swap for a certain period of time.

**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, we receive the fixed price and pay 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 the sale by us of 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.

**Basis Protection Swaps:** These instruments are arrangements that guarantee a fixed price differential to NYMEX from a specified delivery point. We receive the fixed price differential and pay the floating market price differential to the counterparty for the hedged commodity.

The estimated fair values of our oil, natural gas and NGL derivative instrument assets (liabilities) as of March 31, 2018 and December 31, 2017 are provided below:

	March 31, 2018		December 31, 2017	
	Notional	Fair Value	Notional	Fair Value
	Volume		Volume	
		(\$ in millions)		(\$ in millions)
<b>Oil (mmbbl):</b>				
Fixed-price swaps	24	\$ (180 )	21	\$ (151 )
Three-way collars	1	(12 )	2	(10 )
Call swaptions	2	(19 )	2	(13 )
Basis protection swaps	7	5	11	(9 )
Total oil	34	(206 )	36	(183 )
<b>Natural gas (bcf):</b>				
Fixed-price swaps	358	44	532	149
Three-way collars	88	—	—	—
Collars	36	8	47	11
Call options	93	(1 )	110	(3 )
Basis protection swaps	41	3	65	(7 )
Total natural gas	616	54	754	150
<b>NGL (mmgal):</b>				
Fixed-price swaps	47	—	33	(2 )

Total estimated fair value      \$ (152     )      \$ (35     )

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

We have terminated certain commodity derivative contracts that were previously designated as cash flow hedges for which the original contract months are yet to occur. See further discussion below under Effect of Derivative Instruments – Accumulated Other Comprehensive Income (Loss).

## 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 March 31, 2018 and December 31, 2017 on a gross basis and after same-counterparty netting:

Balance Sheet Classification	Gross Fair Value	Amounts Netted in the Consolidated Balance Sheets	Net Fair
			Value Presented in the Consolidated Balance Sheet

(\$ in millions)

As of March 31, 2018

Commodity Contracts:

Short-term derivative asset	\$60	\$ (57 )	\$ 3
Long-term derivative asset	5	(5 )	—
Short-term derivative liability	(206 )	57	(149 )
Long-term derivative liability	(11 )	5	(6 )
Total derivatives	\$(152)	\$ —	\$ (152 )

As of December 31, 2017

Commodity Contracts:

Short-term derivative asset	\$157	\$ (130 )	\$ 27
Short-term derivative liability	(188 )	130	(58 )
Long-term derivative liability	(4 )	—	(4 )
Total derivatives	\$(35 )	\$ —	\$ (35 )

As of March 31, 2018 and December 31, 2017, we did not have any cash collateral balances for our derivatives.



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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## Effect of Derivative Instruments – Condensed Consolidated Statements of Operations

The components of oil, natural gas and NGL revenues for the Current Quarter and the Prior Quarter are presented below:

	Three Months Ended March 31,	
	2018	2017
	(\$ in millions)	
Oil, natural gas and NGL revenues	\$1,360	\$1,147
Gains (losses) on undesignated oil, natural gas and NGL derivatives	(107 )	332
Losses on terminated cash flow hedges	(10 )	(10 )
Total oil, natural gas and NGL revenues	\$1,243	\$1,469

## Effect of Derivative Instruments – Accumulated Other Comprehensive Income (Loss)

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

	Three Months Ended March 31,			
	2018		2017	
	Before Tax	After Tax	Before Tax	After Tax
	(\$ in millions)			
Balance, beginning of period	\$(114)	\$(57)	\$(153)	\$(96)
Net change in fair value	—	—	4	4
Losses reclassified to income	10	10	10	10
Balance, end of period	\$(104)	\$(47)	\$(139)	\$(82)

The accumulated other comprehensive loss as of March 31, 2018 represents the net deferred loss associated with commodity derivative contracts that were previously designated as cash flow hedges for which the original contract months are yet to occur. Remaining deferred gain or loss amounts will be recognized in earnings in the month for which the original contract months are to occur. As of March 31, 2018, we expect to transfer approximately \$33 million of net loss included in accumulated other comprehensive income to net income (loss) during the next 12 months. The remaining amounts will be transferred by December 31, 2022.

## Credit Risk Considerations

Our derivative instruments expose us to our counterparties' credit risk. To mitigate this risk, we enter into derivative contracts only with counterparties that are highly rated or deemed by us to have acceptable credit strength and deemed by management to be competent and competitive market-makers, and we attempt to limit our exposure to non-performance by any single counterparty. As of March 31, 2018, our oil, natural gas and NGL derivative instruments were spread among 11 counterparties.

## Hedging Arrangements

Certain of our hedging arrangements are with counterparties that are also lenders (or affiliates of lenders) under our revolving credit facility. The contracts entered into with these counterparties are secured by the same collateral that secures our revolving credit facility, which allows us to reduce any letters of credit posted as security with those counterparties. In addition, we enter into bilateral hedging agreements with other counterparties. The counterparties' and our obligations under the bilateral hedging agreements must be secured by cash or letters of credit to the extent that any mark-to-market amounts owed to us or by us exceed defined thresholds.



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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## Fair Value

The fair value of our derivatives is based on third-party pricing models which utilize inputs that are either readily available in the public market, such as oil, natural gas and NGL forward curves and discount rates, or can be corroborated from active markets or broker quotes. These values are compared to the values given by our counterparties for reasonableness. Since oil, natural gas and NGL swaps do not include optionality and therefore generally have no unobservable inputs, they are classified as Level 2. All other derivatives have some level of unobservable input, such as volatility curves, and are therefore classified as Level 3. Derivatives are also subject to the risk that either party to a contract will be unable to meet its obligations. We factor non-performance risk into the valuation of our derivatives using current published credit default swap rates. To date, this has not had a material impact on the values of our derivatives.

The following table provides information for financial assets (liabilities) measured at fair value on a recurring basis as of March 31, 2018 and December 31, 2017:

Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
---	---	--	---------------------

(\$ in millions)

As of March 31, 2018

Derivative Assets (Liabilities):

Commodity assets	\$	—\$53	\$ 12	\$ 65
Commodity liabilities	—	(181 )	(36 )	(217 )
Total derivatives	\$	—\$(128)	\$ (24 )	\$ (152 )

As of December 31, 2017

Derivative Assets (Liabilities):

Commodity assets	\$	—\$—	\$ 8	\$ 8
Commodity liabilities	—	(20 )	(23 )	(43 )
Total derivatives	\$	—\$(20 )	\$ (15 )	\$ (35 )

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

A summary of the changes in the fair values of our financial assets (liabilities) classified as Level 3 during the Current Quarter and the Prior Quarter is presented below:

	Commodity Derivatives (\$ in millions)
Balance, as of January 1, 2018	\$ (15 )
Total gains (losses) (realized/unrealized):	
Included in earnings <sup>(a)</sup>	(8 )
Total purchases, issuances, sales and settlements:	
Settlements	(1 )
Balance, as of March 31, 2018	\$ (24 )
Balance, as of January 1, 2017	\$ (10 )
Total gains (losses) (realized/unrealized):	
Included in earnings <sup>(a)</sup>	12
Total purchases, issuances, sales and settlements:	
Settlements	1
Balance, as of March 31, 2017	\$ 3

(a)	Commodity Derivatives 2018 2017 (\$ in millions)
Total gains (losses) included in earnings for the period	\$ (8 ) \$ 12
Change in unrealized gains (losses) related to assets still held at reporting date	\$ (10 ) \$ 5

## Qualitative and Quantitative Disclosures about Unobservable Inputs for Level 3 Fair Value Measurements

The significant unobservable inputs for Level 3 derivative contracts include unpublished forward prices of natural gas, market volatility and credit risk of counterparties. Changes in these inputs impact the fair value measurement of our derivative contracts, which is based on an estimate derived from option models. For example, an increase or decrease in the forward prices and volatility of oil and natural gas prices decreases or increases the fair value of oil and natural gas derivatives, and adverse changes to our counterparties' creditworthiness decreases the fair value of our derivatives. The following table presents quantitative information about Level 3 inputs used in the fair value measurement of our commodity derivative contracts at fair value as of March 31, 2018:

Instrument Type	Unobservable Input	Range	Weighted Average	Fair Value March 31, 2018 (\$ in millions)
Oil trades	Oil price volatility curves	19.20% – 30.57%	27.29%	\$ (31 )
Natural gas trades	Natural gas price volatility curves	14.74% – 40.22%	20.73%	\$ 7

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## 9. Oil and Natural Gas Property Transactions

Under full cost accounting rules, we accounted for the sales of oil and natural gas properties discussed below as adjustments to capitalized costs, with no recognition of gain or loss as the sales did not involve a significant change in proved reserves or significantly alter the relationship between costs and proved reserves.

In the Current Quarter, we sold portions of our acreage, producing properties and other related property and equipment in the Mid-Continent, including our Mississippian Lime assets, for approximately \$420 million, subject to certain customary closing adjustments. Included in the sales were approximately 171,000 net acres and interests in 2,150 wells.

Also, in the Current Quarter, we received proceeds of approximately \$18 million, subject to customary closing adjustments, for the sale of other oil and natural gas properties covering various operating areas.

In the Prior Quarter, we sold portions of our acreage and producing properties in our Haynesville Shale operating area in northern Louisiana for approximately \$915 million, subject to certain customary closing adjustments. Included in the sales were approximately 119,500 net acres and interests in 576 wells that were producing approximately 80 mmcf of gas per day at the time of closing.

Also in the Prior Quarter, we received proceeds of approximately \$20 million, net of post-closing adjustments, for the sale of other oil and natural gas properties covering various operating areas.

## Volumetric Production Payments

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

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

We have committed to purchase natural gas and liquids associated with our VPP transactions. Production purchased under these arrangements is based on market prices at the time of production, and the purchased natural gas and liquids are resold at market prices.

As of March 31, 2018, we had the following VPP outstanding:

VPP #	Date of VPP	Location	Proceeds	Volume Sold			Total
				Oil	Natural Gas	NGL	

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		(\$ in millions)	(mmbbl)	(mmbbl)	(bcfe)	
9	May 2011	Mid-Continent \$ 853	1.7	138	4.8	177

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The volumes remaining to be delivered on behalf of our VPP buyers as of March 31, 2018 were as follows:

VPP #	Term Remaining (in months)	Volume Remaining as of March 31, 2018			Total (bcfe)
		Oil (mmbbl)	Natural Gas (mmbbl)	NGL (mmbbl)	
9	35	0.4	31.3	0.8	38.2

**10. Revenue Recognition**

The FASB issued Revenue from Contracts with Customers (Topic 606) superseding virtually all existing revenue recognition guidance. We adopted this new standard in the first quarter of 2018 using the modified retrospective approach. We applied the new standard to all contracts that were not completed as of January 1, 2018 and reflected the aggregate effect of all modifications in determining and allocating the transaction price. The cumulative effect of adoption of \$8 million did not have a material impact on our condensed consolidated financial statements. However, the adoption did result in certain purchase and sale contracts being recorded on a net basis, as an agent, rather than on a gross basis, as principal, due to management's evaluation under new considerations within Topic 606 that indicated we do not have control over the specified commodity in purchase and sale contracts with the same counterparty. Such presentation change did not have an impact on income (loss) from operations, earnings per share or cash flows, but did reduce marketing revenue and marketing expenses in the condensed consolidated financial statements by approximately \$115 million for the Current Quarter as compared to what would have been recognized using the revenue recognition guidance that was in affect before the adoption of Topic 606.

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on our condensed consolidated balance sheet and condensed consolidated statement of operations was as follows:

	Before adoption of ASC 606	Adjustments	As Reported
	(\$ in millions)		
<b>Balance Sheet as of March 31, 2018</b>			
Other current liabilities	\$ 1,355	\$ 2	\$ 1,357
Other long-term liabilities	\$ 339	\$ 6	\$ 345
Accumulated deficit	\$ (16,232)	\$ (8)	\$ (16,240)

**Statement of Operations for the Three Months**

Ended March 31, 2018

Marketing revenues	\$ 1,361	\$ (115)	\$ 1,246
Marketing operating expenses	\$ 1,383	\$ (115)	\$ 1,268

Revenue from the sale of oil, natural gas and NGL is recognized upon the transfer of control of the products, which is typically when the products are delivered to customers. Revenue is recognized net of royalties due to third parties in an amount that reflects the consideration we expect to receive in exchange for those products.

Revenue from contracts with customers includes the sale of our oil, natural gas and NGL production (recorded as oil, natural gas and NGL revenues in the condensed consolidated statements of operations) as well as the sale of certain of our joint interest holders' production which we purchase under joint operating arrangements (recorded in marketing revenues in the condensed consolidated statements of operations). In connection with the marketing of these products, we obtain control of the oil, natural gas and NGL we purchase from other interest owners at defined delivery points and deliver the product to third parties, at which time revenues are recorded.

Payment terms and conditions vary by contract type, although terms generally include a requirement of payment within 30 days. There are no significant judgments that significantly affect the amount or timing of revenue from contracts with customers.



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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

We also earn revenue from other sources, including from a variety of derivative and hedging activities to reduce our exposure to fluctuations in future commodity prices and to protect our expected operating cash flow against significant market movements or volatility, (recorded within oil, natural gas and NGL revenues in the condensed consolidated statements of operations) as well as a variety of oil, natural gas and NGL purchase and sale contracts with third parties for various commercial purposes, including credit risk mitigation and satisfaction of our pipeline delivery commitments (recorded within marketing revenues in the condensed consolidated statements of operations). In circumstances where we act as an agent rather than a principal, our results of operations related to oil, natural gas and NGL marketing activities are presented on a net basis. These purchase and sales contracts were accounted for as derivatives under Derivatives and Hedging (Topic 815) and were not elected as normal purchase or normal sales. We considered the principal versus agent guidance in Topic 606 in determining whether the gains and losses on these derivatives should be reported on a gross or net basis.

The following table shows revenue disaggregated by operating area and product type, for the Current Quarter:

	Three Months Ended March 31, 2018			
	Oil	Natural Gas	NGL	Total
	(\$ in millions)			
Marcellus	\$—	\$ 294	\$—	\$294
Haynesville	—	210	—	210
Eagle Ford	364	42	40	446
Utica	60	116	52	228
Mid-Continent	73	32	17	122
Powder River Basin	40	12	8	60
Revenue from contracts with customers	537	706	117	1,360
Gains (losses) on oil, natural gas and NGL derivatives	(86 )	(32 )	1	(117 )
Oil, natural gas and NGL revenue	\$451	\$ 674	\$ 118	\$1,243
Marketing revenue from contracts with customers	\$686	\$ 293	\$ 110	\$1,089
Other marketing revenue	117	40	—	157
Marketing revenue	\$803	\$ 333	\$ 110	\$1,246

## Accounts Receivable

Our accounts receivable are primarily from purchasers of oil, natural gas and NGL and from exploration and production companies that own interests in properties we operate. This industry concentration could affect our overall exposure to credit risk, either positively or negatively, because our purchasers and joint working interest owners may be similarly affected by changes in economic, industry or other conditions. We monitor the creditworthiness of all our counterparties and we generally require letters of credit or parent guarantees for receivables from parties deemed to have sub-standard credit, unless the credit risk can otherwise be mitigated. We utilize an allowance method in accounting for bad debt based on historical trends in addition to specifically identifying receivables that we believe may be uncollectible. Accounts receivable as of March 31, 2018 and December 31, 2017 are detailed below:

	March 31, 2018	December 31, 2017
	(\$ in millions)	
Oil, natural gas and NGL sales	\$829	\$ 959
Joint interest	166	209
Other	101	184

Allowance for doubtful accounts	(14 )	(30 )
Total accounts receivable, net	\$1,082	\$ 1,322

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## 11. Investments

In the Current Quarter, FTS International, Inc. (NYSE: FTSI) completed an initial public offering. Due to the offering, the ownership percentage of our equity method investment in FTSI decreased from approximately 29% to 24% and resulted in a gain of \$78 million. In addition, we sold approximately 4.3 million shares of FTSI in the offering for net proceeds of approximately \$74 million and recognized a gain of \$61 million decreasing our ownership percentage to approximately 20%. We continue to hold approximately 22.0 million shares in the publicly traded company.

## 12. Other Operating Expenses

In the Prior Quarter, we terminated future natural gas transportation commitments related to divested assets for cash payments of \$103 million. In addition, we paid \$290 million to assign an oil transportation agreement to a third party.

## 13. Restructuring and Other Termination Costs

## Workforce Reduction

On January 30, 2018, we underwent a reduction in workforce impacting approximately 13% of employees across all functions, primarily on our Oklahoma City campus. In connection with the reduction, we incurred a total charge in the Current Quarter of approximately \$38 million for one-time termination benefits. The following table summarizes our restructuring liabilities:

	Other Current Liabilities (\$ in millions)
Balance as of December 31, 2017	\$ —
Initial restructuring recognition on January 30, 2018	38
Termination benefits paid	(11 )
Balance as of March 31, 2018 <sup>(a)</sup>	\$ 27

(a) Remaining accrued amounts are expected to be paid by the end of the 2018 second quarter.

## 14. Fair Value Measurements

## Recurring Fair Value Measurements

Other Current Assets. Assets related to our deferred compensation plan are included in other current assets. The fair value of these assets is determined using quoted market prices, as they consist of exchange-traded securities.

Other Current Liabilities. Liabilities related to our deferred compensation plan are included in other current liabilities. The fair values of these liabilities are determined using quoted market prices, as the plan consists of exchange-traded mutual funds.

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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Financial Assets (Liabilities). The following table provides fair value measurement information for the above-noted financial assets (liabilities) measured at fair value on a recurring basis as of March 31, 2018 and December 31, 2017:

	Quote Prices Active Markets (Level 1) (\$ in millions)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
As of March 31, 2018				
Financial Assets (Liabilities):				
Other current assets	\$52	\$	—\$	—\$ 52
Other current liabilities	(52 )	—	—	(52 )
Total	\$—	\$	—\$	—\$ —

As of December 31, 2017

Financial Assets (Liabilities):

Other current assets	\$57	\$	—\$	—\$ 57
Other current liabilities	(60 )	—	—	(60 )
Total	\$(3 )	\$	—\$	—\$ (3 )

See Note 3 for information regarding fair value measurement of our debt instruments. See Note 8 for information regarding fair value measurement of our derivatives.

## 15. Condensed Consolidating Financial Information

Chesapeake Energy Corporation is a holding company, owns no operating assets and has no significant operations independent of its subsidiaries. Our obligations under our outstanding senior notes, contingent convertible senior notes, term loan and revolving credit facility listed in Note 3 are fully and unconditionally guaranteed, jointly and severally, by certain of our 100% owned subsidiaries. Subsidiaries with noncontrolling interests, consolidated variable interest entities and certain de minimis subsidiaries are non-guarantors.

The tables below are condensed consolidating financial statements for Chesapeake Energy Corporation (parent) on a stand-alone, unconsolidated basis, and its combined guarantor and combined non-guarantor subsidiaries as of March 31, 2018 and December 31, 2017 and for the three months ended March 31, 2018 and 2017. This financial information may not necessarily be indicative of our results of operations, cash flows or financial position had these subsidiaries operated as independent entities.

**TABLE OF CONTENTS****CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

(Unaudited)

**CONDENSED CONSOLIDATING BALANCE SHEET**

AS OF MARCH 31, 2018

(\$ in millions)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>CURRENT ASSETS:</b>					
Cash and cash equivalents	\$34	\$ 1	\$ 1	\$ (32 )	\$ 4
Other current assets	73	1,147	2	(2 )	1,220
Intercompany receivable, net	7,987	29	173	(8,189 )	—
Total Current Assets	8,094	1,177	176	(8,223 )	1,224
<b>PROPERTY AND EQUIPMENT:</b>					
Oil and natural gas properties at cost, based on full cost accounting, net	478	8,847	27	—	9,352
Other property and equipment, net	—	1,224	—	—	1,224
Property and equipment held for sale, net	—	16	—	—	16
Total Property and Equipment, Net	478	10,087	27	—	10,592
<b>LONG-TERM ASSETS:</b>					
Other long-term assets	49	221	—	—	270
Investments in subsidiaries and intercompany advances	807	77	—	(884 )	—
<b>TOTAL ASSETS</b>	<b>\$9,428</b>	<b>\$ 11,562</b>	<b>\$ 203</b>	<b>\$ (9,107 )</b>	<b>\$ 12,086</b>
<b>CURRENT LIABILITIES:</b>					
Current liabilities	\$197	\$ 2,188	\$ 3	\$ (34 )	\$ 2,354
Intercompany payable, net	28	8,161	—	(8,189 )	—
Total Current Liabilities	225	10,349	3	(8,223 )	2,354
<b>LONG-TERM LIABILITIES:</b>					
Long-term debt, net	9,325	—	—	—	9,325
Other long-term liabilities	98	406	—	—	504
Total Long-Term Liabilities	9,423	406	—	—	9,829
<b>EQUITY:</b>					
Chesapeake stockholders' equity (deficit)	(220 )	807	77	(884 )	(220 )
Noncontrolling interests	—	—	123	—	123
Total Equity (Deficit)	(220 )	807	200	(884 )	(97 )
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$9,428</b>	<b>\$ 11,562</b>	<b>\$ 203</b>	<b>\$ (9,107 )</b>	<b>\$ 12,086</b>

**TABLE OF CONTENTS****CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

(Unaudited)

**CONDENSED CONSOLIDATING BALANCE SHEET**

AS OF DECEMBER 31, 2017

(\$ in millions)

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
<b>CURRENT ASSETS:</b>					
Cash and cash equivalents	\$5	\$ 1	\$ 2	\$ (3 )	\$ 5
Other current assets	154	1,364	3	(1 )	1,520
Intercompany receivable, net	8,697	436	—	(9,133 )	—
Total Current Assets	8,856	1,801	5	(9,137 )	1,525
<b>PROPERTY AND EQUIPMENT:</b>					
Oil and natural gas properties at cost, based on full cost accounting, net	435	8,888	27	—	9,350
Other property and equipment, net	—	1,314	—	—	1,314
Property and equipment held for sale, net	—	16	—	—	16
Total Property and Equipment, Net	435	10,218	27	—	10,680
<b>LONG-TERM ASSETS:</b>					
Other long-term assets	52	168	—	—	220
Investments in subsidiaries and intercompany advances	806	(146 )	—	(660 )	—
<b>TOTAL ASSETS</b>	<b>\$10,149</b>	<b>\$ 12,041</b>	<b>\$ 32</b>	<b>\$ (9,797 )</b>	<b>\$ 12,425</b>
<b>CURRENT LIABILITIES:</b>					
Current liabilities	\$190	\$ 2,168	\$ 2	\$ (4 )	\$ 2,356
Intercompany payable, net	433	8,648	52	(9,133 )	—
Total Current Liabilities	623	10,816	54	(9,137 )	2,356
<b>LONG-TERM LIABILITIES:</b>					
Long-term debt, net	9,921	—	—	—	9,921
Other long-term liabilities	101	419	—	—	520
Total Long-Term Liabilities	10,022	419	—	—	10,441
<b>EQUITY:</b>					
Chesapeake stockholders' equity (deficit)	(496 )	806	(146 )	(660 )	(496 )
Noncontrolling interests	—	—	124	—	124
Total Equity (Deficit)	(496 )	806	(22 )	(660 )	(372 )
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>\$10,149</b>	<b>\$ 12,041</b>	<b>\$ 32</b>	<b>\$ (9,797 )</b>	<b>\$ 12,425</b>

**TABLE OF CONTENTS****CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)**

(Unaudited)

**CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS****THREE MONTHS ENDED MARCH 31, 2018**

(\$ in millions)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>REVENUES:</b>					
Oil, natural gas and NGL	\$ —	\$ 1,238	\$ 5	\$ —	\$ 1,243
Marketing	—	1,246	—	—	1,246
Total Revenues	—	2,484	5	—	2,489
<b>OPERATING EXPENSES:</b>					
Oil, natural gas and NGL production	—	147	—	—	147
Oil, natural gas and NGL gathering, processing and transportation	—	355	1	—	356
Production taxes	—	31	—	—	31
Marketing	—	1,268	—	—	1,268
General and administrative	—	72	—	—	72
Restructuring and other termination costs	—	38	—	—	38
Provision for legal contingencies, net	—	5	—	—	5
Oil, natural gas and NGL depreciation, depletion and amortization	—	267	1	—	268
Depreciation and amortization of other assets	—	18	—	—	18
Net losses on sales of fixed assets	—	8	—	—	8
Total Operating Expenses	—	2,209	2	—	2,211
<b>INCOME FROM OPERATIONS</b>	<b>—</b>	<b>275</b>	<b>3</b>	<b>—</b>	<b>278</b>
<b>OTHER INCOME (EXPENSE):</b>					
Interest expense	(123 )	—	—	—	(123 )
Gains on investments	—	139	—	—	139
Equity in net earnings (losses) of subsidiary	416	2	—	(418 )	—
Total Other Income (Expense)	293	141	—	(418 )	16
<b>INCOME BEFORE INCOME TAXES</b>	<b>293</b>	<b>416</b>	<b>3</b>	<b>(418 )</b>	<b>294</b>
<b>INCOME TAX EXPENSE (BENEFIT)</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>
<b>NET INCOME</b>	<b>293</b>	<b>416</b>	<b>3</b>	<b>(418 )</b>	<b>294</b>
Net income attributable to noncontrolling interests	—	—	(1 )	—	(1 )
<b>NET INCOME ATTRIBUTABLE TO CHESAPEAKE</b>	<b>293</b>	<b>416</b>	<b>2</b>	<b>(418 )</b>	<b>293</b>
Other comprehensive income	—	10	—	—	10
<b>COMPREHENSIVE INCOME ATTRIBUTABLE TO CHESAPEAKE</b>	<b>\$ 293</b>	<b>\$ 426</b>	<b>\$ 2</b>	<b>\$ (418 )</b>	<b>\$ 303</b>





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## CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

## CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2017

(\$ in millions)

	Parent	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated	
<b>REVENUES:</b>						
Oil, natural gas and NGL	\$	—\$ 1,463	\$ 6	\$	—\$ 1,469	
Marketing	—	1,284	—	—	1,284	
Total Revenues	—	2,747	6	—	2,753	
<b>OPERATING EXPENSES:</b>						
Oil, natural gas and NGL production	—	135	—	—	135	
Oil, natural gas and NGL gathering, processing and transportation	—	353	2	—	355	
Production taxes	—	22	—	—	22	
Marketing	—	1,328	—	—	1,328	
General and administrative	—	64	1	—	65	
Provision for legal contingencies, net	—	(2	)	—	(2	)
Oil, natural gas and NGL depreciation, depletion and amortization	—	195	2	—	197	
Depreciation and amortization of other assets	—	21	—	—		