Chesapeake ENERGY

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December 14, 2010

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, NW
Washington, DC 20581

Dear Chairman Gensler:

Chesapeake greatly appreciates the time afforded by the Commission on November 16 and December 10, 2010, at the joint SEC-CFTC roundtable. We commend your efforts to implement the Dodd-Frank Act, something that will have a significant impact on over-the-counter ("OTC") derivatives markets and those who use them. The effort to regulate these markets is no small undertaking, and we appreciate being able to discuss our company and how we use OTC derivatives to protect ourselves from market risk. As an end-user that extensively and exclusively utilizes OTC commodity derivatives as a risk management tool, Chesapeake Energy Corporation supports increased transparency, accountability, and market integrity.

Our company is the nation's most active driller and the second largest producer of American natural gas. However, our efforts to deliver lower natural gas prices to U.S. consumers and help forge a path towards American energy independence are not without significant financial costs. Whether we invest in new acreage or further develop existing reserves, our business requires us to spend significant amounts of cash. Meeting our cash requirements is of paramount concern to Chesapeake and directly impacts our ability to maintain and grow our business. To put this into perspective, we and most other independent exploration and production companies routinely reinvest more than 100 percent of our operating cash flow directly into finding and producing natural gas and oil here in the U.S.

Our risk management program plays an integral role in the development and execution of our business plan. Because we are highly exposed to natural gas and oil prices, both of which can experience significant price volatility, our utilization of OTC derivative contracts provides us with predictability of cash flows from future natural gas and oil production. OTC contracts allow us to sell our future production at prices above our cost to produce our reserves, thus locking in a satisfactory operating margin. This margin is then reinvested in new capital-intensive, job-creating growth initiatives, which range from finding and developing new and existing reserves to investing in new technologies that are more efficient from an economic or environmental perspective. We strongly believe that our efforts to manage our exposure to natural gas and oil price volatility using OTC contracts directly benefits American consumers and the U.S. economy as a whole. If we could not mitigate our price risks in the future in the manner that we do now, we would be forced to drill less – this would eliminate jobs and create higher prices for U.S. energy consumers.

Given the importance of accurately estimating the prices we will receive for our future production and the link to our growth-oriented business model, Chesapeake spends a significant amount of time analyzing and implementing our commodity risk management program. Additionally, to assist with the execution of the program, we utilize a multi-counterparty hedging facility with 13 large, well-capitalized institutions. This hedge facility provides rigorous checks on our utilization of commodity derivatives, most important of which are provisions regarding the collateralization of our derivative contracts and limitations related to the commodity volumes we can hedge in any given period of time. With respect to the latter, we are strictly prohibited from hedging more than our estimated underlying production for any given future month,

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meaning we *can not and do not speculate*. As noted above, we are significantly exposed to energy commodity prices because of the reserves we physically own. We do not look to create synthetic exposure via the OTC market. To do so would be imprudent; thus our company's risk management policy and multi-counterparty hedging facility do not allow for such speculative activities.

For the reasons stated above, Chesapeake has been very interested and engaged in discussions surrounding the OTC legislative and regulatory processes. We continue to maintain some key concerns that we wish to re-emphasize in this letter. Chesapeake's main concerns relate to 1) margin and capital requirements, 2) Swap Dealer and Major Swap Participant definitions and 3) real-time reporting.

Margin and Capital Requirements

One of Chesapeake's greatest concerns about regulating the OTC derivatives market is the potential for the new margining rules to siphon cash away from our efforts to maintain and grow our business. Under the hedge facility referenced above, we collateralize our OTC derivative positions with first-lien mortgages on natural gas and oil properties rather than providing cash margin. While not cash, the security we provide is very significant. At the end of June 2008, when the mark-to-market value of our OTC contracts was over $6 billion, we had posted to our counterparties oil and gas collateral valued at over $11 billion. The collateral coverage is greater than 1-to-1 due to our credit rating and the fact that non-cash collateral is less liquid than cash. If the mark-to-market on the OTC contracts covered under the terms of our multi-counterparty hedging facility equaled the maximum amount of $15 billion allowed by the facility, Chesapeake would be required to post almost $25 billion worth of oil and gas collateral to secure its mark-to-market position. If we were required to post cash margin to cover such a large mark-to-market, we would need to make a strategic decision to either invest in exploring for and developing oil and gas reserves *or* putting cash up for collateralizing OTC contracts. Considering our line of business, it is clear we would decide on the former instead of the latter. What this means though is that we would not execute nearly as many risk-reducing OTC contracts if forced to post cash margin. Ultimately, we will be much more exposed to commodity price swings, which in the current low natural gas price environment would prove disastrous to our business plan. From January 2009 to November 2010, our risk management program has brought in over $4 billion of cash that we have used to drill more wells, thereby boosting American production and lowering cost to American energy consumers.

Please note that our concerns around cash margining are not limited to the energy industry. If we have to curtail our risk management efforts to avoid cash margin calls, other capital-intensive companies in many different industries would need to do the same. I can't speak for the negative effects all industries would face if there was a wholesale reduction in the use of OTC derivatives as risk management tools; however, I am certain that any commodity-based industry would be adversely impacted. In our case, if we were not able to use OTC derivatives to provide some certainty and predictability with respect to the prices we receive from future production, we would not feel comfortable investing as much cash today to bring new energy resources and projects to market. As a result, less exploration and production activity would impact the supply of commodities vital to the U.S. economy. If commodity production declines and the U.S. experiences increased industrial demand as the economy continues to recover and/or from consumers because of weather-related needs, the country could face a significant spike in energy costs. Essentially the market would demand a premium price for produced reserves because companies would not be able to adequately mitigate their commodity price risk exposure using OTC contracts and thus would have to cut back on bringing additional supply online.

There have been some arguments raised that suggest end-users should obtain cash for margin posting from specified margin-posting credit facilities. This argument is misguided and could negatively impact an end-user's ability to access short-term capital to help fund its business. First, institutions that already lend to us for our working capital needs have made their own internal credit decisions determining the amount of credit they are willing to extend. Chesapeake has a $4 billion revolving credit facility, one of the largest in the industry, which we use to fund our short-term business activities. To suggest those lenders would be willing to increase their lending commitments in the aggregate from $4 billion to $19 billion (the sum of our credit facility and maximum permitted hedging facility mark-to-market capacity) is not a reasonable expectation. Essentially, we would not be able to obtain enough credit to sustain the current size of our risk management program, which would directly impact our ability to protect and fund our business.

One question that has been posed to me relative to the acceptance of non-cash collateral for margining purposes is whether there will be regulatory mandated coverage ratios. This is an important question because coverage ratios are integral to the bilateral nature of existing ISDA agreements. As noted previously, we provide more than 1-to-1 coverage of our OTC mark-to-market obligations, which is hard-wired into our multi-counterparty hedging facility. A regulatory-mandated coverage ratio could cause a contractual termination event under the terms of our hedging facility and may not be acceptable to all parties to that facility. This is the same issue discussed during the debate on whether to retroactively or prospectively implement the Dodd-Frank Act. We don't feel it is appropriate to mandate certain coverage ratios for this reason as well as the fact that end-users are not systemically risky to the OTC market. We should be able to continue with bilaterally negotiated coverage ratios and rely on those ratios being determined as the result of well conceived credit decisions by our derivative counterparties linked to the underlying credit-worthiness of our business.

Chesapeake is also concerned about how overly strict capital requirements relative to OTC contracts could impact us, other end-users and the market as a whole. There has been much discussion around whether capital requirements for our derivative counterparties should be stricter for uncleared OTC derivatives; with some saying they should be set at punitive levels to encourage clearing of our trades. If capital requirements are set at an overly burdensome level there could be two very real, negative effects on the OTC market: 1) much higher costs to deploy risk management programs and 2) a reduction in market liquidity as our counterparties curtail their market-making activities or exit the business entirely.

Related to the first point, Chesapeake isn't greatly concerned with minimal credit charges imposed by our counterparties on our OTC contracts, which at this point will undoubtedly be the case. However, we have heard that if Basel 3 capital requirements are adopted, the charges that we currently pay could increase five to seven fold. That causes us great concern, and we firmly believe such extra cost will not be borne by our counterparties. Our counterparties will pass that extra cost down to end-users such as Chesapeake, who in turn will pass it on to consumers via higher costs for goods and services. At a time when the economy is challenged, this strikes us as a step in the wrong direction. This is especially true for the types of trades that end-users currently employ to protect themselves, trades that are not systemically risky to the financial system and did not play a hand in the 2008 financial system collapse.

The second point is very concerning as well. Much like end-users curtailing their risk management efforts if forced to post cash margin, our counterparties may rethink making a market in OTC derivatives if capital charges are set too high. Of course, the larger institutions, which are much more systemically risky to begin with, will continue to operate in the space but possibly to a smaller degree. For mid-level and smaller institutions, the increased costs could be game-changers and could force them out of the business. Just like any market, fewer participants cause the risk to the entire market to be much more pronounced. End-users want a diversity of market-makers so that we can manage our own counterparty risks efficiently and effectively. Ultimately, we feel that if capital charges are too strict the OTC market would shrink, which would likely increase the bid-ask spread and transaction costs. This is especially true for longer-dated risk-management contracts where market liquidity has traditionally been very thin.

Regulatory Definitions

Throughout the OTC legislative and regulatory processes, definitions have played a key role in determining whether end-users would be subject to the same regulatory requirements as our counterparties. The Swap Dealer and Major Swap Participant definitions are the two most important to Chesapeake primarily because such definitions control whether an end-user would face the same regulatory oversight as our market makers. We strongly believe that end-users engaging in prudent risk management activities should not be classified as Swap Dealers or Major Swap Participants.

The theory behind the Swap Dealer definition makes sense to us, essentially capturing those that make a market for others. However, there has been enough uncertainty here to concern end-users like us. As noted earlier in this letter, Chesapeake only executes OTC contracts that protect future expected production from unacceptable commodity price volatility. We are significantly long the underlying asset and *do not speculate* by buying additional exposure from the OTC markets. Additionally, we are not making a market for anyone; to do so would be against our risk management policy. These facts should be sufficient for an end-user to qualify for a clear exemption from the Swap Dealer definition.

The proposed rules pertaining to the Swap Dealer definition contain many concerning features. First, the definition includes vague references alluding to the "tendencies" of institutions operating in the OTC markets. This leaves too much ambiguity with respect to whether an end-user could be classified as a swap dealer or not. To reiterate, an end-user utilizes OTC derivatives to control market risks impacting their business. That fact could be lost without a firm exclusion. Additionally, we feel that the proposed rule for the De Minimis Exemption is set too low; meaning many end-users could be deemed Swap Dealers for activities that are a necessary part of mitigating risks impacting their businesses. We suggest that the De Minimis Exemption to be geared towards "net" exposure instead of "gross" exposure, and remove the conditions pertaining to the number of counterparties and number of swaps. With respect to the gross versus net suggestion, systemic risk should be evaluated based on the net position in all circumstances. Using a gross position concept will inappropriately capture firms that are not systemically risky and thus should not be subject to the Swap Dealer classification. Related to the suggestion for removing the number of counterparties and swaps from the De Minimis qualifier, the true risk to the system is whether the net position is material or not. An end-user with 30 small swaps with 30 different counterparties is not necessarily more systemically risky than a similar end-user who has grouped those trades into one position with a single counterparty. In fact, spreading the trade amongst several different counterparties is a valid risk management activity from a counterparty credit risk perspective.

We are just as concerned with the Major Swap Participant definition. The theory here makes sense to us as well - from a systemic risk perspective, very large entities with massive net positions should be more closely regulated. However, we also believe that end-users that are merely employing prudent risk management practices should be clearly exempted from being a Major Swap Participant. An end-user of OTC contracts is *reducing* the risk of their business, thus to classify them as being more systemically risky because of prudent risk management efforts is counterproductive.

The proposed Major Swap Participant definition contains language defining "substantial positions" and "hedging or mitigating commercial risks". Related to substantial positions, the rules do not appear to explicitly allow for non-cash collateral. They do mention that the rules are targeting uncollateralized positions, but the fact that non-cash collateral isn't specifically allowed is concerning to Chesapeake. Additionally, the thresholds for a substantial position appear too low. To put this into perspective, a $1 move in natural gas prices could cause a $1 billion change in value of OTC contracts covering just *one* year of our future estimated natural gas production. The rules defining what classifies as hedging or mitigating a commercial risk seem very vague. In fact, the language alludes to the test being performed on a trade-by-trade basis. Such a requirement could inject significant regulatory uncertainty into our risk management program.

Real-Time Reporting

Early in the OTC legislative process, Chesapeake noted that periodically reporting OTC derivatives would go a long way to reducing systemic risk through increased transparency. We agree that there isn't enough information available to regulators or the market as a whole to determine what could have a systemic impact on the market. However, we believe that real-time reporting could have a very damaging impact on users of the market. In fact, we believe that real-time reporting could significantly dry up liquidity in many already illiquid markets.

Chesapeake's future production from its natural gas and oil reserves can be projected for as many as 65 years, something that is typical for an exploration and production company. What this means is that our exposure to the markets is long-dated. As such, we often hedge our production beyond 2 or 3 years, with some of our trades extending out longer than 10 years. Given Chesapeake's size and our strategy to lock in acceptable margins if attractive prices present themselves, we oftentimes will execute OTC

However, if we sell a significant amount of our future production further out than 3 years, our trades could potentially impact the market where less liquidity exists. Our concern is that hedging in a less liquid market can move the market against an end-user. Real-time reporting could exacerbate this issue if the requirement to report is too soon after trade execution. The issue is that real-time reporting could send real-time signals to the market that a large producer is selling. It wouldn't take long for bid prices to drop in response.

The negative implications of reporting too frequently could cause our counterparties problems as well. Because our market makers need to balance their derivatives book regularly, they will usually turn right around and sell the gas they buy from us. For less liquid segments or time periods in the market, Chesapeake is assessed a higher credit charge for our trades to account for the risk that the counterparty might not be able to offload the trade as quickly as they desire. Such concerns can be amplified in a scenario where we execute a large trade with a counterparty and they have to report the trade within 15 minutes of execution. Effectively, the counterparty will have 15 minutes to offload the trade before the market at large guesses that a large producer is selling its production and the bid price decreases. Ultimately, Chesapeake believes that we will be forced to absorb higher credit charges because real-time reporting requirements could exacerbate an already existing concern by our market makers. Additionally, to control the risk of being stuck with a large position, our counterparties could reduce their appetite for longer-dated trades or may exit that part of the market entirely. This will decrease liquidity where it is already very thin.

For these reasons, we suggest less-frequent reporting requirements for illiquid parts of the market. This will hopefully reduce potential market signaling, something that if it occurs could unnecessarily impact valid risk management activities. Instead of the 15 minutes currently proposed for large trades, we feel end-of-day reporting would be sufficient to identify systemic risk and promote price transparency. Additionally, we recommend that all end-user trades, whether short- or long-dated, should be allowed more time to report to prevent moving the market against us.

We appreciate your attention and willingness to hear our comments related to additional regulation of the OTC derivatives markets. As noted above, these markets are very important to us and other end-users, and we strongly desire them to be effective and efficient for managing the risks of our business. If you should have any questions, please don't hesitate to contact me.

Best regards,

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