



# **FORM 10-Q**

**CHESAPEAKE ENERGY CORP – CHK**

**Filed: November 01, 2005 (period: September 30, 2005)**

Quarterly report which provides a continuing view of a company's financial position

# Table of Contents

## PART I.

**Item 1.** Condensed Consolidated Financial Statements (Unaudited):

**ITEM 2.** Management's Discussion and Analysis of Financial Condition and Results of Operations

**ITEM 3.** Quantitative and Qualitative Disclosures About Market Risk

**ITEM 4.** Controls and Procedures

## PART II.

### OTHER INFORMATION

**Item 1.** Legal Proceedings

**Item 2.** Unregistered Sales of Equity Securities and Use of Proceeds

**Item 3.** Defaults Upon Senior Securities

**Item 4.** Submission of Matters to a Vote of Security Holders

**Item 5.** Other Information

**Item 6.** Exhibits

SIGNATURES

INDEX TO EXHIBITS

EX-3.1.5

EX-12 (Statement regarding computation of ratios)

EX-31.1

EX-31.2

EX-32.1

EX-32.2

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 September 30, 2005

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  
(State or other jurisdiction of  
incorporation or organization)

73-1395733  
(I.R.S. Employer  
Identification No.)

6100 North Western Avenue  
Oklahoma City, Oklahoma  
(Address of principal executive offices)

73118  
(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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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 October 31, 2005, there were 344,688,952 shares of our \$0.01 par value common stock outstanding.

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**CHESAPEAKE ENERGY CORPORATION AND SUBSIDIARIES**  
**INDEX TO FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2005**

	<b>Page</b>
<b>PART I.</b>	
<b>Financial Information</b>	
Item 1.	
Condensed Consolidated Financial Statements (Unaudited):	
<a href="#">Condensed Consolidated Balance Sheets as of September 30, 2005 and December 31, 2004</a>	3
<a href="#">Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2005 and 2004</a>	4
<a href="#">Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2005 and 2004</a>	5
<a href="#">Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine Months Ended September 30, 2005 and 2004</a>	6
<a href="#">Notes to Condensed Consolidated Financial Statements</a>	7
Item 2.	
<a href="#">Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	21
Item 3.	
<a href="#">Quantitative and Qualitative Disclosures About Market Risk</a>	37
Item 4.	
<a href="#">Controls and Procedures</a>	43
<b>PART II.</b>	
<b>Other Information</b>	
Item 1.	
<a href="#">Legal Proceedings</a>	44
Item 2.	
<a href="#">Unregistered Sales of Equity Securities and Use of Proceeds</a>	44
Item 3.	
<a href="#">Defaults Upon Senior Securities</a>	44
Item 4.	
<a href="#">Submission of Matters to a Vote of Security Holders</a>	44
Item 5.	
<a href="#">Other Information</a>	45
Item 6.	
<a href="#">Exhibits</a>	45

[Table of Contents](#)

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

	September 30, 2005	December 31, 2004
	(\$ in thousands)	
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 127,102	\$ 6,896
Accounts receivable:		
Oil and gas sales	509,071	347,081
Joint interest, net of allowances of \$3,790,000 and \$4,648,000, respectively	77,385	68,220
Related parties	13,276	8,286
Other	53,893	35,781
Deferred income tax asset	510,982	18,068
Short-term derivative instruments	—	51,061
Inventory and other	51,857	32,147
	<u>1,343,566</u>	<u>567,540</u>
Total Current Assets	1,343,566	567,540
<b>PROPERTY AND EQUIPMENT:</b>		
Oil and gas properties, at cost based on full-cost accounting:		
Evaluated oil and gas properties	12,616,358	9,451,413
Unevaluated properties	1,271,662	761,785
Less: accumulated depreciation, depletion and amortization of oil and gas properties	(3,674,895)	(3,057,742)
	<u>10,213,125</u>	<u>7,155,456</u>
Total oil and gas properties, at cost based on full-cost accounting	10,213,125	7,155,456
Other property and equipment	487,241	324,495
Drilling rigs	91,431	49,375
Less: accumulated depreciation and amortization of other property and equipment and drilling rigs	(114,373)	(84,942)
	<u>10,677,424</u>	<u>7,444,384</u>
Total Property and Equipment	10,677,424	7,444,384
<b>OTHER ASSETS:</b>		
Investment in Pioneer Drilling	150,341	65,950
Other investments	59,746	26,793
Long-term derivative instruments	46,345	44,169
Other assets	88,207	95,673
	<u>344,639</u>	<u>232,585</u>
Total Other Assets	344,639	232,585
<b>TOTAL ASSETS</b>	<u>\$ 12,365,629</u>	<u>\$ 8,244,509</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 495,268	\$ 367,176
Short-term derivative instruments	957,756	91,414
Other accrued liabilities	223,700	222,029
Revenues and royalties due others	306,070	216,820
Accrued interest	59,684	66,514
	<u>2,042,478</u>	<u>963,953</u>
Total Current Liabilities	2,042,478	963,953
<b>LONG-TERM LIABILITIES:</b>		
Long-term debt, net	4,250,160	3,075,109
Deferred income tax liability	1,659,128	933,873
Asset retirement obligation	86,022	73,718
Long-term derivative instruments	79,788	1,296
Revenues and royalties due others	21,357	17,007
Other liabilities	20,376	16,670
	<u>6,116,831</u>	<u>4,117,673</u>
Total Long-Term Liabilities	6,116,831	4,117,673
<b>CONTINGENCIES AND COMMITMENTS (Note 3)</b>		
<b>STOCKHOLDERS' EQUITY:</b>		
Preferred Stock, \$.01 par value, 20,000,000 shares authorized:		
6.00% cumulative convertible preferred stock, 101,275 and 103,110 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively, entitled in liquidation to \$5,063,750 and \$5,155,500	5,064	5,156
5.00% cumulative convertible preferred stock (series 2003), 1,027,276 and 1,725,000 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively, entitled in liquidation to \$102,727,600 and \$172,500,000	102,728	172,500
4.125% cumulative convertible preferred stock, 134,575 and 313,250 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively, entitled in liquidation to \$134,575,000 and \$313,250,000	134,575	313,250

5.00% cumulative convertible preferred stock (series 2005), 4,600,000 and 0 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively, entitled in liquidation to \$460,000,000	460,000	—
4.50% cumulative convertible preferred stock, 3,450,000 and 0 shares issued and outstanding as of September 30, 2005 and December 31, 2004, respectively, entitled in liquidation to \$345,000,000	345,000	—
Common Stock, \$.01 par value, 500,000,000 shares authorized, 349,383,583 and 316,940,784 shares issued at September 30, 2005 and December 31, 2004, respectively	3,494	3,169
Paid-in capital	3,071,255	2,440,105
Retained earnings	686,426	262,987
Accumulated other comprehensive income (loss), net of tax of \$276,733,000 and (\$11,489,000), respectively	(481,440)	20,425
Unearned compensation	(94,691)	(32,618)
Less: treasury stock, at cost; 5,324,374 and 5,072,121 common shares as of September 30, 2005 and December 31, 2004, respectively	(26,091)	(22,091)
<b>Total Stockholders' Equity</b>	<b>4,206,320</b>	<b>3,162,883</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 12,365,629</b>	<b>\$ 8,244,509</b>

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

[Table of Contents](#)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
(\$ in thousands, except per share data)				
<b>REVENUES:</b>				
Oil and gas sales	\$ 720,928	\$450,936	\$2,032,271	\$1,270,394
Oil and gas marketing sales	361,915	178,860	882,040	496,823
<b>Total Revenues</b>	<b>1,082,843</b>	<b>629,796</b>	<b>2,914,311</b>	<b>1,767,217</b>
<b>OPERATING COSTS:</b>				
Production expenses	80,765	54,102	222,660	148,500
Production taxes	53,102	30,872	136,313	68,559
General and administrative expenses:				
General and administrative (excluding stock-based compensation)	10,536	8,361	29,468	23,947
Stock-based compensation	5,249	584	10,172	3,125
Oil and gas marketing expenses	353,510	175,426	860,789	486,205
Oil and gas depreciation, depletion and amortization	231,145	153,586	621,484	410,237
Depreciation and amortization of other assets	12,902	7,700	34,791	20,155
<b>Total Operating Costs</b>	<b>747,209</b>	<b>430,631</b>	<b>1,915,677</b>	<b>1,160,728</b>
<b>INCOME FROM OPERATIONS</b>	<b>335,634</b>	<b>199,165</b>	<b>998,634</b>	<b>606,489</b>
<b>OTHER INCOME (EXPENSE):</b>				
Interest and other income	2,428	885	7,790	3,563
Interest expense	(58,593)	(48,689)	(155,623)	(124,040)
Loss on repurchases or exchanges of Chesapeake debt	(747)	—	(70,047)	(6,925)
<b>Total Other Income (Expense)</b>	<b>(56,912)</b>	<b>(47,804)</b>	<b>(217,880)</b>	<b>(127,402)</b>
<b>INCOME BEFORE INCOME TAX</b>	<b>278,722</b>	<b>151,361</b>	<b>780,754</b>	<b>479,087</b>
<b>INCOME TAX EXPENSE:</b>				
Current	—	—	—	—
Deferred	101,734	54,489	284,977	172,470
<b>Total Income Tax Expense</b>	<b>101,734</b>	<b>54,489</b>	<b>284,977</b>	<b>172,470</b>
<b>NET INCOME</b>	<b>176,988</b>	<b>96,872</b>	<b>495,777</b>	<b>306,617</b>
<b>PREFERRED STOCK DIVIDENDS</b>	<b>(10,204)</b>	<b>(11,287)</b>	<b>(25,526)</b>	<b>(30,799)</b>
<b>LOSS ON CONVERSION/EXCHANGE OF PREFERRED STOCK</b>	<b>(17,725)</b>	<b>—</b>	<b>(22,468)</b>	<b>—</b>
<b>NET INCOME AVAILABLE TO COMMON SHAREHOLDERS</b>	<b>\$ 149,059</b>	<b>\$ 85,585</b>	<b>\$ 447,783</b>	<b>\$ 275,818</b>
<b>EARNINGS PER COMMON SHARE:</b>				
Basic	\$ 0.46	\$ 0.33	\$ 1.42	\$ 1.13
Assuming dilution	\$ 0.43	\$ 0.29	\$ 1.32	\$ 0.96
<b>CASH DIVIDEND DECLARED PER COMMON SHARE</b>	<b>\$ 0.050</b>	<b>\$ 0.045</b>	<b>\$ 0.145</b>	<b>\$ 0.125</b>
<b>WEIGHTED AVERAGE COMMON AND COMMON EQUIVALENT SHARES OUTSTANDING (in thousands):</b>				
Basic	322,101	257,096	314,425	245,087
Assuming dilution	367,639	338,285	352,210	320,089

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

[Table of Contents](#)

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

	Nine Months Ended September 30,	
	2005	2004
	(\$ in thousands)	
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
<b>NET INCOME</b>	\$ 495,777	\$ 306,617
<b>ADJUSTMENTS TO RECONCILE NET INCOME TO CASH PROVIDED BY OPERATING ACTIVITIES:</b>		
Depreciation, depletion and amortization	649,907	426,404
Unrealized losses on derivatives	135,175	72,512
Deferred income taxes	284,977	172,470
Amortization of loan costs	6,368	3,988
Amortization of bond discount	4,208	3,300
Stock-based compensation	10,172	3,125
Income from equity investments	(2,171)	(786)
Loss on repurchases or exchanges of Chesapeake debt	70,047	6,925
Other	(503)	569
Cash provided by operating activities before changes in assets and liabilities	1,653,957	995,124
Change in assets and liabilities	(15,589)	43,082
Cash provided by operating activities	1,638,368	1,038,206
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisitions of oil and gas companies, proved properties and unproved properties, net of cash acquired	(1,798,704)	(1,657,481)
Exploration and development of oil and gas properties	(1,622,375)	(888,288)
Additions to buildings and other fixed assets	(156,978)	(77,073)
Additions to drilling rig equipment	(42,056)	(19,315)
Additions to investments	(37,273)	(26,740)
Divestitures of oil and gas properties	1,881	271
Other	461	385
Cash used in investing activities	(3,655,044)	(2,668,241)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from long-term borrowings	3,561,000	1,413,000
Payments on long-term borrowings	(3,620,000)	(1,261,000)
Proceeds from issuance of preferred stock, net of offering costs	782,368	304,936
Proceeds from issuance of common stock, net of offering costs	289,391	624,187
Proceeds from issuance of senior notes, net of offering costs	1,765,383	582,889
Purchases or exchanges of Chesapeake senior notes, including redemption premiums	(617,430)	(57,320)
Common stock dividends	(45,771)	(26,886)
Preferred stock dividends	(17,315)	(30,257)
Financing costs of credit facility	(4,672)	(8,737)
Purchases of treasury shares	(4,000)	—
Net increase in outstanding payments in excess of cash balance	33,751	89,321
Cash received from exercise of stock options and warrants	19,940	9,047
Other financing costs	(5,763)	(653)
Cash provided by financing activities	2,136,882	1,638,527
Net increase (decrease) in cash and cash equivalents	120,206	8,492
Cash and cash equivalents, beginning of period	6,896	40,581
Cash and cash equivalents, end of period	\$ 127,102	\$ 49,073

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



[Table of Contents](#)

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
	(\$ in thousands)			
Net income	\$ 176,988	\$ 96,872	\$ 495,777	\$ 306,617
Other comprehensive income (loss), net of income tax:				
Change in fair value of derivative instruments, net of income taxes of (\$345,346,000), (\$20,586,000), (\$389,909,000) and (\$83,149,000)	(600,807)	(36,598)	(678,334)	(147,820)
Reclassification of (gain) loss on settled contracts, net of income taxes of \$40,815,000, \$7,917,000, \$39,798,000 and \$19,586,000	71,007	14,075	69,238	34,819
Ineffective portion of derivatives qualifying for cash flow hedge accounting, net of income taxes of \$36,307,000, \$643,000, \$36,092,000 and \$6,126,000	63,165	1,143	62,791	10,890
Unrealized gain on marketable securities, net of income taxes of \$12,046,000, \$0, \$25,544,000 and \$0	20,957	—	44,440	—
Comprehensive income (loss)	\$ (268,690)	\$ 75,492	\$ (6,088)	\$ 204,506

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

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

**1. Basis of Presentation and Summary of Significant Accounting Policies***Principles of Consolidation*

The accompanying unaudited condensed consolidated financial statements of Chesapeake Energy Corporation and its subsidiaries have been prepared in accordance with the instructions to Form 10-Q as prescribed by the Securities and Exchange Commission. Chesapeake's 2004 Annual Report on Form 10-K includes certain definitions and a summary of significant accounting policies and should be read in conjunction with this Form 10-Q. All material adjustments (consisting solely of normal recurring adjustments) which, in the opinion of management, are necessary for a fair statement of the results for the interim periods have been reflected. The results for the three and nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the full year. This Form 10-Q relates to the three and nine months ended September 30, 2005 (the "Current Quarter" and "Current Period", respectively) and the three and nine months ended September 30, 2004 (the "Prior Quarter" and "Prior Period", respectively).

*Stock-Based Compensation*

*Stock Options.* Chesapeake has elected to follow APB No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for its employee and director stock options. Under APB No. 25, compensation expense is recognized for the difference between the option exercise price and market value on the measurement date. The original issuance of stock options has not resulted in the recognition of compensation expense because the exercise price of the stock options granted under the plans has equaled the market price of the underlying stock on the date of grant. In March 2000, the Financial Accounting Standards Board issued FASB Interpretation No. 44 (FIN 44), which provided clarification regarding the application of APB No. 25. FIN 44 specifically addressed the accounting consequence of various modifications to the terms of a previously granted fixed-price stock option. Pursuant to FIN 44, we recognized stock-based compensation expense (a sub-category of general and administrative expenses) arising from modifications made to previously issued stock options in the condensed consolidated statements of operations of \$2.3 million, \$0.3 million, \$2.7 million and \$0.5 million in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively.

Pro forma information regarding net income and earnings per share is required by SFAS No. 123 and has been determined as if we had accounted for our employee and director stock options under the fair value method of the statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions for the periods presented: interest rates (zero-coupon U.S. government issues with a remaining life equal to the expected term of the options) ranging from 2.97% to 4.18%, dividend yields ranging from 0.52% to 1.22%, and volatility factors for the expected market price of our common stock ranging from 0.29 to 0.46. We used a weighted-average expected life of the options of five years for each of the periods presented.

Presented below is pro forma financial information assuming Chesapeake had applied the fair value method under SFAS No. 123:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
	(\$ in thousands, except per share amounts)			
<b>Net Income:</b>				
As reported	\$176,988	\$96,872	\$495,777	\$306,617
Stock-based compensation expense included in net income, net of tax	3,333	374	6,459	2,000
Pro forma compensation expense, net of tax	(5,218)	(3,152)	(13,176)	(10,647)
<b>Pro forma</b>	<b>\$175,103</b>	<b>\$94,094</b>	<b>\$489,060</b>	<b>\$297,970</b>
<b>Basic earnings per common share</b>				
As reported	\$ 0.46	\$ 0.33	\$ 1.42	\$ 1.13
<b>Pro forma</b>	<b>\$ 0.46</b>	<b>\$ 0.32</b>	<b>\$ 1.40</b>	<b>\$ 1.09</b>
<b>Diluted earnings per common share</b>				
As reported	\$ 0.43	\$ 0.29	\$ 1.32	\$ 0.96
<b>Pro forma</b>	<b>\$ 0.42</b>	<b>\$ 0.28</b>	<b>\$ 1.30</b>	<b>\$ 0.93</b>

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## [Table of Contents](#)

For purposes of the pro forma disclosures, the estimated fair value of the options is amortized to expense over the option vesting period, which is four years for employee options.

In December 2004, the Financial Accounting Standards Board issued SFAS 123(R), *Share-Based Payment*, a revision of SFAS 123, *Accounting for Stock-Based Compensation*. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services by requiring a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost will be recognized over the period during which an employee is required to provide services in exchange for the award. The fair value of employee stock options will be estimated using option-pricing models. Excess tax benefits will be recognized as an addition to paid-in capital. Cash retained as a result of those excess tax benefits will be presented in the statement of cash flows as financing cash inflows. The write-off of deferred tax assets relating to unrealized tax benefits associated with recognized compensation cost will be recognized as income tax expense unless there are excess tax benefits from previous awards remaining in paid-in capital to which it can be offset. This statement was initially effective as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. However, in April 2005, the Securities and Exchange Commission adopted a new rule that amends the compliance dates for SFAS 123(R). The new rule allows the implementation of SFAS 123(R) at the beginning of the annual reporting period that begins after June 15, 2005, instead of the next reporting period. The SEC's new rule only changes the date for compliance with the standard.

Chesapeake will implement SFAS 123(R) in the first quarter of 2006, and the Black-Scholes option pricing model will be used to value the stock options as of the grant date. Based on the stock options outstanding and vested at September 30, 2005, we do not believe the new accounting requirement will have a significant impact on future results of operations.

*Restricted Stock.* Chesapeake began issuing shares of restricted common stock to employees in January 2004 and to directors in July 2005. The total value of restricted shares granted is recorded as unearned compensation in stockholders' equity based on the fair market value of the shares on the date of grant. This value is amortized over the vesting period, which is four years from the date of grant. To the extent amortization of compensation cost relates to employees directly involved in exploration and development activities, such amounts are capitalized to oil and gas properties. Amounts not capitalized to oil and gas properties are recognized in stock-based compensation expense (a sub-category of general and administrative expenses).

Chesapeake issued 2.0 million, 1.5 million, 3.8 million and 2.7 million shares of restricted stock to employees in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively. Total stock-based compensation related to restricted stock was \$8.0 million, \$0.4 million, \$16.1 million and \$3.9 million in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively. Of this amount, \$4.3 million, \$0.3 million, \$8.7 million and \$2.6 million was reflected as stock-based compensation expense (a sub-category of general and administrative expenses) in the condensed consolidated statements of operations for the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively, and the remainder was capitalized to oil and gas properties.

### *Critical Accounting Policies*

We consider accounting policies related to hedging, oil and gas properties, income taxes and business combinations to be critical policies. These policies are summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in our annual report on Form 10-K for the year ended December 31, 2004.

## **2. Financial Instruments and Hedging Activities**

### *Oil and Gas Hedging Activities*

Our results of operations and operating cash flows are impacted by changes in market prices for oil and gas. To mitigate a portion of the exposure to adverse market changes, we have entered into various derivative instruments. As of September 30, 2005, our oil and gas derivative instruments were comprised of swaps, cap-swaps, basis protection swaps, call options and collars. These instruments allow us to predict with greater certainty the effective oil and gas prices to be received for our hedged production. Although derivatives often fail to achieve 100% effectiveness for accounting purposes, we believe our derivative instruments continue to be highly effective in achieving the risk management objectives for which they were intended.

- For swap instruments, Chesapeake receives a fixed price for the hedged commodity and pays a floating market price to the counterparty. The fixed-price payment and the floating-price payment are netted, resulting in a net amount due to or from the counterparty.

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

- For cap-swaps, Chesapeake receives a fixed price and pays a floating market price. The fixed price received by Chesapeake includes a premium in exchange for a “cap” limiting the counterparty’s exposure. In other words, there is no limit to Chesapeake’s exposure but there is a limit to the downside exposure of the counterparty.
  
- Basis protection swaps are arrangements that guarantee a price differential for oil or gas from a specified delivery point. Chesapeake receives a payment from the counterparty if the price differential is greater than the stated terms of the contract and pays the counterparty if the price differential is less than the stated terms of the contract.
  
- For call options, Chesapeake receives a cash premium from the counterparty in exchange for the sale of a call option. If the market price exceeds the fixed price of the call option, then Chesapeake pays the counterparty such excess. If the market price settles below the fixed price of the call option, no payment is due from Chesapeake.
  
- Collars contain a fixed floor price (put) and ceiling price (call). If the market price exceeds the call strike price or falls below the put strike price, Chesapeake receives the fixed price and pays the market price. If the market price is between the call and the put strike price, no payments are due from either party.

Chesapeake enters into counter-swaps from time to time for the purpose of locking-in the value of a swap. Under the counter-swap, Chesapeake receives a floating price for the hedged commodity and pays a fixed price to the counterparty. The counter-swap is 100% effective in locking-in the value of a swap since subsequent changes in the market value of the swap are entirely offset by subsequent changes in the market value of the counter-swap. We refer to this locked-in value as a locked swap. At the time Chesapeake enters into a counter-swap, Chesapeake removes the original swap’s designation as a cash flow hedge and classifies the original swap as a non-qualifying hedge under SFAS 133. The reason for this new designation is that collectively the swap and the counter-swap no longer hedge the exposure to variability in expected future cash flows. Instead, the swap and counter-swap effectively lock-in a specific gain (or loss) that will be unaffected by subsequent variability in oil and gas prices. Any locked-in gain or loss is recorded in accumulated other comprehensive income and reclassified to oil and gas sales in the month of related production.

With respect to counter-swaps that are designed to lock-in the value of cap-swaps, the counter-swap is effective in locking-in the value of the cap-swap until the floating price reaches the cap (or floor) stipulated in the cap-swap agreement. The value of the counter-swap will increase (or decrease), but in the opposite direction, as the value of the cap-swap decreases (or increases) until the floating price reaches the pre-determined cap (or floor) stipulated in the cap-swap agreement. However, because of the written put option embedded in the cap-swap, the changes in value of the cap-swap are not completely effective in offsetting changes in value of the corresponding counter-swap. Changes in the value of the cap-swaps and the counter-swaps are recorded as adjustments to oil and gas sales.

Chesapeake enters into derivatives from time to time for the purpose of converting a fixed price gas sales contract to a floating price. We refer to these contracts as floating-price swaps. For a floating-price swap, Chesapeake receives a floating market price from the counterparty and pays a fixed price.

In accordance with FASB Interpretation No. 39, to the extent that a legal right of setoff exists, Chesapeake nets the value of its derivative arrangements with the same counterparty in the accompanying condensed consolidated balance sheets.

Chesapeake enters into basis protection swaps for the purpose of locking-in a price differential for oil or gas from a specified delivery point. We currently have basis protection swaps covering four different delivery points which correspond to the actual prices we receive for much of our gas production. By entering into these basis protection swaps, we have effectively reduced our exposure to market changes in future gas price differentials. As of September 30, 2005, the fair value of our basis protection swaps was \$331.4 million. As of September 30, 2005,

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

our basis protection swaps cover approximately 44% of our anticipated remaining gas production in 2005, 25% in 2006, 23% in 2007, 20% in 2008 and 14% in 2009.

Gains or losses from derivative transactions are reflected as adjustments to oil and gas sales on the condensed consolidated statements of operations. Realized gains (losses) included in oil and gas sales were (\$122.6) million, (\$38.0) million, (\$126.6) million and (\$67.6) million in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively. Pursuant to SFAS 133, certain derivatives do not qualify for designation as cash flow hedges. Changes in the fair value of these non-qualifying derivatives that occur prior to their maturity (i.e., temporary fluctuations in value) are reported currently in the consolidated statements of operations as unrealized gains (losses) within oil and gas sales. Unrealized gains (losses) included in oil and gas sales were (\$104.0) million, (\$32.5) million, (\$137.1) million and (\$66.6) million, in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively.

Following provisions of SFAS 133, changes in the fair value of derivative instruments designated as cash flow hedges, to the extent they are effective in offsetting cash flows attributable to the hedged risk, are recorded in other comprehensive income until the hedged item is recognized in earnings. Any change in fair value resulting from ineffectiveness is recognized currently in oil and gas sales as unrealized gains (losses). We recorded a gain (loss) on ineffectiveness of (\$99.5) million, (\$1.8) million, (\$98.9) million and (\$17.0) million in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively.

The estimated fair values of our oil and gas derivative instruments as of September 30, 2005 and December 31, 2004 are provided below. The associated carrying values of these instruments are equal to the estimated fair values.

	<u>September 30,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
(\$ in thousands)		
Derivative assets (liabilities):		
Fixed-price gas swaps	\$(894,620)	\$ 57,073
Gas basis protection swaps	331,361	122,287
Fixed-price gas cap-swaps	(342,884)	(48,761)
Fixed-price gas counter-swaps	44,603	4,654
Gas call options	(36,618)	(5,793)
Fixed-price gas collars	(9,771)	(5,573)
Fixed-price gas locked swaps	(45,041)	(77,299)
Floating-price gas swaps	20,763	—
Fixed-price oil swaps	(35,176)	—
Fixed-price oil cap-swaps	(11,901)	(8,238)
	<u>                    </u>	<u>                    </u>
Estimated fair value	<u>\$(979,284)</u>	<u>\$ 38,350</u>

<sup>(a)</sup> After adjusting for the remaining \$23.8 million and \$3.2 million premium paid to Chesapeake by the counterparty, the cumulative unrealized loss related to these call options as of September 30, 2005 and December 31, 2004 was \$12.8 million and \$2.6 million, respectively.

Based upon the market prices at September 30, 2005, we expect to transfer approximately \$473.3 million (net of income taxes) of the loss included in the balance in accumulated other comprehensive income to earnings during the next 12 months when the transactions actually close. All transactions hedged as of September 30, 2005 are expected to mature by December 31, 2008, with the exception of our basis protection swaps which extend through 2009.

We have two secured hedging facilities, each of which permits us to enter into cash-settled natural gas and oil commodity transactions, valued by the counterparty, for up to \$500 million. The scheduled maturity date for these facilities is May 2010. Outstanding transactions under each facility are collateralized by certain of our oil and gas properties that do not secure any of our other obligations. One of the hedging facilities is subject to an annual fee of 0.30% of the maximum total capacity, and each of them has a 1.0% exposure fee, which is assessed quarterly on the

[Table of Contents](#)

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

average of the daily negative fair market value amounts, if any, during the quarter. As of September 30, 2005, the fair market value of the natural gas and oil hedging transactions was a liability of \$228.0 million under one of the facilities and a liability of \$116.5 million under the other facility. The hedging facilities contain the standard representations and default provisions that are typical of such agreements. The agreements also contain various restrictive provisions which govern the aggregate gas and oil production volumes that we are permitted to hedge under all of our agreements at any one time.

#### *Interest Rate Derivatives*

We utilize hedging strategies to manage our exposure to changes in interest rates. To the extent interest rate swaps have been designated as fair value hedges, changes in the fair value of the derivative instrument and the corresponding debt are reflected as adjustments to interest expense in the corresponding months covered by the derivative agreement. Changes in the fair value of derivative instruments not qualifying as fair value hedges are recorded currently as adjustments to interest expense.

As of September 30, 2005, the following interest rate swaps used to convert a portion of our long-term fixed-rate debt to floating-rate debt were outstanding:

<u>Term</u>	<u>Notional Amount</u>	<u>Fixed Rate</u>	<u>Floating Rate</u>	<u>Fair Value Gain (Loss)</u>
				(\$ in thousands)
September 2004 – August 2012	\$ 75,000,000	9.000%	6 month LIBOR plus 452 basis points	\$ (2,129)
July 2005 – January 2015	\$150,000,000	7.750%	6 month LIBOR plus 289 basis points	\$ (3,582)
July 2005 – June 2014	\$150,000,000	7.500%	6 month LIBOR plus 282 basis points	\$ (3,734)
September 2005 – August 2014	\$250,000,000	7.000%	6 month LIBOR plus 205.5 basis points	\$ (2,470)

Subsequent to September 30, 2005, we entered into the following interest rate swaps (which qualify as fair value hedges) to convert a portion of our long-term fixed-rate debt to floating-rate debt:

<u>Term</u>	<u>Notional Amount</u>	<u>Fixed Rate</u>	<u>Floating Rate</u>
October 2005 – January 2018	\$250,000,000	6.250%	6 month LIBOR plus 99 basis points
October 2005 – June 2015	\$200,000,000	6.375%	6 month LIBOR plus 112 basis points
October 2005 – January 2016	\$200,000,000	6.625%	6 month LIBOR plus 129 basis points

In the Current Quarter and Current Period, we closed various interest rate swaps for gains totaling \$2.0 million and \$7.1 million, respectively. These interest rate swaps were designated as fair value hedges, and the settlement amounts received will be amortized as a reduction to realized interest expense over the remaining terms of the related senior notes.

In March 2004, Chesapeake entered into an interest rate swap which required Chesapeake to pay a fixed rate of 8.68% while the counterparty paid Chesapeake a floating rate of six month LIBOR plus 0.75% on a notional amount of \$142.7 million. On March 15, 2005, we elected to terminate the interest rate swap and paid \$31.8 million to the counterparty.

#### *Fair Value of Financial Instruments*

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of Statement of Financial Accounting Standards No. 107, *Disclosures About Fair Value of Financial Instruments*. We have determined the estimated fair values by using available market information and valuation methodologies. Considerable judgment is required in interpreting market data to develop the estimates of fair value. The use of different market assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

The carrying values of items comprising current assets and current liabilities approximate fair values due to the short-term maturities of these instruments. We estimate the fair value of our long-term fixed-rate debt using primarily quoted market prices. Our carrying amounts for such debt, excluding discounts or premiums related to interest rate derivatives, at September 30, 2005 and December 31, 2004 were \$4.251 billion and \$3.014 billion, respectively, compared to approximate fair values of \$4.444 billion and \$3.281 billion, respectively. The carrying amounts for our convertible preferred stock as of September 30, 2005 and December 31, 2004 were \$1.047 billion and \$490.9 million, respectively, compared to approximate fair values of \$1.197 billion and \$533.7 million, respectively.

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

*Concentration of Credit Risk*

A significant portion of our liquidity is concentrated in derivative instruments that enable us to hedge a portion of our exposure to price volatility from producing oil and natural gas. These arrangements expose us to credit risk from our counterparties. Other financial instruments which potentially subject us to concentrations of credit risk consist principally of investments in equity instruments and accounts receivable. Our accounts receivable are primarily from purchasers of oil and natural gas products and exploration and production companies which own interests in properties we operate. This industry concentration has the potential to impact our overall exposure to credit risk, either positively or negatively, in that our customers may be similarly affected by changes in economic, industry or other conditions. We generally require letters of credit for receivables from customers which are judged to have sub-standard credit, unless the credit risk can otherwise be mitigated.

**3. Contingencies and Commitments**

*Litigation*

Chesapeake is currently involved in various disputes incidental to its business operations. Management, after consultation with legal counsel, is of the opinion that the final resolution of all currently pending or threatened litigation is not likely to have a material adverse effect on our consolidated financial position, results of operations or cash flows.

*Employment Agreements with Officers*

Chesapeake has employment agreements with its chief executive officer, chief operating officer, chief financial officer and various other senior management personnel, which provide for annual base salaries, bonus compensation and various benefits. The agreements provide for the continuation of salary and benefits for varying terms in the event of termination of employment without cause. The agreements with the chief executive officer and chief operating officer have terms of five years commencing July 1, 2005. The term of each agreement is automatically extended for one additional year on each January 31 unless the company provides 30 days notice of non-extension. The agreements with the chief financial officer and other senior managers expire on September 30, 2006. The company's employment agreements with the executive officers provide for the following payments in the event of a change in control. The chief executive officer and chief operating officer are each entitled to receive a payment in the amount of three times his base salary, the prior year's bonus compensation and the value of benefits provided during the prior year, plus a tax gross-up payment, and the chief financial officer and other officers are each entitled to receive a payment in the amount of two times his or her base salary and bonuses paid during the prior year.

*Environmental Risk*

Due to the nature of the oil and gas business, Chesapeake and its subsidiaries are exposed to possible environmental risks. Chesapeake has implemented various policies and procedures to avoid environmental contamination and risks from environmental contamination. Chesapeake conducts periodic reviews, on a company-wide basis, to identify changes in our environmental risk profile. These reviews evaluate whether there is a contingent liability, its amount, and the likelihood that the liability will be incurred. The amount of any potential liability is determined by considering, among other matters, incremental direct costs of any likely remediation and the proportionate cost of employees who are expected to devote a significant amount of time directly to any possible remediation effort. We manage our exposure to environmental liabilities on properties to be acquired by identifying existing problems and assessing the potential liability. Depending on the extent of an identified environmental problem, Chesapeake may exclude a property from the acquisition, require the seller to remediate the property to our satisfaction, or agree to assume liability for the remediation of the property. Chesapeake has historically not experienced any significant environmental liability, and is not aware of any potential material environmental issues or claims at September 30, 2005.

*Other Commitments*

Chesapeake's wholly owned subsidiary, Nomac Drilling Company, as of September 30, 2005, had contracted to acquire 26 rigs to be constructed during 2005 and 2006. The total cost of the rigs will be approximately \$226 million.

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

On September 16, 2005, Chesapeake executed a letter of intent to purchase approximately \$75 million of new common shares from Gastar Exploration Ltd., acquire certain Gastar leasehold interests for \$8.6 million and form an area of mutual interest with Gastar. This transaction is expected to close in the fourth quarter of 2005.

On September 30, 2005, we agreed to acquire Columbia Energy Resources, LLC and its subsidiaries, including Columbia Natural Resources, LLC (CNR) for \$2.2 billion in cash, subject to closing adjustments, and the assumption of certain CNR liabilities. This pending transaction is described in more detail in Note 9.

**4. Net Income Per Share**

Statement of Financial Accounting Standards No. 128, *Earnings Per Share*, requires presentation of “basic” and “diluted” earnings per share, as defined, on the face of the statements of operations for all entities with complex capital structures. SFAS 128 requires a reconciliation of the numerator and denominator of the basic and diluted EPS computations.

The following securities were not included in the calculation of diluted earnings per share, as the effect was antidilutive:

- For the Current Quarter, the Prior Quarter, Current Period and Prior Period, outstanding options to purchase 0.1 million, 0.2 million, 0.1 million and 0.1 million shares of common stock at a weighted-average exercise price of \$30.59, \$22.72, \$29.85 and \$23.58, respectively, were antidilutive because the exercise prices of the options were greater than the average market price of the common stock during the respective periods.
  
- For the Current Quarter and the Current Period, diluted shares do not include the common stock equivalent of 4.125% preferred stock outstanding prior to conversion (convertible into 3,913,918 and 8,403,579 shares, respectively) as the effect was antidilutive, and the preferred stock adjustments to net income do not include \$14.7 million and \$22.9 million, respectively, of dividends and loss on conversion/exchange related to these preferred shares.
  
- For the Current Quarter and the Current Period, diluted shares do not include the common stock equivalent of 5.0% preferred stock (Series 2003) outstanding prior to conversion (convertible into 3,603,567 and 4,034,450 shares, respectively) as the effect was antidilutive, and the preferred stock adjustments to net income do not include \$4.0 million and \$5.8 million, respectively, of dividends and loss on conversion/exchange related to these preferred shares.
  
- For the Current Quarter and the Current Period, diluted shares do not include the common stock equivalent of 4.5% preferred stock (convertible into 1,443,236 and 486,365 shares, respectively) as the effect was antidilutive, and the preferred stock adjustments to net income do not include \$0.7 million and \$0.7 million, respectively, of dividends related to these preferred shares.

During the Current Period, holders of our 4.125% preferred stock converted 178,675 shares into 11,441,008 shares of common stock. During the fourth quarter, holders will be permitted to surrender shares of our 4.125% preferred stock for conversion into shares of our common stock because the closing sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on September 30, 2005 was more than 130% of the conversion price on such trading day.

Also, during the Current Period, we exchanged 697,724 shares of our outstanding 5.0% (Series 2003) preferred stock for 4,354,439 shares of common stock and holders of our 6.0% preferred stock converted 1,835 shares into 8,918 shares of common stock.

In April 2005, we issued 4,600,000 shares of 5.00% (Series 2005) cumulative convertible preferred stock, par value \$0.01 per share and liquidation preference \$100 per share, in a private offering for net proceeds of \$447.2 million.

In September 2005, we issued 3,450,000 shares of 4.50% cumulative convertible preferred stock, par value \$0.01 per share and liquidation preference \$100 per share, in a public offering for net proceeds of \$335.2 million.

In September 2005, we issued 9,200,000 shares of Chesapeake common stock at \$32.72 per share in a public offering for net proceeds of \$289.4 million.



[Table of Contents](#)

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

Reconciliations for the three months ended September 30, 2005 and 2004 and the nine months ended September 30, 2005 and 2004 are as follows:

	<u>Income (Numerator)</u>	<u>Shares (Denominator)</u>	<u>Per Share Amount</u>
(\$ in thousands, except per share data)			
<b>For the Three Months Ended September 30, 2005:</b>			
Basic EPS:			
Income available to common shareholders	\$149,059	322,101	\$ 0.46
<b>Effect of Dilutive Securities</b>			
Assumed conversion as of the beginning of the period of preferred shares outstanding during the period:			
Common shares assumed issued for 4.125% convertible preferred stock	—	8,082	
Common shares assumed issued for 5.00% convertible preferred stock (series 2003)	—	6,262	
Common shares assumed issued for 6.00% convertible preferred stock	—	492	
Common shares assumed issued for 5.00% convertible preferred stock (series 2005)	—	17,853	
Preferred stock dividends	8,498	—	
Employee stock options	—	11,006	
Restricted stock	—	1,843	
<b>Diluted EPS Income available to common shareholders and assumed conversions</b>	<b>\$157,557</b>	<b>367,639</b>	<b>\$ 0.43</b>
<b>For the Three Months Ended September 30, 2004:</b>			
Basic EPS:			
Income available to common shareholders	\$ 85,585	257,096	\$ 0.33
<b>Effect of Dilutive Securities</b>			
Assumed conversion as of the beginning of the period of preferred shares outstanding during the period:			
Common shares assumed issued for 5.00% convertible preferred stock (series 2003)	—	10,516	
Common shares assumed issued for 6.00% convertible preferred stock	—	22,358	
Common shares assumed issued for 6.75% convertible preferred stock	—	17,625	
Common shares assumed issued for 4.125% convertible preferred stock	—	18,812	
Common stock equivalent of preferred stock outstanding prior to conversion, 6.75% convertible preferred stock	—	1,621	
Preferred stock dividends	11,287	—	
Employee stock options	—	9,992	
Restricted stock	—	249	
Warrants assumed in Gothic acquisition	—	16	
<b>Diluted EPS Income available to common shareholders and assumed conversions</b>	<b>\$ 96,872</b>	<b>338,285</b>	<b>\$ 0.29</b>
<b>For the Nine Months Ended September 30, 2005:</b>			
Basic EPS:			
Income available to common shareholders	\$447,783	314,425	\$ 1.42
<b>Effect of Dilutive Securities</b>			
Assumed conversion as of the beginning of the period of preferred shares outstanding during the period:			
Common shares assumed issued for 4.125% convertible preferred stock	—	8,082	
Common shares assumed issued for 5.00% convertible preferred stock (series 2003)	—	6,262	
Common shares assumed issued for 6.00% convertible preferred stock	—	492	
Common shares assumed issued for 5.00% convertible preferred stock (series 2005)	—	10,739	
Common stock equivalent of preferred stock outstanding prior to conversion, 6.00% convertible preferred stock	—	5	
Preferred stock dividends	18,546	—	
Employee stock options	—	10,810	
Restricted stock	—	1,382	
Warrants assumed in Gothic acquisition	—	13	
<b>Diluted EPS Income available to common shareholders and assumed conversions</b>	<b>\$466,329</b>	<b>352,210</b>	<b>\$ 1.32</b>

[Table of Contents](#)

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

	<u>Income</u> <u>(Numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Per</u> <u>Share</u> <u>Amount</u>
(\$ in thousands, except per share data)			
<b>For the Nine Months Ended September 30, 2004:</b>			
Basic EPS:			
Income available to common shareholders	\$275,818	245,087	\$ 1.13
<b>Effect of Dilutive Securities</b>			
Assumed conversion as of the beginning of the period of preferred shares outstanding during the period:			
Common shares assumed issued for 5.00% convertible preferred stock (series 2003)	—	10,516	
Common shares assumed issued for 6.00% convertible preferred stock	—	22,358	
Common shares assumed issued for 6.75% convertible preferred stock	—	17,625	
Common shares assumed issued for 4.125% convertible preferred stock	—	12,651	
Common stock equivalent of preferred stock outstanding prior to conversion, 6.75% convertible preferred stock	—	1,774	
Preferred stock dividends	30,799	—	
Employee stock options	—	9,927	
Restricted stock	—	142	
Warrants assumed in Gothic acquisition	—	9	
<b>Diluted EPS Income available to common shareholders and assumed conversions</b>	<b>\$306,617</b>	<b>320,089</b>	<b>\$ 0.96</b>

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

**5. Senior Notes and Revolving Bank Credit Facility**

Our long-term debt consisted of the following as of September 30, 2005 and December 31, 2004:

	<b>September 30, 2005</b>	<b>December 31, 2004</b>
	(\$ in thousands)	
8.375% Senior Notes due 2008	\$ 7,990	\$ 18,990
8.125% Senior Notes due 2011	—	245,407
9.0% Senior Notes due 2012	—	300,000
7.5% Senior Notes due 2013	363,823	363,823
7.0% Senior Notes due 2014	300,000	300,000
7.5% Senior Notes due 2014	300,000	300,000
7.75% Senior Notes due 2015	300,408	300,408
6.375% Senior Notes due 2015	600,000	600,000
6.625% Senior Notes due 2016	600,000	—
6.875% Senior Notes due 2016	670,437	670,437
6.5% Senior Notes due 2017	600,000	—
6.25% Senior Notes due 2018	600,000	—
Revolving bank credit facility	—	59,000
Discount on senior notes	(91,357)	(84,924)
Premium (discount) for interest rate derivatives <sup>(a)</sup>	(1,141)	1,968
<b>Total senior notes and long-term debt</b>	<b>\$ 4,250,160</b>	<b>\$ 3,075,109</b>

<sup>(a)</sup> See note 2 for further discussion related to these instruments.

On November 1, 2005, we redeemed the 8.375% Senior Notes due 2008 for \$8.3 million. No scheduled principal payments are required until 2013 when \$363.8 million is due.

[Table of Contents](#)

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

During the periods covered by this report, we redeemed, repurchased or exchanged Chesapeake debt through various private and public transactions. The following table sets forth the losses we incurred in connection with these transactions (\$ in millions):

	Loss on Repurchases/Exchanges			
	Notes Retired	Premium	Other <sup>(a)</sup>	Total
<b>For the Three Months Ended September 30, 2005:</b>				
8.125% Senior Notes due 2011	\$ 7.6	\$ 0.5	\$ 0.1	\$ 0.6
9.0% Senior Notes due 2012	1.1	0.1	0.0	0.1
	<u>\$ 8.7</u>	<u>\$ 0.6</u>	<u>\$ 0.1</u>	<u>\$ 0.7</u>
<b>For the Nine Months Ended September 30, 2005:</b>				
8.375% Senior Notes due 2008	\$ 11.0	\$ 0.8	\$ 0.1	\$ 0.9
8.125% Senior Notes due 2011	245.4	17.3	4.4	21.7
9.0% Senior Notes due 2012	300.0	41.4	6.0	47.4
	<u>\$556.4</u>	<u>\$59.5</u>	<u>\$10.5</u>	<u>\$70.0</u>
<b>For the Nine Months Ended September 30, 2004:</b>				
7.875% Senior Notes due 2004	\$ 42.1	\$ —	\$ —	\$ —
8.5% Senior Notes due 2012	4.3	0.2	0.7	0.9
8.125% Senior Notes due 2011	482.8	—	6.0	6.0
7.75% Senior Notes due 2015	9.1	—	—	—
	<u>\$538.3</u>	<u>\$ 0.2</u>	<u>\$ 6.7</u>	<u>\$ 6.9</u>

<sup>(a)</sup> Includes the write-off of unamortized discounts, deferred charges, transaction costs and derivative charges.

There were no repurchases or exchanges of Chesapeake debt in the Prior Quarter.

The senior note indentures permit us to redeem the senior notes at any time at specified make-whole or redemption prices. The indentures (other than the indenture governing the 6.5% Senior Notes due 2017) contain covenants limiting our ability and our restricted subsidiaries' ability to incur additional indebtedness; pay dividends on our capital stock or redeem, repurchase or retire our capital stock or subordinated indebtedness; make investments and other restricted payments; incur liens; engage in transactions with affiliates; sell assets and consolidate, merge or transfer assets.

Chesapeake is a holding company and owns no operating assets and has no significant operations independent of its subsidiaries. Our obligations under our outstanding senior notes have been fully and unconditionally guaranteed, on a joint and several basis, by all of our wholly owned subsidiaries.

We have a \$1.25 billion syndicated revolving bank credit facility which matures in January 2010. As of September 30, 2005, we had no outstanding borrowings under our facility and utilized \$80.1 million of the facility for various letters of credit. Borrowings under our facility are collateralized by certain producing oil and gas properties and bear interest at either (i) the greater of the reference rate of Union Bank of California, N.A. or the federal funds effective rate plus 0.50% or (ii) the London Interbank Offered Rate (LIBOR), at our option, plus a margin that varies according to our senior unsecured long-term debt ratings. The collateral value and borrowing base are determined periodically. The unused portion of the facility is subject to an annual commitment fee that also varies according to our senior unsecured long-term debt ratings. Currently, the annual commitment fee rate is 0.30%. Interest is payable quarterly or, if LIBOR applies, it may be payable at more frequent intervals.

The credit facility agreement contains various covenants and restrictive provisions which govern our ability to incur additional indebtedness, sell properties, purchase or redeem our capital stock, make investments or loans, and create liens. The credit facility agreement requires us to maintain a fixed charge coverage ratio (as defined) of at

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

least 2.5 to 1 and an indebtedness to EBITDA ratio (as defined) not to exceed 3.5 to 1. At September 30, 2005, our fixed charge coverage ratio was 6.24 to 1 and our indebtedness to EBITDA ratio was 2.03 to 1. If we should fail to perform our obligations under these and other covenants, the revolving credit commitment could be terminated and any outstanding borrowings under the facility could be declared immediately due and payable. Such acceleration, if involving a principal amount of \$10 million (\$50 million in the case of our 6.625% Senior Notes due 2016, 6.25% Senior Notes due 2018 and 6.5% Senior Notes due 2017), would constitute an event of default under our senior note indentures which could in turn result in the acceleration of a significant portion of our senior note indebtedness. The credit facility agreement also has cross default provisions that apply to other indebtedness we may have with an outstanding principal amount in excess of \$50 million.

Our subsidiary, Chesapeake Exploration Limited Partnership, is the borrower under our revolving bank credit facility. The facility is guaranteed by Chesapeake and all of our other wholly owned subsidiaries.

### 6. Segment Information

In accordance with Statement of Financial Accounting Standards No. 131, *Disclosures about Segments of an Enterprise and Related Information*, we have identified two reportable operating segments. These segments are managed separately because of the nature of their products and services. Chesapeake's two segments are the exploration and production segment and the marketing segment. The exploration and production segment is responsible for finding and producing natural gas and crude oil. The marketing segment is responsible for gathering, processing, transporting, and selling natural gas and crude oil production primarily from Chesapeake operated wells. Revenues from the marketing segment's sale of oil and gas related to Chesapeake's ownership interests are reflected as exploration and production revenues. Such amounts totaled \$617.4 million and \$349.6 million for the Current Quarter and the Prior Quarter, respectively, and \$1.487 billion and \$932.0 million for the Current Period and the Prior Period, respectively.

Management evaluates the performance of our segments based upon income before income taxes.

	<u>Exploration and Production</u>	<u>Marketing</u>	<u>Consolidated</u>
<b>For the Three Months Ended September 30, 2005:</b>			
Revenues	\$ 720,928	\$ 361,915	\$ 1,082,843
Income before income taxes	271,835	6,887	278,722
<b>For the Three Months Ended September 30, 2004:</b>			
Revenues	\$ 450,936	\$ 178,860	\$ 629,796
Income (loss) before income taxes	151,714	(353)	151,361
<b>For the Nine Months Ended September 30, 2005:</b>			
Revenues	\$ 2,032,271	\$ 882,040	\$ 2,914,311
Income before income taxes	764,200	16,554	780,754
<b>For the Nine Months Ended September 30, 2004:</b>			
Revenues	\$ 1,270,394	\$ 496,823	\$ 1,767,217
Income before income taxes	478,127	960	479,087
<b>As of September 30, 2005:</b>			
Total assets	\$ 11,813,195	\$ 552,434	\$ 12,365,629
<b>As of December 31, 2004:</b>			
Total assets	\$ 7,926,263	\$ 318,246	\$ 8,244,509

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

**7. Acquisitions**

The following table describes significant acquisitions that we completed in the Current Period (\$ in millions):

Quarter	Acquisition	Location	Amount
First	BRG Petroleum Corporation	Mid-Continent and Ark-La-Tex	\$ 325 <sup>(a)</sup>
	Laredo Energy II, L.L.C.	South Texas	228
	Other	Various	89 <sup>(b)</sup>
Second	Houston-based oil and gas company	Texas Gulf Coast/South Texas	202
	Pecos Production Company	Permian	198
	Laredo II Partners	Texas Gulf Coast/South Texas	139
	Dallas-based oil and gas company	Ark-La-Tex	85
	Midland-based oil and gas company	Permian	38
	Other	Various	65
Third	Hallwood Energy III, L.P.	Barnett Shale	250 <sup>(c)</sup>
	Corpus Christi-based oil and gas company	Ark-La-Tex	95
	Other	Various	116
			<b>\$ 1,830</b>

<sup>(a)</sup> We paid \$16.3 million of the purchase amount in 2004.

<sup>(b)</sup> During the Current Period, we paid the remaining \$57 million of the purchase price related to an acquisition transaction with Hallwood Energy Corporation in the fourth quarter of 2004.

<sup>(c)</sup> Includes \$15 million related to gathering systems which was allocated to other property and equipment.

During the Current Period, we have recorded approximately \$253 million of deferred tax liability to reflect the tax effect of the cost paid in excess of the tax basis acquired on certain corporate acquisitions.

**8. Recently Issued Accounting Standards**

The Financial Accounting Standards Board recently issued the following standards which were reviewed by Chesapeake to determine the potential impact on our financial statements upon adoption.

In December 2004, the Financial Accounting Standards Board issued SFAS 123(R), *Share-Based Payment*, a revision of SFAS 123, *Accounting for Stock-Based Compensation*. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services by requiring a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This statement is effective as of the beginning of the first annual reporting period that begins after June 15, 2005. The effect of SFAS 123 (R) is more fully described in Note 1.

In March 2005, the FASB issued FASB Interpretation No. (FIN) 47, *Accounting for Conditional Asset Retirement Obligations*. FIN 47 specifies the accounting treatment for conditional asset retirement obligations under the provisions of Statement of Financial Accounting Standards No. 143. FIN 47 is effective no later than the end of the fiscal year ending after December 15, 2005. We plan to adopt this statement effective December 31, 2005. Implementation of FIN 47 is not expected to have a material effect on our financial statements.

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

**9. Subsequent Events**

On September 30, 2005, Chesapeake agreed to acquire Columbia Energy Resources, LLC and its subsidiaries, including Columbia Natural Resources, LLC, (CNR) for \$2.2 billion in cash, subject to closing adjustments. Chesapeake will assume certain CNR liabilities, the final calculation of which is dependent upon natural gas prices on the day of the closing, among other things. CNR's primary assets are Appalachian Basin proved natural gas reserves, unevaluated oil and gas leasehold interests and natural gas gathering systems. The closing is expected to occur by December 1, 2005. Chesapeake plans to finance the acquisition through proceeds from debt and equity offerings, borrowings under its revolving bank credit facility and, if needed, a bridge loan.

PART I. FINANCIAL INFORMATION

ITEM 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

Overview

The following table sets forth certain information regarding the production volumes, oil and gas sales, average sales prices received and expenses for the three and nine months ended September 30, 2005 (the "Current Quarter" and the "Current Period") and the three and nine months ended September 30, 2004 (the "Prior Quarter" and the "Prior Period"):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2005	2004	2005	2004
<b>Net Production:</b>				
Oil (m bbl)	1,926	1,834	5,684	4,972
Gas (mmcf)	108,801	83,219	304,060	229,827
Gas equivalent (mmcfe)	120,357	94,223	338,164	259,659
<b>Oil and Gas Sales (\$ in thousands):</b>				
Oil sales	\$ 113,590	\$ 73,921	\$ 290,332	\$ 181,882
Oil derivatives – realized gains (losses)	(10,937)	(20,464)	(28,654)	(41,672)
Oil derivatives – unrealized gains (losses)	(4,009)	(14,436)	(5,951)	(21,925)
Total oil sales	98,644	39,021	255,727	118,285
Gas sales	833,992	447,466	2,005,670	1,222,783
Gas derivatives – realized gains (losses)	(111,668)	(17,514)	(97,955)	(25,976)
Gas derivatives – unrealized gains (losses)	(100,040)	(18,037)	(131,171)	(44,698)
Total gas sales	622,284	411,915	1,776,544	1,152,109
Total oil and gas sales	\$ 720,928	\$ 450,936	\$ 2,032,271	\$ 1,270,394
<b>Average Sales Price (excluding all gains (losses) on derivatives):</b>				
Oil (\$ per bbl)	\$ 58.98	\$ 40.31	\$ 51.08	\$ 36.58
Gas (\$ per mcf)	\$ 7.67	\$ 5.38	\$ 6.60	\$ 5.32
Gas equivalent (\$ per mcfe)	\$ 7.87	\$ 5.53	\$ 6.79	\$ 5.41
<b>Average Sales Price (excluding unrealized gains (losses) on derivatives):</b>				
Oil (\$ per bbl)	\$ 53.30	\$ 29.15	\$ 46.04	\$ 28.20
Gas (\$ per mcf)	\$ 6.64	\$ 5.17	\$ 6.27	\$ 5.21
Gas equivalent (\$ per mcfe)	\$ 6.85	\$ 5.13	\$ 6.42	\$ 5.15
<b>Expenses (\$ per mcfe):</b>				
Production expenses	\$ 0.67	\$ 0.57	\$ 0.66	\$ 0.57
Production taxes	\$ 0.44	\$ 0.33	\$ 0.40	\$ 0.26
General and administrative expenses:				
General and administrative expenses (excluding stock-based compensation)	\$ 0.09	\$ 0.09	\$ 0.09	\$ 0.09
Stock-based compensation	\$ 0.04	\$ 0.01	\$ 0.03	\$ 0.01
Oil and gas depreciation, depletion and amortization	\$ 1.92	\$ 1.63	\$ 1.84	\$ 1.58
Depreciation and amortization of other assets	\$ 0.11	\$ 0.08	\$ 0.10	\$ 0.08
Interest expense	\$ 0.48	\$ 0.45	\$ 0.47	\$ 0.46
<b>Interest Expense (\$ in thousands):</b>				
Interest expense	\$ 58,206	\$ 42,258	\$ 160,209	\$ 118,335
Interest rate derivatives – realized (gains) losses	(843)	221	(2,639)	(184)
Interest rate derivatives – unrealized (gains) losses	1,230	6,210	(1,947)	5,889
Total interest expense	\$ 58,593	\$ 48,689	\$ 155,623	\$ 124,040
<b>Net Wells Drilled</b>	218	181	583	420
<b>Net Producing Wells as of the End of the Period</b>	9,313	7,838	9,313	7,838

(a) The Prior Period includes a pre-tax benefit of \$6.8 million, or \$0.03 per mcfe, from prior period severance tax credits.

(b) Includes the effects of realized gains (losses) from hedging, but does not include the effects of unrealized gains (losses) from hedging.



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## Table of Contents

Chesapeake is the third largest independent producer of natural gas in the U.S. and we own interests in approximately 22,000 producing oil and gas wells. Our strategy is focused on discovering, developing and acquiring onshore natural gas reserves in the southwestern U.S. and in the Appalachian Basin in the eastern U.S. Specific areas of operating focus include the Mid-Continent region of the United States, which includes Oklahoma, Arkansas, Kansas and the Texas Panhandle, the South Texas and Texas Gulf Coast regions, the Permian Basin of West Texas and eastern New Mexico, the Barnett Shale area of north-central Texas and the Ark-La-Tex area of East Texas and northern Louisiana. Following our pending acquisition of Columbia Energy Resources, LLC and its subsidiaries, including Columbia Natural Resources, LLC (CNR) as described below, we will also have a significant presence in the Appalachian Basin, principally in West Virginia, eastern Kentucky, eastern Ohio and southern New York.

Our revenues, operating results, profitability and future growth depend on our ability to find, develop and acquire oil and gas reserves that are economically recoverable based on prevailing prices for natural gas and oil. We favor gas over oil, strive to establish regional dominance in our operating areas, have grown through a combination of drilling and acquisitions and manage price risk through opportunistic oil and natural gas hedging. Chesapeake has built what it believes to be the largest inventories of onshore leasehold (8.0 million net acres) and 3-D seismic (11.0 million net acres) in the U.S. (pro forma for the pending CNR acquisition). On this leasehold, we have identified more than a 10-year inventory of approximately 25,000 drillsites on which we believe we can develop approximately 2.6 tcf of proved undeveloped reserves.

Oil and natural gas production for the Current Quarter was 120.4 bcf, an increase of 26.2 bcf, or 28%, over the 94.2 bcf produced in the Prior Quarter. We have increased our production for 17 consecutive quarters. During these 17 quarters, Chesapeake's U.S. production has increased 234%, for an average compound quarterly growth rate of 7.4% and an average compound annual growth rate of 32.8%.

In addition to increased oil and natural gas production, the prices we received were higher in the Current Quarter than in the Prior Quarter. On a natural gas equivalent basis, weighted average prices (excluding the effect of unrealized gains or losses on derivatives) were \$6.85 per mcf in the Current Quarter compared to \$5.13 per mcf in the Prior Quarter. The increase in prices resulted in an increase in revenue of \$207.5 million, and increased production resulted in an increase in revenue of \$134.1 million, for a total increase in revenue of \$341.6 million (excluding the effect of unrealized gains or losses on derivatives). In each of the operating areas where Chesapeake sells its oil and natural gas, established marketing and transportation infrastructures exist thereby contributing to relatively high wellhead price realizations for our production.

During the Current Quarter, Chesapeake drilled 241 (186 net) operated wells and participated in another 278 (32 net) wells operated by other companies. The company's drilling success rate was 97% for both operated wells and non-operated wells. During the Current Quarter, Chesapeake invested \$390.2 million in operated wells (using an average of 72 operated rigs), \$74.3 million in non-operated wells (using an average of approximately 65 non-operated rigs) and \$91.3 million in acquiring new 3-D seismic data and new leasehold (excluding leasehold acquired through acquisitions). Our acquisition expenditures totaled \$489.1 million during the Current Quarter (including amounts paid for unproved leasehold and excluding \$1.5 million of deferred taxes in connection with certain corporate acquisitions).

Chesapeake began 2005 with estimated proved reserves of 4,902 bcf and, based on internal estimates, ended the Current Quarter with 6,213 bcf, an increase of 1,311 bcf, or 27%. During the Current Period, we replaced 338 bcf of production with an estimated 1,649 bcf of new proved reserves, for a reserve replacement rate of 488%. Reserve replacement through the drillbit was 929 bcf, or 275% of production (including a negative 19 bcf from performance revisions and a positive 94 bcf from oil and natural gas price increases), or 56% of the total increase. Reserve replacement through acquisitions was 720 bcf, or 213% of production, or 44% of the total increase.

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## [Table of Contents](#)

On September 30, 2005, we agreed to acquire CNR for \$2.2 billion in cash, plus assumed liabilities, the final calculation of which are subject to closing adjustments and natural gas prices on the day of closing. With the CNR acquisition, we will add approximately 1.1 tcf of proved reserves, based on our internal estimates, and 3.5 million net oil and gas leasehold acres in the Appalachian Basin. The CNR proved reserves are 99% natural gas and 70% proved developed. We expect to finance the acquisition through the issuance of a combination of debt and equity securities and borrowings under our revolving credit facility and, if needed, a bridge loan. The closing is expected to occur before December 1, 2005 although there is no assurance that the acquisition will close, or close without material adjustment.

We have taken several actions to mitigate higher field service costs, ensure our timely access to drilling rigs and participate in service industry growth. Through our wholly owned subsidiary Nomac Drilling Corporation, we have 14 rigs dedicated to drilling Chesapeake-operated wells and we have an additional 26 rigs on order for delivery over the next year. In addition, we have entered into drilling contracts for the use of approximately 20 rigs that have been or are being built or refurbished by private drilling companies, to be available to us in 2005 and 2006. We also have invested approximately \$43 million in the common stock of publicly held Pioneer Drilling Company over the past two years, and now hold approximately 17% of its outstanding common stock. At September 30, 2005, our Pioneer shares had a market value of \$150.3 million. During the Current Period, we invested \$15 million in the common stock of DHS Drilling Company, Inc., a Wyoming-based drilling company which has 8 rigs operating in the Rocky Mountains and which will expand to 11 rigs over the next several months. At September 30, 2005, our ownership percentage was approximately 45%. During the Current Period, we also acquired a 49% interest in Mountain Drilling Company, a newly formed venture with a New York-based investment banking firm in which Chesapeake and its partner have each invested \$25 million to secure four specialty rigs for drilling in urban areas or in areas of special environmental sensitivity.

As of September 30, 2005, the company's debt as a percentage of total capitalization (total capitalization is the sum of debt and stockholders' equity) was 50%, compared to 49% as of December 31, 2004. During the Current Period, we received net proceeds of \$2.837 billion through issuances of \$805 million of preferred equity, \$301 million of common equity, and \$1.800 billion principal amount of senior notes. We issued 15,804,365 shares of common stock in exchange for outstanding shares of our 4.125% and 5.0% (Series 2003) preferred stock and upon conversions of our 6.0% preferred stock. Additionally, we purchased and retired \$556.4 million principal amount of outstanding senior notes during the Current Period. As a result of our debt transactions during the Current Period, we have extended the average maturity of our long-term debt to over ten years and have lowered our average interest rate to approximately 6.8%.

We intend to continue to focus on improving the strength of our balance sheet. We believe our business strategy and operational performance will lead to an investment grade credit rating for our unsecured debt in the future.

## **Liquidity and Capital Resources**

### *Sources of Liquidity*

Our primary source of liquidity to meet operating expenses and fund capital expenditures (other than for certain acquisitions) is cash flow from operations. Based on our current production, price and expense assumptions, we expect cash flow from operations will exceed our drilling capital expenditures in 2005. Our budget for drilling, land and seismic activities during 2005 is currently between \$2.0 billion and \$2.2 billion. We believe this level of exploration and development will be sufficient to increase our reserves in 2005 and achieve our goal of a 10% to 20% increase in production over 2004 production (inclusive of acquisitions completed or scheduled to close in 2005 through the filing date of this report but without regard to any additional acquisitions that may be completed in 2005). However, higher drilling and field operating costs, drilling results that alter planned development schedules, acquisitions or other factors could cause us to revise our drilling program, which is largely discretionary. Any cash flow from operations not needed to fund our drilling program will be available for acquisitions, debt repayment or other general corporate purposes in 2005.

## Table of Contents

Cash provided by operating activities (exclusive of changes in assets and liabilities) was \$1.654 billion in the Current Period compared to \$995.1 million in the Prior Period. The \$658.9 million increase was primarily due to higher realized prices and higher volumes of oil and gas production. We expect that 2005 production volumes will be higher than in 2004 and that cash provided by operating activities in 2005 will exceed 2004 levels. While a precipitous decline in gas prices in the remainder of 2005 would significantly affect the amount of cash flow that would be generated from operations, we have 55% of our expected oil production for the fourth quarter of 2005 hedged at an average NYMEX price of \$54.97 per barrel of oil and 73% of our expected natural gas production for the fourth quarter of 2005 hedged at an average NYMEX price of \$8.14 per mcf. This level of hedging provides greater certainty of the cash flow we will receive for a substantial portion of our remaining 2005 production. Depending on changes in oil and gas futures markets and management's view of underlying oil and natural gas supply and demand trends, however, we may increase or decrease our current hedging positions.

Based on fluctuations in natural gas and oil prices, our hedging counterparties may require us to deliver cash collateral or other assurances of performance from time to time. At September 30, 2005 and October 31, 2005, we had issued \$77.0 million and \$68.0 million, respectively, of letters of credit securing our performance of hedging contracts. To mitigate the liquidity impact of those collateral requirements, we have negotiated caps on the amount of collateral that we might be required to post with four of our counterparties. All of our existing commodity hedges that are not under our secured hedge facilities (described below under *Contractual Obligations*) are with these counterparties and the maximum amount of collateral that we would be required to post with them no more than \$230 million in the aggregate.

A significant source of liquidity is our \$1.25 billion syndicated revolving bank credit facility which matures in January 2010. At October 31, 2005, there was \$1.2 billion of borrowing capacity available under the revolving bank credit facility. We use the facility to fund daily operating activities and acquisitions as needed. We borrowed \$3.561 billion and repaid \$3.620 billion in the Current Period, and we borrowed \$1.413 billion and repaid \$1.261 billion in the Prior Period under our revolving bank credit facility. We incurred \$4.7 million and \$8.7 million of financing costs related to our revolving bank credit facility in the Current Period and the Prior Period, respectively, as a result of amendments to the credit agreement.

We believe that our available cash, cash provided by operating activities and funds available under our revolving bank credit facility will be sufficient to fund our operating, interest, general and administrative expenses, our capital expenditure budget, our short-term contractual obligations and dividend payments at current levels for the foreseeable future. We intend to finance the CNR acquisition with proceeds from debt and equity offerings, borrowings from our revolving bank credit facility and, if needed, a bridge loan.

The public and institutional markets have been our principal source of long-term financing for acquisitions. We have sold debt and equity in both public and private offerings in the past, and we expect that these sources of capital will continue to be available to us in the future for acquisitions. Nevertheless, we caution that ready access to capital on reasonable terms and the availability of desirable acquisition targets at attractive prices are subject to many uncertainties, as explained under "Risk Factors" in Item 1—Business of our Form 10-K for the year ended December 31, 2004.

The following table reflects the proceeds from sales of securities we issued in the Current Period and the Prior Period (\$ in millions):

	For the Nine Months Ended September 30,			
	2005		2004	
	Total Proceeds	Net Proceeds	Total Proceeds	Net Proceeds
Convertible preferred stock	\$ 805.0	\$ 782.4	\$ 313.3	\$ 304.9
Common stock	301.0	289.4	650.0	624.2
Unsecured senior notes guaranteed by subsidiaries	1,800.0	1,765.4	600.0	582.9
<b>Total</b>	<b>\$ 2,906.0</b>	<b>\$ 2,837.2</b>	<b>\$ 1,563.3</b>	<b>\$ 1,512.0</b>

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[Table of Contents](#)

We expect to utilize the automatic shelf registration, which will become available beginning December 1, 2005, to register future debt and equity issuances with the Securities and Exchange Commission. A prospectus supplement will be prepared at the time of an offering and will contain a description of the security issued, the plan of distribution and other information. We believe this new form of registration will provide us additional flexibility in responding to our capital needs.

We paid dividends on our common stock of \$45.8 million and \$26.9 million in the Current Period and the Prior Period, respectively. We paid dividends on our preferred stock of \$17.3 million and \$30.3 million in the Current Period and the Prior Period, respectively. We received \$19.9 million and \$9.0 million from the exercise of employee and director stock options and warrants in the Current Period and the Prior Period, respectively.

Outstanding payments from certain disbursement accounts in excess of funded cash balances where no legal right of set-off exists increased by \$33.8 million and \$89.3 million in the Current Period and the Prior Period, respectively. All disbursements are funded on the day they are presented to our bank using available cash on hand or draws on our revolving bank credit facility.

## Table of Contents

Historically, we have used significant funds to redeem or purchase and retire outstanding senior notes issued by Chesapeake. The following table shows our redemption, purchases and exchanges of senior notes during the Current Period and the Prior Period (\$ in millions):

	Senior Notes Activity				Cash Paid
	Retired	Premium	Other <sup>(a)</sup>	Issued <sup>(b)</sup>	
<b>For the Nine Months Ended September 30, 2005:</b>					
8.375% Senior Notes due 2008	\$ 11.0	\$ 0.8	\$ —	\$ —	\$ 11.8
8.125% Senior Notes due 2011	245.4	17.3	0.7	—	263.4
9.0% Senior Notes due 2012	300.0	41.4	0.8	—	342.2
	<u>\$556.4</u>	<u>\$ 59.5</u>	<u>\$ 1.5</u>	<u>\$ —</u>	<u>\$617.4</u>
<b>For the Nine Months Ended September 30, 2004:</b>					
7.875% Senior Notes due 2004	\$ 42.1	\$ —	\$ —	\$ —	\$ 42.1
8.5% Senior Notes due 2012	4.3	0.2	—	—	4.5
8.125% Senior Notes due 2011	482.8	—	61.5	(533.6)	10.7
7.75% Senior Notes due 2015	9.1	—	0.6	(9.7)	—
	<u>\$538.3</u>	<u>\$ 0.2</u>	<u>\$ 62.1</u>	<u>\$ (543.3)</u>	<u>\$ 57.3</u>

(a) Includes adjustments to accrued interest and discount associated with notes retired and new notes issued, cash in lieu of fractional notes, transaction costs and fair value hedging adjustments.

(b) We issued \$72.8 million of our 7.75% Senior Notes and \$470.5 million of our 6.875% Senior Notes.

Cash used in investing activities increased to \$3.655 billion during the Current Period, compared to \$2.668 billion during the Prior Period. The following table shows our capital expenditures during these periods (\$ in millions):

	Nine Months Ended September 30,	
	2005	2004
Acquisitions of oil and gas companies, proved and unproved properties, net of cash acquired	\$1,798.7	\$1,657.5
Exploration and development of oil and gas properties	1,622.4	888.3
Additions to buildings and other fixed assets	157.0	77.1
Additions to drilling rig equipment	42.1	19.3
Additions to investments	37.3	26.7
Divestitures of oil and gas properties	(1.9)	(0.3)
Other	(0.6)	(0.4)
<b>Total</b>	<u>\$3,655.0</u>	<u>\$2,668.2</u>

Our accounts receivable are primarily from purchasers of oil and natural gas (\$509.1 million at September 30, 2005) and exploration and production companies which own interests in properties we operate (\$77.4 million at September 30, 2005). This industry concentration has the potential to impact our overall exposure to credit risk, either positively or negatively, in that our customers may be similarly affected by changes in economic, industry or other conditions. We generally require letters of credit for receivables from customers which are judged to have sub-standard credit, unless the credit risk can otherwise be mitigated.

Our liquidity is not dependent on the use of off-balance sheet financing arrangements, such as the securitization of receivables or obtaining access to assets through special purpose entities. We have not relied on off-balance sheet financing arrangements in the past and we do not intend to rely on such arrangements in the future as a source of liquidity. We are not a commercial paper issuer.

## [Table of Contents](#)

### *Investing and Financing Transactions*

The following table describes significant investing transactions that we completed in the Current Period (\$ in millions):

<b>Quarter</b>	<b>Acquisition</b>	<b>Location</b>	<b>Amount</b>
First	BRG Petroleum Corporation	Mid-Continent and Ark-La-Tex	\$ 325 <sup>(a)</sup>
	Laredo Energy II, L.L.C.	South Texas	228
	Other	Various	89 <sup>(b)</sup>
Second	Houston-based oil and gas company	Texas Gulf Coast/South Texas	202
	Pecos Production Company	Permian	198
	Laredo II Partners	Texas Gulf Coast/South Texas	139
	Dallas-based oil and gas company	Ark-La-Tex	85
	Midland-based oil and gas company	Permian	38
	Other	Various	65
Third	Hallwood Energy, III L.P.	Barnett Shale	250 <sup>(c)</sup>
	Corpus Christi-based oil and gas company	Ark-La-Tex	95
	Other	Various	116
			<b>\$ 1,830</b>

<sup>(a)</sup> We paid \$16.3 million of the purchase amount in 2004.

<sup>(b)</sup> During the Current Period, we paid the remaining \$57 million of the purchase price related to an acquisition transaction with Hallwood Energy Corporation in the fourth quarter of 2004.

<sup>(c)</sup> Includes \$15 million related to gathering systems which was allocated to other property and equipment.

During 2004 and continuing in 2005, we have taken several steps to improve our capital structure. These transactions enabled us to extend our average maturity of long-term debt to over ten years with an average interest rate of approximately 6.8%. Achieving a debt-to-total-capitalization ratio of below 50% and reducing debt per mcfe of proved reserves remain key goals of our business strategy.

We completed the following significant financing transactions in the Current Period:

#### First Quarter 2005

- Amended our revolving bank credit facility to increase the committed borrowing base to \$1.25 billion and extended the maturity of the facility to January 2010.
- Completed a private purchase of \$11.0 million of our 8.375% Senior Notes due 2008 for \$12.0 million (including a premium of \$0.8 million).

#### Second Quarter 2005

- Completed private offerings of \$600 million principal amount of 6.625% Senior Notes due 2016 and 4,600,000 shares of 5.0% cumulative convertible preferred stock having a liquidation preference of \$100 per share. Net proceeds of \$1.032 billion from these transactions were used to finance acquisitions totaling \$459 million that closed in the second quarter of 2005 and to repay debt incurred under our revolving bank credit facility to temporarily finance the BRG and the Laredo acquisitions completed in the first quarter.
- Completed a private placement of \$600 million of 6.25% Senior Notes due 2018. Net proceeds of approximately \$596.4 million were used to fund our purchases in June 2005 of \$237.8 million of our 8.125% Senior Notes due 2011 for \$255.3 million (including a premium of \$16.8 million and transaction costs of \$0.7 million) and \$298.9 million of our 9.0% Senior Notes due 2012 for \$341.0 million (including a premium of \$41.3 million and transaction costs of \$0.8 million) pursuant to tender offers for the 8.125% and 9.0% Senior Notes.

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## Table of Contents

- Completed a private exchange of 45,000 shares of our outstanding 4.125% cumulative convertible preferred stock for 2,911,250 shares of common stock. No cash was received or paid in connection with this transaction.

### Third Quarter 2005

- Completed cash tender offers for our 8.125% Senior Notes due 2011 and 9.0% Senior Notes due 2012. Approximately \$0.3 million was used to purchase \$0.1 million of 8.125% Senior Notes due 2011 and \$0.2 million of 9.0% Senior Notes due 2012. Together with the amounts acquired in June 2005, we acquired a total of \$237.9 million principal amount of 8.125% Senior Notes due 2011 and \$299.1 million principal amount of 9.0% Senior Notes due 2012, representing 96.9% and 99.7%, respectively, of the amounts outstanding, in the tender offers, which expired on July 6, 2005. We redeemed the remaining \$7.5 million of 8.125% and \$0.9 million of 9.0% Senior Notes for \$9.1 million (including a premium of \$0.6 million) on August 17, 2005 based on the make-whole redemption provisions in the indentures.
- Completed a number of transactions whereby we exchanged 133,675 shares of our 4.125% cumulative convertible preferred stock for 8,529,758 shares of our common stock. No cash was received or paid in connection with these transactions.
- Completed a number of transactions whereby we exchanged 697,724 shares of our 5.0% (Series 2003) cumulative convertible preferred stock for 4,354,439 shares of our common stock. No cash was received or paid in connection with these transactions.
- Completed a private placement of \$600 million of 6.5% Senior Notes due 2017. Net proceeds of approximately \$584.6 million were used to repay amounts outstanding under our revolving bank credit facility which resulted from acquisitions completed in the Current Quarter.
- Completed public offerings of 3,450,000 shares of 4.5% cumulative convertible preferred stock having a liquidation preference of \$100 per share and 9,200,000 shares of common stock at \$32.72 per share. Net proceeds from both offerings of approximately \$624.6 million were used to repay amounts outstanding under our revolving bank credit facility which resulted from acquisitions completed in the Current Quarter.

### *Contractual Obligations*

We currently have a \$1.25 billion syndicated revolving bank credit facility which matures in January 2010. The credit facility was increased from \$600 million to \$1.25 billion in January 2005. As of September 30, 2005, we had no outstanding borrowings under this facility and had utilized \$80.1 million of the facility for various letters of credit. Borrowings under the facility are collateralized by certain producing oil and gas properties and bear interest at either (i) the greater of the reference rate of Union Bank of California, N.A., or the federal funds effective rate plus 0.50% or (ii) London Interbank Offered Rate (LIBOR), at our option, plus a margin that varies according to our senior unsecured long-term debt ratings. The collateral value and borrowing base are redetermined periodically. The unused portion of the facility is subject to an annual commitment fee that also varies according to our senior unsecured long-term debt ratings. Currently the annual commitment fee is 0.30%. Interest is payable quarterly or, if LIBOR applies, it may be payable at more frequent intervals.

The credit facility agreement contains various covenants and restrictive provisions which limit our ability to incur additional indebtedness, sell properties, purchase or redeem our capital stock, make investments or loans, and create liens. The credit facility agreement requires us to maintain a fixed charge coverage ratio (as defined) of at least 2.5 to 1 and an indebtedness to EBITDA ratio (as defined) not to exceed 3.5 to 1. At September 30, 2005, our fixed charge coverage ratio was 6.24 to 1 and our indebtedness to EBITDA ratio was 2.03 to 1. If we should fail to perform our obligations under these and other covenants, the revolving credit commitment could be terminated and any outstanding borrowings under the facility could be declared immediately due and payable. Such acceleration, if involving a principal amount of \$10 million (\$50 million in the case of our 6.625% Senior Notes due 2016, 6.25% Senior Notes due 2018 and 6.5% Senior Notes due 2017), would constitute an event of default under our senior note indentures which could in turn result in the acceleration of a significant portion of our senior note indebtedness. The

## [Table of Contents](#)

credit facility agreement also has cross default provisions that apply to other indebtedness we may have with an outstanding principal amount in excess of \$50 million.

As of September 30, 2005, we owned 14 rigs dedicated to drilling wells operated by Chesapeake and have contracted to acquire 26 additional rigs to be constructed in 2005 and 2006. We expect to spend approximately \$226 million to complete the rigs under construction.

Some of our commodity price and financial risk management arrangements require us to deliver cash collateral or other assurances of performance to the counterparties in the event that our payment obligations exceed certain levels. As of September 30, 2005, we were required to post \$77.0 million of collateral in the form of letters of credit with respect to such derivative transactions. These collateral requirements were \$68.0 million as of October 31, 2005. Future collateral requirements are uncertain and will depend on arrangements with our counterparties and fluctuations in natural gas and oil prices and interest rates. We currently have arrangements with four of our counterparties which limit the amount of collateral that we would be required to post with them to no more than \$230 million in the aggregate.

We have two secured hedging facilities, each of which permits us to enter into cash-settled natural gas and oil commodity transactions, valued by the counterparty, for up to \$500 million. The scheduled maturity date for these facilities is May 2010. Outstanding transactions under each facility are collateralized by certain of our oil and gas properties that do not secure any of our other obligations. One of the hedging facilities is subject to an annual fee of 0.30% of the maximum total capacity and each of them has a 1.0% exposure fee, which is assessed quarterly on the average of the daily negative fair market value amounts, if any, during the quarter. As of September 30, 2005, the fair market value of the natural gas and oil hedging transactions was a liability of \$228.0 million under one of the facilities and a liability of \$116.5 million under the other facility. The hedging facilities contain the standard representations and default provisions that are typical of such agreements. The agreements also contain various restrictive provisions which govern the aggregate gas and oil production volumes that we are permitted to hedge under all of our agreements at any one time.

Our subsidiary, Chesapeake Exploration Limited Partnership, is the borrower under our revolving bank credit facility and is the named party to our hedging facilities. The facilities are guaranteed by Chesapeake and all its other subsidiaries. Our revolving bank credit facility and secured hedge facilities do not contain material adverse change or adequate assurance clauses. Although the applicable interest rates and commitment fees in our bank credit facility fluctuate slightly based on our long-term senior unsecured credit ratings, the bank facility and the secured hedge facilities do not contain provisions which would trigger an acceleration of amounts due under the facilities or a requirement to post additional collateral in the event of a downgrade of our credit ratings.

As of September 30, 2005, our senior notes represented approximately \$4.3 billion of our long-term debt and consisted of the following (\$ in thousands):

8.375% Senior Notes due 2008	\$ 7,990
7.5% Senior Notes due 2013	363,823
7.0% Senior Notes due 2014	300,000
7.5% Senior Notes due 2014	300,000
7.75% Senior Notes due 2015	300,408
6.375% Senior Notes due 2015	600,000
6.625% Senior Notes due 2016	600,000
6.875% Senior Notes due 2016	670,437
6.5% Senior Notes due 2017	600,000
6.25% Senior Notes due 2018	600,000
Discount on senior notes	(91,357)
Discount for interest rate derivatives	(1,141)
	<u>\$4,250,160</u>

On November 1, 2005, we redeemed the 8.375 % Senior Notes due 2008 for \$8.3 million. No scheduled principal payments are required until 2013, when \$363.8 million is due.



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## [Table of Contents](#)

As of September 30, 2005 and currently, debt ratings for the senior notes are Ba2 by Moody's Investor Service (stable outlook), BB by Standard & Poor's Ratings Services (stable outlook) and BB by Fitch Ratings.

Our senior notes are unsecured senior obligations of Chesapeake and rank equally with all of our other unsecured indebtedness. All of our wholly owned subsidiaries guarantee the notes. The indentures permit us to redeem the senior notes at any time at specified make-whole or redemption prices. The indentures (other than the indenture governing the 6.5% Senior Notes due 2017) contain covenants limiting our ability and our restricted subsidiaries' ability to incur additional indebtedness; pay dividends on our capital stock or redeem, repurchase or retire our capital stock or subordinated indebtedness; make investments and other restricted payments; incur liens; engage in transactions with affiliates; sell assets; and consolidate, merge or transfer assets. The debt incurrence covenants do not presently restrict our ability to borrow under or expand our secured credit facility. As of September 30, 2005, we estimate that secured commercial bank indebtedness of approximately \$2.4 billion could have been incurred under the most restrictive indenture covenant.

On September 30, 2005, Chesapeake agreed to acquire Columbia Energy Resources, LLC and its subsidiaries, including Columbia Natural Resources, LLC, (CNR) for \$2.2 billion in cash, subject to closing adjustments related to outstanding debt, title defects and satisfaction of certain conditions prior to closing. CNR's primary assets are Appalachian Basin proved natural gas reserves, unevaluated oil and gas leasehold interests and natural gas gathering systems. Chesapeake will acquire CNR subject to liabilities related to a prepaid sales agreement and hedging arrangements. As part of the acquisition, we expect to record a mark-to-market liability on those obligations, the final calculation of which is dependent upon natural gas prices on the day of the closing. We plan to finance the acquisition through the issuance of a combination of debt and equity securities, borrowings under our revolving bank credit facility and, if needed, a bridge loan. We expect to close the CNR acquisition by December 1 2005, although there is no assurance that the acquisition will close or close without material adjustment.

We recently received a commitment for up to a \$1.5 billion bridge loan to provide us with an additional funding source to complete the CNR acquisition. The bridge loan commitment is limited to \$1.5 billion less the gross proceeds of any debt or equity offering made by us prior to the closing of the acquisition. The maturity for the bridge loan would be the earlier of January 31, 2007 or the closing date of permanent financing for the CNR acquisition. The bridge loan would bear interest, reset quarterly, at the greater of the rate of the three-month LIBOR plus 2.25% per year or the bid side yield on our 6.625% Senior Notes due 2016 quoted at market close on the quarterly interest reset date.

### **Results of Operations — Three Months Ended September 30, 2005 vs. September 30, 2004**

*General.* For the Current Quarter, Chesapeake had net income of \$177.0 million, or \$0.43 per diluted common share, on total revenues of \$1.083 billion. This compares to net income of \$96.9 million, or \$0.29 per diluted common share, on total revenues of \$629.8 million during the Prior Quarter. Net income included, on a pre-tax basis, net unrealized losses on oil and gas and interest rate derivatives of \$105.3 million in the Current Quarter and \$38.7 million in the Prior Quarter.

*Oil and Gas Sales.* During the Current Quarter, oil and gas sales were \$720.9 million compared to \$450.9 million in the Prior Quarter. In the Current Quarter, Chesapeake produced 120.4 bcfе at a weighted average price of \$6.85 per mcfе, compared to 94.2 bcfе produced in the Prior Quarter at a weighted average price of \$5.13 per mcfе (weighted average prices exclude the effect of unrealized gains or (losses) on derivatives of (\$104.0) million and (\$32.5) million in the Current Quarter and Prior Quarter, respectively). In the Current Quarter, the increase in prices resulted in an increase in revenue of \$207.5 million and increased production resulted in a \$134.1 million increase, for a total increase in revenues of \$341.6 million (excluding unrealized gains or losses on oil and gas derivatives). The increase in production from the Prior Quarter to the Current Quarter is due to the combination of production growth generated from drilling as well as acquisitions completed in 2004 and 2005.

The change in oil and gas prices has a significant impact on our oil and gas revenues and cash flows. Assuming the Current Quarter production levels, a change of \$0.10 per mcf of gas sold would have resulted in an increase or decrease in revenues and cash flow of approximately \$10.9 million and \$10.2 million, respectively, and a change of \$1.00 per barrel of oil sold would have resulted in an increase or decrease in revenues and cash flow of approximately \$1.9 million and \$1.8 million, respectively, without considering the effect of derivative activities.

For the Current Quarter, we realized an average price per barrel of oil of \$53.30, compared to \$29.15 in the Prior Quarter (weighted average prices for both quarters discussed exclude the effect of unrealized gains or losses on derivatives). Natural gas prices realized per mcf (excluding unrealized gains or losses on derivatives) were \$6.64 and \$5.17 in the Current Quarter and Prior Quarter, respectively. Realized gains or losses from our oil and gas derivatives resulted in a net decrease in oil and gas revenues of \$122.6 million, or \$1.02 per mcfе, in the Current Quarter and a net decrease of \$38.0 million, or \$0.40 per mcfе, in the Prior Quarter.

## [Table of Contents](#)

The following table shows our production by region for the Current Quarter and the Prior Quarter:

	For the Three Months Ended September 30,			
	2005		2004	
	Mmcfe	Percent	Mmcfe	Percent
Mid-Continent	74,910	62%	68,236	72%
South Texas and Texas Gulf Coast	17,018	14	10,954	12
Ark-La-Tex and Barnett Shale	15,843	13	6,364	7
Permian Basin	11,843	10	7,995	8
Other	743	1	674	1
Total Production	120,357	100%	94,223	100%

Natural gas production represented approximately 90% of our total production volume on an equivalent basis in the Current Quarter, compared to 88% in the Prior Quarter.

*Oil and Gas Marketing Sales and Expenses.* Chesapeake realized \$361.9 million in oil and gas marketing sales to third parties in the Current Quarter, with corresponding oil and gas marketing expenses of \$353.5 million, for a net margin of \$8.4 million. Marketing activities are substantially for third parties that are owners in Chesapeake-operated wells. This compares to sales of \$178.9 million, expenses of \$175.4 million and a net margin of \$3.5 million in the Prior Quarter. In the Current Quarter, Chesapeake realized an increase in oil and gas marketing sales volumes and an increase in oil and gas prices.

*Production Expenses.* Production expenses, which include lifting costs and ad valorem taxes, were \$80.8 million in the Current Quarter compared to \$54.1 million in the Prior Quarter. On a unit-of-production basis, production expenses were \$0.67 per mcf in the Current Quarter compared to \$0.57 per mcf in the Prior Quarter. The increase in the Current Quarter was primarily due to higher field service costs and ad valorem taxes on oil and gas properties. We expect that production expenses for the remainder of 2005 will range from \$0.70 to \$0.74 per mcf produced.

*Production Taxes.* Production taxes were \$53.1 million and \$30.9 million in the Current Quarter and the Prior Quarter, respectively. On a unit-of-production basis, production taxes were \$0.44 per mcf in the Current Quarter compared to \$0.33 per mcf in the Prior Quarter. The \$22.2 million increase in production taxes in the Current Quarter is due primarily to 26.2 bcfe of increased production and the increase in sales prices (excluding gains or losses on derivatives). In general, production taxes are calculated using value-based formulas that produce higher per unit costs when oil and gas prices are higher. We expect production taxes for the remainder of 2005 to range from \$0.60 to \$0.64 per mcf based on NYMEX prices of \$60 per barrel of oil and natural gas wellhead prices ranging from \$9.00 to \$11.30 per mcf.

*General and Administrative Expenses (excluding stock-based compensation).* Excluding stock-based compensation and internal payroll and non-payroll general and administrative costs capitalized in our oil and gas properties, general and administrative expenses were \$10.5 million, or \$0.09 per mcf, in the Current Quarter and \$8.4 million, or \$0.09 per mcf, in the Prior Quarter. The \$2.1 million increase in the Current Quarter was the result of the company's growth related to various acquisitions completed in the Current Period and in 2004 and the increase in drilling activity. This growth has resulted in a substantial increase in employees and related costs. We anticipate that general and administrative expenses for the remainder of 2005 will be between \$0.10 and \$0.12 per mcf produced.

Chesapeake follows the full-cost method of accounting under which all costs associated with property acquisition, exploration and development activities are capitalized. We capitalize internal costs that can be directly identified with our acquisition, exploration and development activities and do not include any costs related to production, general corporate overhead or similar activities. We capitalized \$29.5 million and \$12.0 million of internal costs in the Current Quarter and the Prior Quarter, respectively, directly related to our oil and gas exploration and development efforts.

*Stock-Based Compensation.* Stock-based compensation was \$5.2 million in the Current Quarter and \$0.6 million in the Prior Quarter. During the Current Quarter, 2.0 million shares of restricted stock were issued to employees and directors. The cost of all outstanding restricted shares is amortized over a four-year period except for grants to directors which are amortized over a three-year period. This resulted in the recognition of \$8.0 million of expense during the Current Quarter. Of this amount, \$4.3 million was

## [Table of Contents](#)

reflected as stock-based compensation expense (a sub-category of general and administrative expenses) and the remaining \$3.7 million was capitalized to oil and gas properties. We also recognized \$2.3 million in stock-based compensation expense in the Current Quarter as a result of an increase in the market value of certain stock options which were previously modified. Of this amount \$1.4 million was capitalized to oil and gas properties. Stock-based compensation was \$0.04 per mcf for the Current Quarter and \$0.01 per mcf for the Prior Quarter. We anticipate that stock-based compensation expense for the remainder of 2005 will be between \$0.03 and \$0.05 per mcf produced.

*Oil and Gas Depreciation, Depletion and Amortization.* Depreciation, depletion and amortization of oil and gas properties was \$231.1 million and \$153.6 million during the Current Quarter and the Prior Quarter, respectively. The average DD&A rate per mcf, which is a function of capitalized costs, future development costs and the related underlying reserves in the periods presented, was \$1.92 and \$1.63 in the Current Quarter and in the Prior Quarter, respectively. The \$0.29 increase in the average DD&A rate is primarily the result of higher drilling costs and higher costs associated with acquisitions, including the recognition of the tax effect of acquisition costs in excess of tax basis acquired in certain corporate acquisitions. We expect the DD&A rate for the remainder of 2005 to be between \$2.05 and \$2.10 per mcf produced.

*Depreciation and Amortization of Other Assets.* Depreciation and amortization of other assets was \$12.9 million in the Current Quarter compared to \$7.7 million in the Prior Quarter. The increase in the Current Quarter was primarily the result of higher depreciation costs resulting from the acquisition of various gathering facilities, construction of new buildings at our corporate headquarters and the purchase of additional information technology equipment in 2004 and the Current Period. Property and equipment costs are depreciated on a straight-line basis. Buildings are depreciated over 39 years, drilling rigs are depreciated over 15 years and all other property and equipment are depreciated over the estimated useful lives of the assets, which range from two to fifteen years. To the extent drilling rigs are used to drill our wells, the depreciation is capitalized in oil and gas properties as exploration or development costs. We expect depreciation and amortization of other assets for the remainder of 2005 to be between \$0.10 and \$0.12 per mcf produced.

*Interest and Other Income.* Interest and other income was \$2.4 million in the Current Quarter compared to \$0.9 million in the Prior Quarter. The Current Quarter income consisted of \$0.4 million of interest income, a \$0.1 million loss related to our equity investments and \$2.1 million of miscellaneous income. The Prior Quarter income consisted of \$0.6 million of interest income, a \$0.3 million gain related to our equity investments and \$0.6 million of miscellaneous income.

*Interest Expense.* Interest expense increased from \$48.7 million in the Prior Quarter to \$58.6 million in the Current Quarter as follows:

	Three Months Ended September 30,	
	2005	2004
	(\$ in millions)	
Interest expense on senior notes and revolving bank credit facility	\$ 77.6	\$ 51.6
Capitalized interest	(20.8)	(10.5)
Amortization of loan discount	1.4	1.2
Unrealized (gain) loss on interest rate derivatives	1.2	6.2
Realized (gain) loss on interest rate derivatives	(0.8)	0.2
<b>Total interest expense</b>	<b>\$ 58.6</b>	<b>\$ 48.7</b>
<b>Average long-term borrowings</b>	<b>\$4,047</b>	<b>\$2,540</b>

Interest expense on senior notes increased \$20.0 million due to a higher average balance of senior notes outstanding, \$4.0 billion in the Current Quarter compared to \$2.5 billion in the Prior Quarter, and was partially offset by a decrease in the average interest rate, 6.8% in the Current Quarter compared to 7.7% in the Prior Quarter. The revolving bank credit facility interest expense increased \$6.0 million which is the result of higher borrowings and an increase in interest rates.

The \$10.3 million increase in capitalized interest is the result of interest capitalized on our additional investments in unevaluated properties acquired since the Prior Quarter. Interest is capitalized on significant investments in unevaluated properties that are not being currently depreciated, depleted or amortized and on which exploration activities are in progress.

Interest expense, excluding unrealized gains or losses on derivatives, was \$0.48 per mcf in the Current Quarter compared to \$0.45 per mcf in the Prior Quarter. We expect interest expense (before considering the effect of interest rate derivatives) for the remainder of 2005 to be between \$0.48 and \$0.52 per mcf produced.

## [Table of Contents](#)

*Loss on Repurchases or Exchanges of Chesapeake Debt.* We repurchased or exchanged Chesapeake debt in the Current Quarter and incurred losses in connection with these transactions. The following table shows the losses related to these transactions (\$ in millions):

	Loss on Repurchases/Exchanges			Total
	Notes Retired	Premium	Other <sup>(a)</sup>	
<b>For the Three Months Ended September 30, 2005:</b>				
8.125% Senior Notes due 2011	\$ 7.6	\$0.5	\$ 0.1	\$0.6
9.0% Senior Notes due 2012	1.1	0.1	0.0	0.1
	<u>\$ 8.7</u>	<u>\$0.6</u>	<u>\$ 0.1</u>	<u>\$0.7</u>

<sup>(a)</sup> Includes write-offs of discounts, deferred charges and interest rate derivatives associated with notes retired and transaction costs.

There were no losses on repurchases or exchanges of Chesapeake debt in the Prior Quarter.

*Income Tax Expense.* Chesapeake recorded income tax expense of \$101.7 million in the Current Quarter, compared to income tax expense of \$54.5 million in the Prior Quarter. Our effective income tax rate increased to 36.5% in the Current Quarter compared to 36% in the Prior Quarter. The increase in the Current Quarter reflected the impact state income taxes and permanent differences had on our overall effective rate. All 2004 income tax expense was deferred, and we expect all of our 2005 income tax expense to be deferred.

### Results of Operations — Nine Months Ended September 30, 2005 vs. September 30, 2004

*General.* For the Current Period, Chesapeake had net income of \$495.8 million, or \$1.32 per diluted common share, on total revenues of \$2.914 billion. This compares to net income of \$306.6 million, or \$0.96 per diluted common share, on total revenues of \$1.767 billion during the Prior Period. The Current Period net income included, on a pre-tax basis, \$135.2 million in net unrealized losses on oil and gas and interest rate derivatives and a \$70.0 million loss on repurchases or exchanges of debt. The Prior Period net income included, on a pre-tax basis, \$72.5 million in net unrealized losses on oil and gas and interest rate derivatives and a \$6.9 million loss on repurchases or exchanges of debt.

*Oil and Gas Sales.* During the Current Period, oil and gas sales were \$2.032 billion compared to \$1.270 billion in the Prior Period. In the Current Period, Chesapeake produced 338.2 bcf at a weighted average price of \$6.42 per mcf, compared to 259.7 bcf produced in the Prior Period at a weighted average price of \$5.15 per mcf (weighted average prices exclude the effect of unrealized gains or (losses) on derivatives of (\$137.1) million and (\$66.6) million in the Current Period and Prior Period, respectively). In the Current Period, the increase in prices resulted in an increase in revenue of \$428.1 million and increased production resulted in a \$404.3 million increase, for a total increase in revenues of \$832.4 million (excluding unrealized gains or losses on oil and gas derivatives). The increase in production from the Prior Period to the Current Period is due to the combination of production growth generated from drilling as well as acquisitions completed in 2004 and 2005.

The change in oil and gas prices has a significant impact on our oil and gas revenues and cash flows. Assuming the Current Period production levels, a change of \$0.10 per mcf of gas sold would have resulted in an increase or decrease in revenues and cash flow of approximately \$30.4 million and \$28.5 million, respectively, and a change of \$1.00 per barrel of oil sold would have resulted in an increase or decrease in revenues and cash flow of approximately \$5.7 million and \$5.3 million, respectively, without considering the effect of derivative activities.

For the Current Period, we realized an average price per barrel of oil of \$46.04, compared to \$28.20 in the Prior Period (weighted average prices for both periods discussed exclude the effect of unrealized gains or losses on derivatives). Natural gas prices realized per mcf (excluding unrealized gains or losses on derivatives) were \$6.27 and \$5.21 in the Current Period and Prior Period, respectively. Realized gains or losses from our oil and gas derivatives resulted in a net decrease in oil and gas revenues of \$126.6 million, or \$0.37 per mcf, in the Current Period and a net decrease of \$67.6 million, or \$0.26 per mcf, in the Prior Period.

## [Table of Contents](#)

The following table shows our production by region for the Current Period and the Prior Period:

	For the Nine Months Ended September 30,			
	2005		2004	
	Mmcfe	Percent	Mmcfe	Percent
Mid-Continent	222,290	65%	194,875	75%
South Texas and Texas Gulf Coast	45,082	13	29,682	11
Ark-La-Tex and Barnett Shale	39,772	12	11,663	5
Permian Basin	28,955	9	21,459	8
Other	2,065	1	1,980	1
<b>Total Production</b>	<b>338,164</b>	<b>100%</b>	<b>259,659</b>	<b>100%</b>

Natural gas production represented approximately 90% of our total production volume on an equivalent basis in the Current Period, compared to 89% in the Prior Period.

*Oil and Gas Marketing Sales and Expenses.* Chesapeake realized \$882.0 million in oil and gas marketing sales to third parties in the Current Period, with corresponding oil and gas marketing expenses of \$860.8 million, for a net margin of \$21.2 million. Marketing activities are substantially for third parties that are owners in Chesapeake-operated wells. This compares to sales of \$496.8 million, expenses of \$486.2 million and a net margin of \$10.6 million in the Prior Period. In the Current Period, Chesapeake realized an increase in oil and gas marketing sales volumes and an increase in oil and gas prices.

*Production Expenses.* Production expenses, which include lifting costs and ad valorem taxes, were \$222.7 million in the Current Period compared to \$148.5 million in the Prior Period. On a unit-of-production basis, production expenses were \$0.66 per mcf in the Current Period compared to \$0.57 per mcf in the Prior Period. The increase in the Current Period was primarily due to higher field service costs and ad valorem taxes on oil and gas properties. We expect that production expenses for the remainder of 2005 will range from \$0.70 to \$0.74 per mcf.

*Production Taxes.* Production taxes were \$136.3 million and \$68.6 million in the Current Period and the Prior Period, respectively. On a unit-of-production basis, production taxes were \$0.40 per mcf in the Current Period compared to \$0.26 per mcf in the Prior Period. The \$67.7 million increase in production taxes in the Current Period is due primarily to approximately 78.5 bcf of increased production and the increase in sales price (excluding gains or losses on derivatives). Also included in the Prior Period was a credit of \$6.8 million, or \$0.03 per mcf, related to certain Oklahoma severance tax abatements for the period July 2003 through December 2003. In April 2004, the Oklahoma Tax Commission concluded that a pre-determined oil and gas price cap for 2003 sales had not been exceeded (on a statewide basis) and notified the company that it was eligible to receive certain severance tax abatements for the period from July 1, 2003 through June 30, 2004. The company had previously estimated that the average oil and gas sales prices in Oklahoma (on a statewide basis) could exceed the price cap, and did not reflect the benefit from these potential severance tax abatements until the first quarter of 2004. In general, production taxes are calculated using value-based formulas that produce higher per unit costs when oil and gas prices are higher. We expect production taxes for the remainder of 2005 will range from \$0.60 to \$0.64 per mcf based on NYMEX prices of \$60 per barrel of oil and natural gas wellhead prices ranging from \$9.00 to \$11.30 per mcf.

*General and Administrative Expenses (excluding stock-based compensation).* Excluding stock-based compensation and internal payroll and non-payroll general and administrative costs capitalized in our oil and gas properties, general and administrative expenses were \$29.5 million, or \$0.09 per mcf, in the Current Period and \$23.9 million, or \$0.09 per mcf, in the Prior Period. The \$5.6 million increase in the Current Period was the result of the company's growth related to various acquisitions completed in the Current Period and in 2004 and the increase in drilling activity. This growth has resulted in a substantial increase in employees and related costs. We anticipate that general and administrative expenses for the remainder of 2005 will be between \$0.10 and \$0.12 per mcf produced.

Chesapeake follows the full-cost method of accounting under which all costs associated with property acquisition, exploration and development activities are capitalized. We capitalize internal costs that can be directly identified with our acquisition, exploration and development activities and do not include any costs related to production, general corporate overhead or similar activities. We capitalized \$75.3 million and \$35.3 million of internal costs in the Current Period and the Prior Period, respectively, directly related to our oil and gas exploration and development efforts.

*Stock-Based Compensation.* Stock-based compensation was \$10.2 million in the Current Period and \$3.1 million in the Prior Period. During the Current Period, 3.8 million shares of restricted stock were issued to employees and directors. The cost of all outstanding restricted shares is amortized over a four-year period except for grants to directors which are amortized over a three-year period. This resulted in the recognition of \$16.1 million of expense during the Current Period. Of this amount, \$8.7 million was reflected as

## Table of Contents

stock-based compensation expense (a sub-category of general and administrative expenses), and the remaining \$7.4 million was capitalized to oil and gas properties. We also recognized \$2.7 million in stock-based compensation expense in the Current Period as a result of an increase in the market value of certain stock options which were previously modified. Of this amount \$1.4 million was capitalized to oil and gas properties and an additional \$0.1 million was related to the issuance of common stock to a director. Stock-based compensation was \$0.03 per mcf for the Current Period and \$0.01 per mcf for the Prior Period. We anticipate that stock-based compensation expense for the remainder of 2005 will be between \$0.03 and \$0.05 per mcf produced.

*Oil and Gas Depreciation, Depletion and Amortization.* Depreciation, depletion and amortization of oil and gas properties was \$621.5 million and \$410.2 million during the Current Period and the Prior Period, respectively. The average DD&A rate per mcf, which is a function of capitalized costs, future development costs and the related underlying reserves in the periods presented, was \$1.84 and \$1.58 in the Current Period and in the Prior Period, respectively. The \$0.26 increase in the average DD&A rate is primarily the result of higher drilling costs and higher costs associated with acquisitions, including the recognition of the tax effect of acquisition costs in excess of tax basis acquired in certain corporate acquisitions. We expect the DD&A rate for the remainder of 2005 to be between \$2.05 and \$2.10 per mcf produced.

*Depreciation and Amortization of Other Assets.* Depreciation and amortization of other assets was \$34.8 million in the Current Period compared to \$20.2 million in the Prior Period. The increase in the Current Period was primarily the result of higher depreciation costs resulting from the acquisition of various gathering facilities, construction of new buildings at our corporate headquarters and the purchase of additional information technology equipment in 2004 and the Current Period. Property and equipment costs are depreciated on a straight-line basis. Buildings are depreciated over 39 years, drilling rigs are depreciated over 15 years and all other property and equipment are depreciated over the estimated useful lives of the assets, which range from two to fifteen years. To the extent drilling rigs are used to drill our wells, the depreciation is capitalized in oil and gas properties as exploration or development costs. We expect depreciation and amortization of other assets for the remainder of 2005 to be between \$0.10 and \$0.12 per mcf produced.

*Interest and Other Income.* Interest and other income was \$7.8 million in the Current Period compared to \$3.6 million in the Prior Period. The Current Period income consisted of \$3.5 million of interest income, a \$1.1 million gain related to our equity investments and \$3.2 million of miscellaneous income. The Prior Period income consisted of \$1.5 million of interest income, a \$0.8 million gain related to our equity investments and \$1.3 million of miscellaneous income.

*Interest Expense.* Interest expense increased from \$124.0 million in the Prior Period to \$155.6 million in the Current Period as follows:

	Nine Months Ended September 30,	
	2005	2004
	(\$ in millions)	
Interest expense on senior notes and revolving bank credit facility	\$210.7	\$138.2
Capitalized interest	(54.8)	(23.2)
Amortization of loan discount	4.2	3.3
Unrealized gain on interest rate derivatives	(1.9)	5.9
Realized gain on interest rate derivatives	(2.6)	(0.2)
<b>Total interest expense</b>	<b>\$155.6</b>	<b>\$124.0</b>
<b>Average long-term borrowings</b>	<b>\$3,593</b>	<b>\$2,309</b>

Interest expense on senior notes increased \$57.1 million due to a higher average balance of senior notes outstanding, \$3.6 billion in the Current Quarter compared to \$2.3 billion in the Prior Quarter, and was partially offset by a decrease in the average interest rate, 7.1% in the Current Quarter compared to 7.7% in the Prior Quarter. The revolving bank credit facility interest expense increased \$15.4 million which is the result of higher borrowings and an increase in interest rates.

The \$31.6 million increase in capitalized interest is the result of interest capitalized on our additional investments in unevaluated properties acquired since the Prior Period. Interest is capitalized on significant investments in unevaluated properties that are not being currently depreciated, depleted or amortized and on which exploration activities are in progress.

Interest expense, excluding unrealized gains or losses on derivatives, was \$0.47 per mcf in the Current Period compared to \$0.46 per mcf in the Prior Period. We expect interest expense (before considering the effect of interest rate derivatives) for the remainder of 2005 to be between \$0.48 and \$0.52 per mcf produced.

## Table of Contents

*Loss on Repurchases or Exchanges of Chesapeake Debt.* We have repurchased or exchanged Chesapeake debt and incurred losses in connection with these transactions. The following table shows the losses related to these transactions (\$ in millions):

	Loss on Repurchases/Exchanges			Total
	Notes Retired	Premium	Other <sup>(a)</sup>	
<b>For the Nine Months Ended September 30, 2005:</b>				
8.375% Senior Notes due 2008	\$ 11.0	\$ 0.8	\$ 0.1	\$ 0.9
8.125% Senior Notes due 2011	245.4	17.3	4.4	21.7
9.0% Senior Notes due 2012	300.0	41.4	6.0	47.4
	<u>\$556.4</u>	<u>\$59.5</u>	<u>\$ 10.5</u>	<u>\$70.0</u>
<b>For the Nine Months Ended September 30, 2004:</b>				
7.875% Senior Notes due 2004	\$ 42.1	\$ —	\$ —	\$ —
8.5% Senior Notes due 2012	4.3	0.2	0.7	0.9
8.125% Senior Notes due 2011	482.8	—	6.0	6.0
7.75% Senior Notes due 2015	9.1	—	—	—
	<u>\$538.3</u>	<u>\$ 0.2</u>	<u>\$ 6.7</u>	<u>\$ 6.9</u>

<sup>(a)</sup> Includes write-offs of discounts, deferred charges and interest rate derivatives associated with notes retired and transaction costs.

*Income Tax Expense.* Chesapeake recorded income tax expense of \$285.0 million in the Current Period, compared to income tax expense of \$172.5 million in the Prior Period. Our effective income tax rate increased to 36.5% in the Current Period compared to 36% in the Prior Period. The increase in the Current Period reflected the impact state income taxes and permanent differences had on our overall effective rate. All 2004 income tax expense was deferred, and we expect all of our 2005 income tax expense to be deferred.

### Critical Accounting Policies

We consider accounting policies related to hedging, oil and gas properties, income taxes and business combinations to be critical policies. These policies are summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in our annual report on Form 10-K for the year ended December 31, 2004.

### Recently Issued Accounting Standards

The Financial Accounting Standards Board recently issued the following standards which were reviewed by Chesapeake to determine the potential impact on our financial statements upon adoption.

In December 2004, the Financial Accounting Standards Board issued SFAS 123(R), *Share-Based Payment*, a revision of SFAS 123, accounting for stock-based compensation. This statement establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services by requiring a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This statement is effective as of the beginning of the annual reporting period that begins after June 15, 2005.

Chesapeake will implement SFAS 123(R) in the first quarter of 2006 and the Black-Scholes option pricing model will be used to value the stock options as of the grant date. Based on the stock options outstanding and vested at September 30, 2005 and our current intention to limit future awards of stock options, we do not believe the new accounting requirement will have a significant impact on future results of operations.

In March 2005, the FASB issued FASB Interpretation No. (FIN) 47, *Accounting for Conditional Asset Retirement Obligations*. FIN 47 specifies the accounting treatment for conditional asset retirement obligations under the provisions of Statement of Financial Accounting Standards No. 143. FIN 47 is effective no later than the end of the fiscal year ending after December 15, 2005. Implementation of FIN 47 is not expected to have a material effect on our financial statements.

### Forward-Looking Statements

This report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements give our current expectations or forecasts of future events. They include statements regarding oil and gas reserve estimates, planned capital expenditures, the drilling of oil and gas wells and future acquisitions, including the pending CNR acquisition,

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## Table of Contents

expected oil and gas production, cash flow and anticipated liquidity, business strategy and other plans and objectives for future operations and expected future expenses. Statements concerning the fair values of derivative contracts and their estimated contribution to our future results of operations are based upon market information as of a specific date. These market prices are subject to significant volatility.

Although we believe the expectations and forecasts reflected in these and other forward-looking statements are reasonable, we can give no assurance they will prove to have been correct. They can be affected by inaccurate assumptions or by known or unknown risks and uncertainties. Factors that could cause actual results to differ materially from expected results are described under "Risk Factors" in Item 1 of our annual report on Form 10-K for the year ended December 31, 2004 and include:

- the volatility of oil and gas prices,
- our level of indebtedness,
- the strength and financial resources of our competitors,
- the availability of capital on an economic basis to fund reserve replacement costs,
- uncertainties inherent in estimating quantities of oil and gas reserves and projecting future rates of production and the timing of development expenditures,
- our ability to replace reserves and sustain production,
- uncertainties in evaluating oil and gas reserves of acquired properties and associated potential liabilities,
- unsuccessful exploration and development drilling,
- declines in the value of our oil and gas properties resulting in ceiling test write-downs,
- lower prices realized on oil and gas sales and collateral required to secure hedging liabilities resulting from our commodity price risk management activities, and
- drilling and operating risks.

In addition, there are uncertainties associated with closing our pending acquisition of CNR and the integration and operation of its properties after closing.

We caution you not to place undue reliance on these forward-looking statements, which speak only as of the date of this report, and we undertake no obligation to update this information. We urge you to carefully review and consider the disclosures made in this report and our other filings with the Securities and Exchange Commission that attempt to advise interested parties of the risks and factors that may affect our business.

### **ITEM 3. *Quantitative and Qualitative Disclosures About Market Risk***

#### *Oil and Gas Hedging Activities*

Our results of operations and operating cash flows are impacted by changes in market prices for oil and gas. To mitigate a portion of the exposure to adverse market changes, we have entered into various derivative instruments. As of September 30, 2005, our oil and gas derivative instruments were comprised of swaps, cap-swaps, basis protection swaps, call options and collars. These instruments allow us to predict with greater certainty the effective oil and gas prices to be received for our hedged production. Although derivatives often fail to achieve 100% effectiveness for accounting purposes, we believe our derivative instruments continue to be highly effective in achieving the risk management objectives for which they were intended.

- For swap instruments, Chesapeake receives a fixed price for the hedged commodity and pays a floating market price to the counterparty. The fixed-price payment and the floating-price payment are netted, resulting in a net amount due to or from the counterparty.





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## Table of Contents

- For cap-swaps, Chesapeake receives a fixed price and pays a floating market price. The fixed price received by Chesapeake includes a premium in exchange for a “cap” limiting the counterparty’s exposure. In other words, there is no limit to Chesapeake’s exposure but there is a limit to the downside exposure of the counterparty.
- Basis protection swaps are arrangements that guarantee a price differential for oil or gas from a specified delivery point. Chesapeake receives a payment from the counterparty if the price differential is greater than the stated terms of the contract and pays the counterparty if the price differential is less than the stated terms of the contract.
- For call options, Chesapeake receives a cash premium from the counterparty in exchange for the sale of a call option. If the market price exceeds the fixed price of the call option, then Chesapeake pays the counterparty such excess. If the market price settles below the fixed price of the call option, no payment is due from Chesapeake.
- Collars contain a fixed floor price (put) and ceiling price (call). If the market price exceeds the call strike price or falls below the put strike price, Chesapeake receives the fixed price and pays the market price. If the market price is between the call and the put strike price, no payments are due from either party.

Chesapeake enters into counter-swaps from time to time for the purpose of locking-in the value of a swap. Under the counter-swap, Chesapeake receives a floating price for the hedged commodity and pays a fixed price to the counterparty. The counter-swap is 100% effective in locking-in the value of a swap since subsequent changes in the market value of the swap are entirely offset by subsequent changes in the market value of the counter-swap. We refer to this locked-in value as a locked swap. At the time Chesapeake enters into a counter-swap, Chesapeake removes the original swap’s designation as a cash flow hedge and classifies the original swap as a non-qualifying hedge under SFAS 133. The reason for this new designation is that collectively the swap and the counter-swap no longer hedge the exposure to variability in expected future cash flows. Instead, the swap and counter-swap effectively lock-in a specific gain (or loss) that will be unaffected by subsequent variability in oil and gas prices. Any locked-in gain or loss is recorded in accumulated other comprehensive income and reclassified to oil and gas sales in the month of related production.

With respect to counter-swaps that are designed to lock-in the value of cap-swaps, the counter-swap is effective in locking-in the value of the cap-swap until the floating price reaches the cap (or floor) stipulated in the cap-swap agreement. The value of the counter-swap will increase (or decrease), but in the opposite direction, as the value of the cap-swap decreases (or increases) until the floating price reaches the pre-determined cap (or floor) stipulated in the cap-swap agreement. However, because of the written put option embedded in the cap-swap, the changes in value of the cap-swap are not completely effective in offsetting changes in value of the corresponding counter-swap. Changes in the value of cap-swaps and the counter-swaps are recorded as adjustments to oil and gas sales.

Chesapeake enters into derivatives from time to time for the purpose of converting a fixed price gas sales contract to a floating price. We refer to these contracts as floating price swaps. For a floating price swap, Chesapeake receives a floating market price from the counterparty and pays a fixed price.

In accordance with FASB Interpretation No. 39, to the extent that a legal right of setoff exists, Chesapeake nets the value of its derivative arrangements with the same counterparty in the accompanying condensed consolidated balance sheets.

Chesapeake enters into basis protection swaps for the purpose of locking-in a price differential for oil or gas from a specified delivery point. We currently have basis protection swaps covering four different delivery points which correspond to the actual prices we receive for much of our gas production. By entering into these basis protection swaps, we have effectively reduced our exposure to market changes in future gas price differentials. As of September 30, 2005, the fair value of our basis protection swaps was \$331.4 million. As of September 30, 2005, our basis protection swaps cover approximately 44% of our anticipated gas production remaining in 2005, 25% in 2006, 23% in 2007, 20% in 2008 and 14% in 2009.

Gains or losses from derivative transactions are reflected as adjustments to oil and gas sales on the condensed consolidated statements of operations. Realized gains (losses) included in oil and gas sales were (\$122.6) million, (\$38.0) million, (\$126.6) million and (\$67.6) million in the Current Quarter, Prior Quarter, Current Period and Prior

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## [Table of Contents](#)

Period, respectively. Pursuant to SFAS 133, certain derivatives do not qualify for designation as cash flow hedges. Changes in the fair value of these non-qualifying derivatives that occur prior to their maturity (i.e., temporary fluctuations in value) are reported currently in the consolidated statements of operations as unrealized gains (losses) within oil and gas sales. Unrealized gains (losses) included in oil and gas sales were (\$104.0) million, (\$32.5) million, (\$137.1) million and (\$66.6) million, in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively.

Following provisions of SFAS 133, changes in the fair value of derivative instruments designated as cash flow hedges, to the extent they are effective in offsetting cash flows attributable to the hedged risk, are recorded in other comprehensive income until the hedged item is recognized in earnings. Any change in fair value resulting from ineffectiveness is recognized currently in oil and gas sales as unrealized gains (losses). We recorded a gain (loss) on ineffectiveness of (\$99.5) million, (\$1.8) million, (\$98.9) million and (\$17.0) million in the Current Quarter, Prior Quarter, Current Period and Prior Period, respectively.

## Table of Contents

As of September 30, 2005, we had the following open oil and gas derivative instruments designed to hedge a portion of our oil and gas production for periods after September 2005:

	Volume	Weighted-Average Fixed Price to be Received (Paid)	Weighted Average Put Fixed Price	Weighted-Average Call Fixed Price	Weighted-Average Differential	SFAS 133 Hedge	Net Premiums Received	Fair Value at September 30, 2005 (\$ in thousands)
<b>Natural Gas (mmbtu):</b>								
Swaps:								
4Q 2005	59,355,000	\$ 8.65	\$ —	\$ —	\$ —	Yes	\$ —	\$ (322,465)
1Q 2006	53,100,000	9.57	—	—	—	Yes	—	(258,689)
2Q 2006	34,580,000	7.89	—	—	—	Yes	—	(98,462)
3Q 2006	34,960,000	7.89	—	—	—	Yes	—	(95,131)
4Q 2006	28,235,000	8.06	—	—	—	Yes	—	(83,683)
1Q 2007	14,400,000	9.09	—	—	—	Yes	—	(36,190)
Basis Protection Swaps:								
4Q 2005	49,360,000	—	—	—	(0.27)	No	—	99,046
1Q 2006	34,200,000	—	—	—	(0.33)	No	—	29,809
2Q 2006	30,940,000	—	—	—	(0.31)	No	—	19,090
3Q 2006	31,280,000	—	—	—	(0.31)	No	—	14,247
4Q 2006	33,720,000	—	—	—	(0.32)	No	—	17,991
1Q 2007	32,850,000	—	—	—	(0.29)	No	—	20,805
2Q 2007	29,575,000	—	—	—	(0.27)	No	—	17,149
3Q 2007	29,900,000	—	—	—	(0.27)	No	—	12,728
4Q 2007	34,170,000	—	—	—	(0.29)	No	—	16,040
1Q 2008	33,215,000	—	—	—	(0.29)	No	—	17,352
2Q 2008	26,845,000	—	—	—	(0.25)	No	—	14,323
3Q 2008	27,140,000	—	—	—	(0.25)	No	—	10,494
4Q 2008	31,410,000	—	—	—	(0.28)	No	—	12,262
1Q 2009	26,100,000	—	—	—	(0.32)	No	—	10,187
2Q 2009	20,020,000	—	—	—	(0.28)	No	—	8,013
3Q 2009	20,240,000	—	—	—	(0.28)	No	—	5,288
4Q 2009	20,240,000	—	—	—	(0.28)	No	—	6,537
Cap-Swaps:								
4Q 2005	20,100,000	6.31	4.61	—	—	No	—	(148,836)
1Q 2006	7,200,000	7.11	5.06	—	—	No	—	(52,470)
2Q 2006	11,830,000	6.84	5.13	—	—	No	—	(46,038)
3Q 2006	11,960,000	6.85	5.13	—	—	No	—	(45,321)
4Q 2006	11,960,000	6.89	5.13	—	—	No	—	(50,219)
Counter Swaps:								
1Q 2006	(1,800,000)	(6.19)	—	—	—	No	—	14,840
2Q 2006	(1,820,000)	(5.35)	—	—	—	No	—	9,816
3Q 2006	(1,840,000)	(5.33)	—	—	—	No	—	9,726
4Q 2006	(1,840,000)	(5.50)	—	—	—	No	—	10,221
Call Options:								
4Q 2005	1,840,000	—	—	5.86	—	No	819	(14,304)
1Q 2006	1,800,000	—	—	12.50	—	No	1,890	(5,164)
2Q 2006	1,820,000	—	—	12.50	—	No	1,911	(1,700)
3Q 2006	1,840,000	—	—	12.50	—	No	1,932	(1,454)
4Q 2006	1,840,000	—	—	12.50	—	No	1,932	(2,376)
1Q 2007	1,800,000	—	—	12.50	—	No	1,890	(3,431)
2Q 2007	1,820,000	—	—	12.50	—	No	1,911	(1,118)
3Q 2007	1,840,000	—	—	12.50	—	No	1,932	(1,091)
4Q 2007	1,840,000	—	—	12.50	—	No	1,932	(1,635)
1Q 2008	1,820,000	—	—	12.50	—	No	1,911	(2,014)
2Q 2008	1,820,000	—	—	12.50	—	No	1,911	(573)
3Q 2008	1,840,000	—	—	12.50	—	No	1,932	(607)
4Q 2008	1,840,000	—	—	12.50	—	No	1,932	(1,151)
Collars:								
4Q 2005	1,384,000	—	3.49	5.27	—	Yes	—	(8,918)
1Q 2006	180,000	—	6.00	9.70	—	Yes	—	(853)

[Table of Contents](#)

	Volume	Weighted-Average Fixed Price to be Received (Paid)	Weighted Average Put Fixed Price	Weighted-Average Call Fixed Price	Weighted-Average Differential	SFAS 133 Hedge	Premiums Received	Fair Value at September 30, 2005 (\$ in thousands)
<b>Locked Swaps:</b>								
4Q 2005	8,280,000	—	—	—	—	No	—	(10,812)
1Q 2006	6,300,000	—	—	—	—	No	—	(7,598)
2Q 2006	6,370,000	—	—	—	—	No	—	(5,199)
3Q 2006	6,440,000	—	—	—	—	No	—	(5,099)
4Q 2006	6,440,000	—	—	—	—	No	—	(4,706)
1Q 2007	6,300,000	—	—	—	—	No	—	(4,789)
2Q 2007	6,370,000	—	—	—	—	No	—	(2,517)
3Q 2007	6,440,000	—	—	—	—	No	—	(2,049)
4Q 2007	6,440,000	—	—	—	—	No	—	(2,272)
<b>Floating-Price Swaps:</b>								
4Q 2005	(1,830,000)	(7.96)	—	—	—	No	—	7,443
1Q 2006	(2,700,000)	(7.96)	—	—	—	No	—	13,320
<b>Total Natural Gas</b>							<b>23,835</b>	<b>(932,207)</b>
<b>Oil (bbls):</b>								
<b>Swaps:</b>								
4Q 2005	797,500	58.69	—	—	—	Yes	—	(6,120)
1Q 2006	900,000	60.00	—	—	—	Yes	—	(6,272)
2Q 2006	880,000	59.88	—	—	—	Yes	—	(6,239)
3Q 2006	828,000	60.16	—	—	—	Yes	—	(5,361)
4Q 2006	828,000	59.78	—	—	—	Yes	—	(5,205)
1Q 2007	360,000	57.13	—	—	—	Yes	—	(2,139)
2Q 2007	91,000	51.04	—	—	—	Yes	—	(1,282)
3Q 2007	92,000	50.56	—	—	—	Yes	—	(1,285)
4Q 2007	92,000	50.11	—	—	—	Yes	—	(1,273)
<b>Cap-Swaps:</b>								
4Q 2005	276,000	44.22	33.33	—	—	No	—	(6,117)
1Q 2006	135,000	57.82	40.67	—	—	No	—	(1,372)
2Q 2006	136,500	57.82	40.67	—	—	No	—	(1,540)
3Q 2006	138,000	57.82	40.67	—	—	No	—	(1,644)
4Q 2006	92,000	56.53	40.00	—	—	No	—	(1,228)
<b>Total Oil</b>							<b>—</b>	<b>(47,077)</b>
<b>Total Natural Gas and Oil</b>							<b>\$ 23,835</b>	<b>\$ (979,284)</b>

## Table of Contents

We have established the fair value of all derivative instruments using estimates of fair value reported by our counterparties and subsequently evaluated internally using established index prices and other sources. The actual contribution to our future results of operations will be based on the market prices at the time of settlement and may be more or less than the fair value estimates used at September 30, 2005.

Based upon the market prices at September 30, 2005, we expect to transfer approximately \$473.3 million (net of income taxes) of the loss included in the balance in accumulated other comprehensive income to earnings during the next 12 months when the transactions actually occur. All transactions hedged as of September 30, 2005 are expected to mature by December 31, 2008, with the exception of our basis protection swaps which extend through 2009.

Additional information concerning the fair value of our oil and gas derivative instruments is as follows:

	2005
	(\$ in thousands)
Fair value of contracts outstanding, as of January 1	\$ 38,350
Change in fair value of contracts during the period	(1,121,228)
Fair value of contracts when entered into during the period	(23,016)
Contracts realized or otherwise settled during the period	126,610
<b>Fair value of contracts outstanding, as of September 30</b>	<b>\$ (979,284)</b>

The change in the fair value of our derivative instruments since January 1, 2005 resulted from the settlement of derivatives for a realized loss as well as an increase in oil and natural gas prices. Derivative instruments reflected as current in the condensed consolidated balance sheet represent the estimated fair value of derivative instrument settlements scheduled to occur over the subsequent twelve-month period based on market prices for oil and gas as of the condensed consolidated balance sheet date. The derivative settlement amounts are not due and payable until the month in which the related underlying hedged transaction occurs.

### Interest Rate Risk

The table below presents principal cash flows and related weighted average interest rates by expected maturity dates. As of September 30, 2005, the fair value of the fixed-rate long-term debt has been estimated based on quoted market prices.

	Years of Maturity						Total	Fair Value
	2005	2006	2007	2008	2009	Thereafter		
<b>Liabilities:</b>								
Long-term debt — fixed-rate <sup>(a)</sup>	\$ —	\$ —	\$ —	\$ 8.0	\$ —	\$ 4,334.7	\$ 4,342.7	\$ 4,443.7
Average interest rate	—	—	—	8.4	—	6.8%	6.8%	6.8%
Long-term debt — variable rate	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Average interest rate	—	—	—	—	—	— %	— %	— %

<sup>(a)</sup> This amount does not include the discount included in long-term debt of (\$91.4) million and the discount for interest rate swaps of (\$1.1) million.

## [Table of Contents](#)

Changes in interest rates affect the amount of interest we earn on our cash, cash equivalents and short-term investments and the interest rate we pay on borrowings under our revolving bank credit facility. All of our other long-term indebtedness is fixed rate and therefore does not expose us to the risk of earnings or cash flow loss due to changes in market interest rates. However, changes in interest rates do affect the fair value of our debt.

### *Interest Rate Derivatives*

We use interest rate derivatives to mitigate our exposure to the volatility in interest rates. For interest rate derivative instruments designated as fair value hedges (in accordance with SFAS 133), changes in fair value of interest rate derivatives are recorded on the consolidated balance sheets as assets (liabilities) and the debt's carrying value amount is adjusted by the change in the fair value of the debt subsequent to the initiation of the derivative. Any resulting differences are recorded currently as ineffectiveness in the consolidated statements of operations as an adjustment to interest expense. Changes in the fair value of derivative instruments not qualifying as fair value hedges are recorded currently as adjustments to interest expense.

As of September 30, 2005, the following interest rate swaps used to convert a portion of our long-term fixed-rate debt to floating-rate debt were outstanding:

<u>Term</u>	<u>Notional Amount</u>	<u>Fixed Rate</u>	<u>Floating Rate</u>	<u>Fair Value Gain (Loss)</u>
				(\$ in thousands)
September 2004 – August 2012	\$ 75,000,000	9.000%	6 month LIBOR plus 452 basis points	\$ (2,129)
July 2005 – January 2015	\$150,000,000	7.750%	6 month LIBOR plus 289 basis points	\$ (3,582)
July 2005 – June 2014	\$150,000,000	7.500%	6 month LIBOR plus 282 basis points	\$ (3,734)
September 2005 – August 2014	\$250,000,000	7.000%	6 month LIBOR plus 205.5 basis points	\$ (2,470)

Subsequent to September 30, 2005, we entered into the following interest rate swaps (which qualify as fair value hedges) to convert a portion of our long-term fixed-rate debt to floating-rate debt:

<u>Term</u>	<u>Notional Amount</u>	<u>Fixed Rate</u>	<u>Floating Rate</u>
October 2005 – January 2018	\$250,000,000	6.250%	6 month LIBOR plus 99 basis points
October 2005 – June 2005	\$200,000,000	6.375%	6 month LIBOR plus 112 basis points
October 2005 – January 2016	\$200,000,000	6.625%	6 month LIBOR plus 129 basis points

In the Current Quarter and Current Period, we closed various interest rate swaps for gains totaling \$2.0 million and \$7.1 million, respectively. These interest rate swaps were designated as fair value hedges, and the settlement amounts received will be amortized as a reduction to realized interest expense over the remaining terms of the related senior notes.

In March 2004, Chesapeake entered into an interest rate swap which required Chesapeake to pay a fixed rate of 8.68% while the counterparty paid Chesapeake a floating rate of six month LIBOR plus 0.75% on a notional amount of \$142.7 million. On March 15, 2005, we elected to terminate the interest rate swap and paid \$31.8 million to the counterparty.

#### **ITEM 4. Controls and Procedures**

We maintain disclosure controls and procedures designed to ensure that information required to be disclosed by Chesapeake in reports filed or submitted by it under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. At the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of Chesapeake management, including Chesapeake's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of Chesapeake's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15(b). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

No changes in Chesapeake's internal control over financial reporting occurred during the Current Quarter that have materially affected, or are reasonably likely to materially affect, Chesapeake's internal control over financial reporting.

## PART II. OTHER INFORMATION

**Item 1. Legal Proceedings**

Chesapeake is currently involved in various disputes incidental to its business operations. Management is of the opinion that the final resolution of currently pending or threatened litigation is not likely to have a material adverse effect on our consolidated financial position, results of operations or cash flows.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table presents information about repurchases of our common stock during the three months ended September 30, 2005:

<u>Period</u>	<u>Total Number of Shares Purchased<sup>(a)</sup></u>	<u>Average Price Paid Per Share<sup>(a)</sup></u>	<u>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</u>	<u>Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs<sup>(b)</sup></u>
July 1, 2005 through July 31, 2005	136,450	\$ 24.787	—	—
August 1, 2005 through August 31, 2005	44,529	28.703	—	—
September 1, 2005 through September 30, 2005	22,782	33.314	—	—
<b>Total</b>	<b>203,761</b>	<b>\$ 26.596</b>	<b>—</b>	<b>—</b>

<sup>(a)</sup> Includes 103,907 shares purchased in the open market for the matching contributions we make to our 401(k) plans, the deemed surrender to the company of 6,078 shares of common stock to pay the exercise price in connection with the exercise of employee stock options and the surrender to the company of 93,776 shares of common stock to pay withholding taxes in connection with the vesting of employee restricted stock.

<sup>(b)</sup> We make matching contributions to our 401(k) plans and 401(k) make-up plan using Chesapeake common stock which is held in treasury or is purchased by the respective plan trustees in the open market. The plans contain no limitation on the number of shares that may be purchased for purposes of company contributions.

**Item 3. Defaults Upon Senior Securities**

Not applicable.

**Item 4. Submission of Matters to a Vote of Security Holders**

Not applicable.



## Table of Contents

### **Item 5. Other Information**

Not applicable.

### **Item 6. Exhibits**

The following exhibits are filed as a part of this report:

<b>Exhibit Number</b>	<b>Description</b>
2	Purchase Agreement dated as of September 30, 2005 between Chesapeake and Triana Energy Holdings, LLC relating to the purchase and sale of Columbia Energy Resources, LLC. Incorporated herein by reference to Exhibit 2 to Chesapeake's current report on Form 8-K filed November 1, 2005.
3.1.1	Restated Certificate of Incorporation, as amended. Incorporated herein by reference to Exhibit 3.1.1 to Chesapeake's Form 10-Q for the quarter ended March 31, 2005.
3.1.2	Certificate of Designation of Series A Junior Participating Preferred Stock, as amended. Incorporated herein by reference to Exhibit 3.1.2 to Chesapeake's Form 10-Q for the quarter ended March 31, 2005.
3.1.3	Certificate of Designation of 6% Cumulative Convertible Preferred Stock, as amended. Incorporated herein by reference to Exhibit 3 to Chesapeake's Form 8-A filed October 11, 2005.
3.1.4	Certificate of Designation of 5% Cumulative Convertible Preferred Stock (Series 2003), as amended. Incorporated herein by reference to Exhibit 4 to Chesapeake's Form 8-A filed October 11, 2005.
3.1.5*	Certificate of Designation of 4.125% Cumulative Convertible Preferred Stock, as amended.
3.1.6	Certificate of Designation of 5% Cumulative Convertible Preferred Stock (Series 2005), as amended. Incorporated herein by reference to Exhibit 3.1.6 to Chesapeake's Form 10-Q for the quarter ended March 31, 2005.
3.1.7	Certificate of Designation of 4.5% Cumulative Convertible Preferred Stock. Incorporated herein by reference to Exhibit 3.1 to Chesapeake's current report on Form 8-K filed September 15, 2005.
4.13	Indenture dated as of August 16, 2005 among Chesapeake, as Issuer, the subsidiaries signatory thereto, as Subsidiary Guarantors and The Bank of New York Trust Company, N.A., as Trustee, with respect to 6.5% Senior Notes due 2017. Incorporated herein by reference to Exhibit 4.1 to Chesapeake's current report on Form 8-K filed August 16, 2005.
4.14	Registration Rights Agreement dated August 16, 2005 between Chesapeake and Banc of America Securities LLC, Bear, Stearns & Co. Inc., Credit Suisse First Boston LLC, Lehman Brothers Inc. and UBS Securities LLC as representatives of the several purchasers, with respect to 6.5% Senior Notes due 2017. Incorporated herein by reference to Exhibit 4.2 to Chesapeake's registration statement on Form S-4 (No. 333-128453) filed September 20, 2005.
12*	Computation of Ratios of Earnings to Combined Fixed Charges and Preferred Stock Dividends.
31.1*	Aubrey K. McClendon, Chairman and Chief Executive Officer, Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Marcus C. Rowland, Executive Vice President and Chief Financial Officer, Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Aubrey K. McClendon, Chairman and Chief Executive Officer, Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Marcus C. Rowland, Executive Vice President and Chief Financial Officer, Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed herewith.

\*\* Furnished as provided in Item 601 of Regulation S-K.



## INDEX TO EXHIBITS

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CERTIFICATE OF DESIGNATION  
OF  
4.125% CUMULATIVE CONVERTIBLE PREFERRED STOCK  
OF  
CHESAPEAKE ENERGY CORPORATION

Pursuant to Section 1032(G) of the Oklahoma General Corporation Act

CHESAPEAKE ENERGY CORPORATION, an Oklahoma corporation (the "Company"), does hereby certify that the following resolution was duly adopted by action of the Board of Directors of the Company, with the provisions thereof fixing the number of shares of the series and the dividend rate being set by action of the Board of Directors of the Company:

RESOLVED that pursuant to the authority expressly granted to and vested in the Board of Directors of the Company by the provisions of Article IV, Section 1 of the Certificate of Incorporation of the Company, as amended from time to time (the "Certificate of Incorporation"), and pursuant to Section 1032(G) of the Oklahoma General Corporation Act, the Board of Directors hereby creates a series of preferred stock of the Company and hereby states that the voting powers, designations, preferences and relative, participating, optional or other special rights of which, and qualifications, limitations or restrictions thereof (in addition to the provisions set forth in the Certificate of Incorporation which are applicable to the preferred stock of all classes and series), shall be as follows:

**1. Designation and Amount: Ranking**

(a) There shall be created from the 10,000,000 shares of preferred stock, par value \$0.01 per share, of the Company authorized to be issued pursuant to the Certificate of Incorporation, a series of preferred stock, designated as the "4.125% Cumulative Convertible Preferred Stock," par value \$0.01 per share (the "Preferred Stock"), and the number of shares of such series shall be 313,250. Such number of shares may be decreased by resolution of the Board of Directors; provided that no decrease shall reduce the number of shares of Preferred Stock to a number less than that of the shares of Preferred Stock then outstanding plus the number of shares issuable upon exercise of options or rights then outstanding.

(b) The Preferred Stock will, with respect to both dividend rights and rights upon the liquidation, winding-up or dissolution of the Company, rank on a parity with the 6.75% Preferred Stock, the 6.00% Preferred Stock and the 5.00% Preferred Stock, and the Preferred Stock will, with respect to dividend rights or rights upon the liquidation, winding-up or dissolution of the Company rank (i) senior to all Junior Stock, (ii) on a parity with all other Parity Stock and (iii) junior to all Senior Stock.

**2. Definitions.** As used herein, the following terms shall have the following meanings:

(a) "Accrued Dividends" shall mean, with respect to any share of Preferred Stock, as of any date, the accrued and unpaid dividends on such share from and including the most recent Dividend Payment Date (or the Issue Date, if such date is prior to the first Dividend Payment Date) to but not including such date.

(b) "Accumulated Dividends" shall mean, with respect to any share of Preferred Stock, as of any date, the aggregate accumulated and unpaid dividends on such share from the Issue Date until the most recent Dividend Payment Date on or prior to such date. There shall be no Accumulated Dividends with respect to any share of Preferred Stock prior to the first Dividend Payment Date.

(c) "Affiliate" shall have the meaning ascribed to it, on the date hereof, under Rule 405 of the Securities Act of 1933, as amended.

(d) "Board of Directors" shall mean the Board of Directors of the Company or, with respect to any action to be taken by the Board of Directors, any committee of the Board of Directors duly authorized to take such action.

(e) "Business Day" shall mean any day other than a Saturday, Sunday or other day on which commercial banks in The City of New York are authorized or required by law or executive order to close.

(f) "Change of Control" shall mean any of the following events: (i) the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of the Company's assets (determined on a consolidated basis) to any Person or group (as such term is used in Section 13(d)(3) of the Exchange Act), other than to Permitted Holders; (ii) the adoption of a plan the consummation of which would result in the liquidation or dissolution of the Company; (iii) the acquisition, directly or indirectly, by any Person or group (as such term is used in Section 13(d)(3) of the Exchange Act), other than Permitted

Holders, of beneficial ownership (as defined in Rule 13d-3 under the Exchange Act) of more than 50% of the aggregate voting power of the Voting Stock of the Company; provided, however, that the Permitted Holders beneficially own (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, in the aggregate a lesser percentage of the total voting power of the Voting Stock of the Company than such other Person or group and do not have the right or ability by voting power, contract or otherwise to elect or designate for election a majority of the Board of Directors (for the purposes of this definition, such other Person or group shall be deemed to beneficially own any Voting Stock of a specified corporation held by a parent corporation, if such other Person or group is the beneficial owner (as defined above), directly or indirectly, of more than 35% of the voting power of the Voting Stock of such parent corporation and the Permitted Holders beneficially own (as defined in this proviso), directly or indirectly, in the aggregate a lesser percentage of the voting power of the Voting Stock of such parent corporation and do not have the right or ability by voting power, contract or otherwise to elect or designate for election a majority of the Board of Directors of such parent corporation); or (iv) during any period of two consecutive years, individuals who at the beginning of such period comprised the Board of Directors of the Company (together with any new directors whose election by such Board of Directors or whose nomination for election by the shareholders of the Company was approved by a vote of 66 2/3% of the directors of the Company then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the Board of Directors of the Company then in office. For purposes of this definition of "Change of Control," the term "Permitted Holders" means Aubrey K. McClendon and Tom L. Ward and their respective Affiliates.

(g) "Change of Control Date" shall mean the date on which the Change of Control event occurs.

(h) "Closing Sale Price" of the Common Stock on any date means the closing sale price per share (or if no closing sale price is reported, the average of the closing bid and ask prices or, if more than one in either case, the average of the average closing bid and the average closing ask prices) on such date as reported on the principal United States securities exchange on which the Common Stock is traded or, if the Common Stock is not listed on a United States national or regional securities exchange, as reported by Nasdaq or by the National Quotation Bureau Incorporated. In the absence of such a quotation, the Company will determine the Closing Sale Price on the basis it considers appropriate.

(i) "Conversion Price" shall mean \$16.6513, subject to adjustment as set forth in Section 7(d).

(j) "Common Stock" shall mean the common stock, par value \$0.01 per share, of the Company, or any other class of stock resulting from successive changes or reclassifications of such common stock consisting solely of changes in par value, or from par value to no par value, or as a result of a subdivision, combination, or merger, consolidation or similar transaction in which the Company is a constituent corporation.

(k) "DTC" or "Depository" shall mean The Depository Trust Company.

(l) "Dividend Payment Date" shall mean March 15, June 15, September 15 and December 15 of each year, commencing June 15, 2004.

(m) "Dividend Record Date" shall mean March 1, June 1, September 1 and December 1 of each year.

(n) "Exchange Act" shall mean the Securities Exchange Act of 1934, as amended, and the rules and regulations promulgated thereunder.

(o) "Holder" or "holder" shall mean a holder of record of the Preferred Stock.

(p) "Issue Date" shall mean March 30, 2004, the original date of issuance of the Preferred Stock.

(q) "Junior Stock" shall mean all classes of common stock of the Company and the Series A Junior Participating Convertible Preferred Stock and each other class of capital stock or series of preferred stock established after the Issue Date, by the Board of Directors, the terms of which do not expressly provide that such class or series ranks senior to or on parity with the Preferred Stock as to dividend rights or rights upon the liquidation, winding-up or dissolution of the Company.

(r) "Liquidation Preference" shall mean, with respect to each share of Preferred Stock, \$1,000.00.

(s) "Market Value" shall mean the average closing price of the Common Stock for a five consecutive trading day period on the NYSE (or such other national securities exchange or automated quotation system on which the Common Stock is then listed or authorized for quotation or, if the Common Stock is not so listed or authorized for quotation, an amount determined in good faith by the Board of Directors to be the fair value of the Common Stock).

(t) "NYSE" shall mean the New York Stock Exchange, Inc.

- (u) "Officer" shall mean the Chairman of the Board of Directors, the President, any Vice President, the Treasurer, the Secretary or any Assistant Secretary of the Company.
- (v) "Officers' Certificate" shall mean a certificate signed by two Officers.
- (w) "Opinion of Counsel" shall mean a written opinion from legal counsel who is acceptable to the Transfer Agent. The counsel may be an employee of or counsel to the Company or the Transfer Agent.
- (x) "Parity Stock" shall mean the 6.00% Preferred Stock, the 6.75% Preferred Stock, the 5.00% Preferred Stock and any class of capital stock or series of preferred stock established after the Issue Date by the Board of Directors, the terms of which expressly provide that such class or series will rank on parity with the Preferred Stock as to dividend rights or rights upon the liquidation, winding-up or dissolution of the Company.
- (y) "Person" shall mean any individual, corporation, general partnership, limited partnership, limited liability partnership, joint venture, association, joint-stock company, trust, limited liability company, unincorporated organization or government or any agency or political subdivision thereof.
- (z) "Purchase Agreement" shall mean that certain Purchase Agreement with respect to the Preferred Stock, dated March 24, 2004, among the Company, Lehman Brothers Inc., Banc of America Securities LLC, Bear, Stearns & Co. Inc. and Credit Suisse First Boston LLC and the other initial purchasers named therein.
- (aa) "Registration Rights Agreement" means the Registration Rights Agreement dated March 30, 2004, among the Company, Lehman Brothers Inc., Banc of America Securities LLC, Bear, Stearns & Co. Inc. and Credit Suisse First Boston LLC and the other initial purchasers named in the Purchase Agreement, with respect to the Preferred Stock.
- (bb) "SEC" or "Commission" shall mean the Securities and Exchange Commission.
- (cc) "Securities Act" shall mean the Securities Act of 1933, as amended.
- (dd) "Senior Stock" shall mean each class of capital stock or series of preferred stock established after the Issue Date by the Board of Directors, the terms of which expressly provide that such class or series will rank senior to the Preferred Stock as to dividend rights or rights upon the liquidation, winding-up or dissolution of the Company.
- (ee) "Shelf Registration Statement" shall mean a shelf registration statement filed with the SEC to cover resales of Transfer Restricted Securities by holders thereof, as required by the Registration Rights Agreement.
- (ff) "5.00% Preferred Stock" shall mean the series of preferred stock, par value \$0.01 per share, of the Company designated as the "5.00% Cumulative Convertible Preferred Stock."
- (gg) "6.00% Preferred Stock" shall mean the series of preferred stock, par value \$0.01 per share, of the Company designated as the "6.00% Cumulative Convertible Preferred Stock."
- (hh) "6.75% Preferred Stock" shall mean the series of preferred stock, par value \$0.01 per share, of the Company designated as the "6.75% Cumulative Convertible Preferred Stock."
- (ii) "Trading Day" shall mean a day during which trading in securities generally occurs on the New York Stock Exchange or, if Common Stock is not listed on the New York Stock Exchange, on the principal other national or regional securities exchange on which Common Stock is then listed or, if Common Stock is not listed on a national or regional securities exchange, on Nasdaq or, if Common Stock is not quoted on Nasdaq, on the principal other market on which Common Stock is then traded.
- (jj) "Trading Price" of the Preferred Stock on any date of determination means the average of the secondary market bid quotations obtained by the Company or the calculation agent for 5,000 shares of Preferred Stock at approximately 3:30 p.m., New York City time, on such determination date from three independent nationally recognized securities dealers that the Company or the calculation agent selects; provided that if three such bids cannot reasonably be obtained by the Company or the calculation agent, but two such bids are obtained, the average of the two bids shall be used, and if only one such bid can reasonably be obtained by the Company or the calculation agent, that one bid shall be used. If the Company or the calculation agent cannot reasonably obtain at least one bid for 5,000 shares of Preferred Stock from a nationally recognized securities dealer, then the Trading Price per share of Preferred Stock will be deemed to be less than 98% of the product of (A) the Closing Sale Price of the Common Stock on such date (B) and the Conversion Price on such date.

(kk) "Transfer Agent" shall mean UMB Bank, N.A., the Company's duly appointed transfer agent, registrar and conversion and dividend disbursing agent for the Preferred Stock. The Company may, in its sole discretion, remove the Transfer Agent with 10 days' prior notice to the Transfer Agent; provided, that the Company shall appoint a successor Transfer Agent who shall accept such appointment prior to the effectiveness of such removal.

(ll) "Transfer Restricted Securities" shall mean each share of Preferred Stock (or the shares of Common Stock into which such share of Preferred Stock is convertible) until (i) the date on which such security or its predecessor has been effectively registered under the Securities Act and disposed of in accordance with the Shelf Registration Statement or (ii) the date on which such security or predecessor is distributed to the public pursuant to Rule 144 under the Securities Act or is saleable pursuant to Rule 144(k) under the Securities Act.

(mm) "Voting Rights Triggering Event" shall mean the failure of the Company to pay dividends on the Preferred Stock with respect to six or more quarterly periods (whether or not consecutive).

(nn) "Voting Stock" shall mean, with respect to any Person, securities of any class or classes of Capital Stock in such Person entitling the holders thereof (whether at all times or only so long as no senior class of stock has voting power by reason of contingency) to vote in the election of members of the Board of Directors or other governing body of such Person. For purposes of this definition, "Capital Stock" shall mean, with respect to any Person, any and all shares, interests, participations or other equivalents (however designated) of corporate stock or partnership interests and any and all warrants, options and rights with respect thereto (whether or not currently exercisable), including each class of common stock and preferred stock of such Person.

### 3. Dividends.

(a) The holders of shares of the outstanding Preferred Stock shall be entitled, when, as and if declared by the Board of Directors out of funds of the Company legally available therefor, to receive cumulative cash dividends at the rate per annum of 4.125 % per share on the Liquidation Preference (equivalent to \$41.25 per annum per share), payable quarterly in arrears (the "Dividend Rate"). The Dividend Rate may be increased in the circumstances described in Section 3(b) below. Dividends payable for each full dividend period will be computed by dividing the Dividend Rate by four and shall be payable in arrears on each Dividend Payment Date (commencing June 15, 2004) for the quarterly period ending immediately prior to such Dividend Payment Date, to the holders of record of Preferred Stock at the close of business on the Dividend Record Date applicable to such Dividend Payment Date. Such dividends shall be cumulative from the most recent date as to which dividends shall have been paid or, if no dividends have been paid, from the Issue Date (whether or not in any dividend period or periods there shall be funds of the Company legally available for the payment of such dividends) and shall accrue on a day-to-day basis, whether or not earned or declared, from and after the Issue Date. Dividends payable for any partial dividend period, including the initial partial dividend period ending immediately prior to June 15, 2004, shall be computed on the basis of days elapsed over a 360-day year consisting of twelve 30-day months. Accumulations of dividends on shares of Preferred Stock shall not bear interest.

(b) If (i) by July 28, 2004, the Shelf Registration Statement has not been filed with the Commission, (ii) by November 25, 2004, the Shelf Registration Statement has not been declared effective by the Commission or (iii) after the Shelf Registration Statement has been declared effective, (A) the Shelf Registration Statement thereafter ceases to be effective or (B) the Shelf Registration Statement or the related prospectus ceases to be usable (in each case, subject to the exceptions described below) in connection with resales of Transfer Restricted Securities during the period that any Transfer Restricted Securities (other than Transfer Restricted Securities held or beneficially owned by affiliates of the Company) remain outstanding (each such event referred to in clauses (i), (ii) and (iii), a "Registration Default"), additional dividends shall accrue on the Preferred Stock at the rate of .50% per annum (resulting in a Dividend Rate of 4.625% per annum during the continuance of a Registration Default), from and including the date on which any such Registration Default shall occur to but excluding the date on which all Registration Defaults have been cured. At all other times, dividends shall accumulate on the Preferred Stock at the Dividend Rate as described in Section 3(a).

A Registration Default referred to in clause (iii) of Section 3(b) shall be deemed not to have occurred and be continuing in relation to the Shelf Registration Statement or the related prospectus if (i) such Registration Default has occurred solely as a result of (x) the filing of a post-effective amendment to the Shelf Registration Statement to incorporate annual audited financial information with respect to the Company where such post-effective amendment is not yet effective and needs to be declared effective to permit Holders to use the related prospectus or (y) other material events, with respect to the Company that would need to be described in the Shelf Registration Statement or the related prospectus and (ii) in the case of clause (y), the Company is proceeding promptly and in good faith to amend or supplement such Shelf Registration Statement and related prospectus to describe such events; provided, however, that in any case if such Registration Default referred to in clause (iii)

of Section 3(b) occurs for a continuous period in excess of 30 days, additional dividends as described in Section 3(b) shall be payable in accordance therewith from the day such Registration Default occurs until such Registration Default is cured.

(c) No dividend will be declared or paid upon, or any sum set apart for the payment of dividends upon, any outstanding share of the Preferred Stock with respect to any dividend period unless all dividends for all preceding dividend periods have been declared and paid or declared and a sufficient sum set apart for the payment of such dividend, upon all outstanding shares of Preferred Stock.

(d) No dividends or other distributions (other than a dividend or distribution payable solely in shares of Parity Stock or Junior Stock (in the case of Parity Stock) or Junior Stock (in the case of Junior Stock) and other than cash paid in lieu of fractional shares) may be declared, made or paid, or set apart for payment upon, any Parity Stock or Junior Stock, nor may any Parity Stock or Junior Stock be redeemed, purchased or otherwise acquired for any consideration (or any money paid to or made available for a sinking fund for the redemption of any Parity Stock or Junior Stock) by or on behalf of the Company (except by conversion into or exchange for shares of Parity Stock or Junior Stock (in the case of Parity Stock) or Junior Stock (in the case of Junior Stock)), unless full Accumulated Dividends shall have been or contemporaneously are declared and paid, or are declared and a sum sufficient for the payment thereof is set apart for such payment, on the Preferred Stock and any Parity Stock for all dividend payment periods terminating on or prior to the date of such declaration, payment, redemption, purchase or acquisition. Notwithstanding the foregoing, if full dividends have not been paid on the Preferred Stock and any Parity Stock, dividends may be declared and paid on the Preferred Stock and such Parity Stock so long as the dividends are declared and paid pro rata so that the amounts of dividends declared per share on the Preferred Stock and such Parity Stock will in all cases bear to each other the same ratio that accumulated and unpaid dividends per share on the shares of Preferred Stock and such other Parity Stock bear to each other.

(e) Holders of shares of Preferred Stock shall not be entitled to any dividends on the Preferred Stock, whether payable in cash, property or stock, in excess of full cumulative dividends. No interest, or sum of money in lieu of interest, shall be payable in respect of any dividend payment or payments on the Preferred Stock which may be in arrears.

(f) The holders of shares of Preferred Stock at the close of business on a Dividend Record Date will be entitled to receive the dividend payment on those shares on the next following Dividend Payment Date notwithstanding the subsequent conversion thereof or the Company's default in payment of the dividend due on that Dividend Payment Date. However, shares of Preferred Stock surrendered for conversion during the period between the close of business on any Dividend Record Date and the close of business on the Business Day immediately preceding the applicable Dividend Payment Date must be accompanied by payment of an amount equal to the dividend payable on the shares on that Dividend Payment Date. A holder of shares of Preferred Stock on a Dividend Record Date who (or whose transferee) tenders any shares for conversion on the corresponding Dividend Payment Date will receive the dividend payable by the Company on the Preferred Stock on that date, and the converting holder need not include payment in the amount of such dividend upon surrender of shares of Preferred Stock for conversion. Except as provided above with respect to a voluntary conversion pursuant to Section 7, the Company shall make no payment or allowance for unpaid dividends, whether or not in arrears, on converted shares or for dividends on the shares of Common Stock issued upon conversion.

#### 4. Change of Control.

(a) Upon the occurrence of a Change of Control, each holder of Preferred Stock shall, in the event that the Market Value for the period ending on the Change of Control Date is less than the Conversion Price, have a one-time option (the "Change of Control Option") to convert all of such holder's outstanding shares of Preferred Stock into fully paid and nonassessable shares of Common Stock at an adjusted Conversion Price equal to the greater of (i) the Market Value for the period ending on the Change of Control Date and (ii) \$8.0733. The Change of Control Option must be exercised, if at all, during the period of not less than 30 days nor more than 60 days commencing on the third Business Day after notice of a Change in Control has been given by the Company in accordance with Section 4(b). In lieu of issuing the shares of Common Stock issuable upon conversion in the event of a Change of Control, the Company may, at its option, make a cash payment equal to the Market Value for each share of such Common Stock otherwise issuable determined for the period ending on the Change of Control Date. Notwithstanding the foregoing, upon the occurrence of a Change of Control in which (i) each holder of Common Stock receives consideration consisting solely of common stock of the successor, acquiror or other third party (and cash paid in lieu of fractional shares) that is listed on a national securities exchange or quoted on the NASDAQ National Market and (ii) all the Common Stock has been exchanged for, converted into or acquired for common stock of the successor, acquiror or other third party (and cash in lieu of fractional shares), and the Preferred Stock becomes convertible solely into such common stock, the Conversion Price will not be adjusted as described in this Section 4(a).

(b) In the event of a Change of Control (other than a Change of Control described in the last sentence of Section 4(a)), notice of such Change of Control shall be given, within five Business Days of the Change of Control Date, by the Company by first-class mail to each record holder of shares of Preferred Stock, at such holder's address as the same appears on the



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books of the Company. Each such notice shall state (i) that a Change of Control has occurred; (ii) the last day on which the Change of Control Option may be exercised (the "Expiration Date") pursuant to the terms hereof; (iii) the name and address of the Transfer Agent; and (iv) the procedures that holders must follow to exercise the Change of Control Option.

(c) On or before the Expiration Date, each holder of shares of Preferred Stock wishing to exercise the Change of Control Option shall surrender the certificate or certificates representing the shares of Preferred Stock to be converted, in the manner and at the place designated in the notice described in Section 4(b), and on such date the cash or shares of Common Stock due to such holder shall be delivered to the Person whose name appears on such certificate or certificates as the owner thereof and the shares represented by each surrendered certificate shall be returned to authorized but unissued shares. Upon surrender (in accordance with the notice described in Section 4(b)) of the certificate or certificates representing any shares to be so converted (properly endorsed or assigned for transfer, if the Company shall so require and the notice shall so state), such shares shall be converted by the Company at the adjusted Conversion Price, if applicable, as described in Section 4(a).

(d) The rights of holders of Preferred Stock pursuant to this Section 4 are in addition to, and not in lieu of, the rights of holders of Preferred Stock provided for in Section 7 hereof.

## 5. Voting.

(a) The shares of Preferred Stock shall have no voting rights except as set forth below or as otherwise required by Oklahoma law from time to time:

(i) If and whenever at any time or times a Voting Rights Triggering Event occurs, then the holders of shares of Preferred Stock, voting as a single class with any other preferred stock or preference securities having similar voting rights that are exercisable, including the 5.00% Preferred Stock, the 6.00% Preferred Stock and the 6.75% Preferred Stock (the "Voting Rights Class"), will be entitled at the next regular or special meeting of stockholders of the Company to elect two additional directors of the Company. Upon the election of any such additional directors, the number of directors that comprise the Board of Directors shall be increased by such number of additional directors.

(ii) Such voting rights may be exercised at a special meeting of the holders of the shares of the Voting Rights Class, called as hereinafter provided, or at any annual meeting of stockholders held for the purpose of electing directors, and thereafter at each such annual meeting until such time as all dividends in arrears on the shares of Preferred Stock shall have been paid in full, at which time or times such voting rights and the term of the directors elected pursuant to Section 5(a)(i) shall terminate.

(iii) At any time when such voting rights shall have vested in holders of shares of the Voting Rights Class, an Officer of the Company may call, and, upon written request of the record holders of shares representing at least twenty-five percent (25%) of the voting power of the shares then outstanding of the Voting Rights Class, addressed to the Secretary of the Company, shall call a special meeting of the holders of shares of the Voting Rights Class. Such meeting shall be held at the earliest practicable date upon the notice required for annual meetings of stockholders at the place for holding annual meetings of stockholders of the Company, or, if none, at a place designated by the Board of Directors. Notwithstanding the provisions of this Section 5(a)(iii), no such special meeting shall be called during a period within the 60 days immediately preceding the date fixed for the next annual meeting of stockholders in which such case, the election of directors pursuant to Section 5(a)(i) shall be held at such annual meeting of stockholders.

(iv) At any meeting held for the purpose of electing directors at which the holders of the Voting Rights Class shall have the right to elect directors as provided herein, the presence in person or by proxy of the holders of shares representing more than fifty percent (50%) in voting power of the then outstanding shares of the Voting Rights Class shall be required and shall be sufficient to constitute a quorum of such class for the election of directors by such class. The affirmative vote of the holders of shares of Preferred Stock constituting a majority of the shares of Preferred Stock present at such meeting, in person or by proxy, shall be sufficient to elect any such director.

(v) Any director elected pursuant to the voting rights created under this Section 5(a) shall hold office until the next annual meeting of stockholders (unless such term has previously terminated pursuant to Section 5(a)(ii) ) and any vacancy in respect of any such director shall be filled only by vote of the remaining director so elected by holders of the Voting Rights Class, or if there be no such remaining director, by the holders of shares of the Voting Rights Class at a special meeting called in accordance with the procedures set forth in this Section 5, or, if no such special meeting is called, at the next annual meeting of stockholders. Upon any termination of such voting rights, the term of office of all directors elected pursuant to this Section 5 shall terminate.

(vi) So long as any shares of Preferred Stock remain outstanding, unless a greater percentage shall then be required by law, the Company shall not, without the affirmative vote or consent of the holders of at least 66 2/3% of the

outstanding Preferred Stock voting or consenting, as the case may be, separately as one class, (i) create, authorize or issue any class or series of Senior Stock (or any security convertible into Senior Stock) or (ii) amend the Certificate of Incorporation so as to affect adversely the specified rights, preferences, privileges or voting rights of holders of shares of Preferred Stock.

(vii) In exercising the voting rights set forth in this Section 5(a), each share of Preferred Stock shall be entitled to one vote.

(b) The Company may authorize, increase the authorized amount of, or issue any class or series of Parity Stock or Junior Stock, without the consent of the holders of Preferred Stock, and in taking such actions the Company shall not be deemed to have affected adversely the rights, preferences, privileges or voting rights of holders of shares of Preferred Stock.

#### 6. Liquidation Rights.

(a) In the event of any liquidation, winding-up or dissolution of the Company, whether voluntary or involuntary, each holder of shares of Preferred Stock shall be entitled to receive and to be paid out of the assets of the Company available for distribution to its stockholders the Liquidation Preference plus Accumulated Dividends and Accrued Dividends thereon in preference to the holders of, and before any payment or distribution is made on, any Junior Stock, including, without limitation, on any Common Stock.

(b) Neither the sale, conveyance, exchange or transfer (for cash, shares of stock, securities or other consideration) of all or substantially all the assets or business of the Company (other than in connection with the liquidation, winding-up or dissolution of its business) nor the merger or consolidation of the Company into or with any other Person shall be deemed to be a liquidation, winding-up or dissolution, voluntary or involuntary, for the purposes of this Section 6.

(c) After the payment to the holders of the shares of Preferred Stock of full preferential amounts provided for in this Section 6, the holders of Preferred Stock as such shall have no right or claim to any of the remaining assets of the Company.

(d) In the event the assets of the Company available for distribution to the holders of shares of Preferred Stock upon any liquidation, winding-up or dissolution of the Company, whether voluntary or involuntary, shall be insufficient to pay in full all amounts to which such holders are entitled pursuant to Section 6(a), no such distribution shall be made on account of any shares of Parity Stock upon such liquidation, dissolution or winding-up unless proportionate distributable amounts shall be paid on account of the shares of Preferred Stock, ratably, in proportion to the full distributable amounts for which holders of all Preferred Stock and of any Parity Stock are entitled upon such liquidation, winding-up or dissolution.

#### 7. Conversion.

(a) Each holder of Preferred Stock shall have the right, only on or after the occurrence of the conversion triggering events described in Section 7(b), at its option, from the Issue Date to convert, subject to the terms and provisions of this Section 7, any or all of such holder's shares of Preferred Stock. In such case, the shares of Preferred Stock shall be converted into such whole number of fully paid and nonassessable shares of Common Stock as is equal, subject to Section 7(h), to the product of the number of shares of Preferred Stock being so converted multiplied by the quotient of (i) the Liquidation Preference divided by (ii) the Conversion Price (as defined below) then in effect. The Conversion Price initially shall be \$16.6513, subject to adjustment as set forth in Section 7(d).

The conversion right of a holder of Preferred Stock shall be exercised by the holder by the surrender to the Company of the certificates representing shares to be converted at any time during usual business hours at its principal place of business or the offices of its duly appointed Transfer Agent to be maintained by it, accompanied by written notice to the Company in the form of Exhibit B that the holder elects to convert all or a portion of the shares of Preferred Stock represented by such certificate and specifying the name or names (with address) in which a certificate or certificates for shares of Common Stock are to be issued and (if so required by the Company or its duly appointed Transfer Agent) by a written instrument or instruments of transfer in form reasonably satisfactory to the Company or its duly appointed Transfer Agent duly executed by the holder or its duly authorized legal representative and transfer tax stamps or funds therefor, if required pursuant to Section 7(j). Immediately prior to the close of business on the date of receipt by the Company or its duly appointed Transfer Agent of notice of conversion of shares of Preferred Stock, each converting holder of Preferred Stock shall be deemed to be the holder of record of Common Stock issuable upon conversion of such holder's Preferred Stock notwithstanding that the share register of the Company shall then be closed or that certificates representing such Common Stock shall not then be actually delivered to such holder. On the date of any conversion, all rights with respect to the shares of Preferred Stock so converted, including the rights, if any, to receive notices, will terminate, except only the rights of holders thereof to (i) receive certificates for the number of whole shares of Common Stock into which such shares of Preferred Stock have been converted and cash, in lieu of

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any fractional shares as provided in Section 7(g); and (ii) exercise the rights to which they are entitled as holders of Common Stock.

(b) A holder's right to convert its shares of Preferred Stock will arise only upon the occurrence of the following events:

(i) *Conversion Rights Based on Common Share Price.* A holder may surrender shares of Preferred Stock for conversion into shares of Common Stock during any fiscal quarter after the fiscal quarter ending June 30, 2004 (and only during such fiscal quarter) if the Closing Sale Price of Common Stock for at least 20 Trading Days in a period of 30 consecutive Trading Days ending on the last Trading Day of the immediately preceding fiscal quarter is more than 130% of the Conversion Price on such Trading Day. If this Closing Sale Price condition is not satisfied at the end of any fiscal quarter, then conversion pursuant to this Section 7(b)(i) will not be permitted in the following fiscal quarter. The Company shall determine for each Trading Day during the 30 consecutive Trading Day period specified in this Section 7(b)(i) whether the Closing Sale Price exceeds 130% of the Conversion Price and whether the Preferred Stock shall be convertible as a result of the occurrence of the event set forth in this Section 7(b)(i).

(ii) *Conversion Upon Satisfaction of Trading Price Condition.* A holder may surrender its shares of Preferred Stock for conversion into Common Stock during the five business day period after any five consecutive Trading Day period in which the Trading Price of the Preferred Stock for each day of such five Trading Day period was less than 98% of the product of the Closing Sale Price of the Common Stock and the Conversion Price in effect on each such day. The Company shall determine whether the Preferred Stock may be converted pursuant to this Section 7(b)(ii) based on Trading Prices obtained from three independent nationally known securities dealers. The Company shall have no obligation to determine the Trading Price unless a holder of Preferred Stock provides it with reasonable evidence that the Trading Price was less than 98% of the product of the Closing Sale Price and the then-current Conversion Price. If such evidence is provided, the Company shall determine the Trading Price of the Preferred Stock beginning on the next Trading Day and on each successive Trading Day until the Trading Price is greater than or equal to 98% of the product of the Closing Sale Price and the then current Conversion Price.

(iii) *Conversion Rights Upon Occurrence of Certain Corporate Transactions.*

(1) If the Company is party to a consolidation, merger, binding share exchange or sale of all or substantially all of the Company's assets, in each case pursuant to which the Common Stock would be converted into cash, securities or other property, a holder may surrender its shares of Preferred Stock for conversion into Common Stock at any time from and after the date that is 15 days prior to the anticipated effective date of the transaction until 15 days after the actual date of such transaction and, at the effective time, the right to convert shares of Preferred Stock into Common Stock will be changed into a right to convert such Preferred Stock into the kind and amount of cash, securities or other property of the Company or another person that the holder would have received if the holder had converted the holder's Preferred Stock immediately prior to the transaction.

(2) If the Company elects to (A) distribute to all holders of Common Stock rights or warrants entitling them to purchase, for a period expiring within 45 days of the record date for such distribution, Common Stock at less than the average Closing Sale Price for the ten consecutive Trading Days immediately preceding the declaration date for such distribution or (B) distribute to all holders of Common Stock, cash, assets, debt securities or rights to purchase the Company's securities, which distribution has a per share value exceeding 5% of the Closing Sale Price of Common Stock on the Trading Day immediately preceding the declaration date for such distribution; then, in either case, the Company must notify holders of Preferred Stock at least 20 days prior to the ex-dividend date for such distribution. Once the Company has given such notice, a holder may surrender its shares of Preferred Stock for conversion at any time until the earlier of the close of business on the business day immediately preceding the ex-dividend date or any announcement by the Company that such distribution will not take place. Notwithstanding the foregoing, holders shall not have the right to surrender shares of Preferred Stock for conversion pursuant to this Section 7(b)(iii)(2), and no adjustment to the Conversion Price will be made, if all holders of the Preferred Stock will otherwise participate, on the same basis as a holder of Common Shares, in the distribution described above without first converting Preferred Stock into Common Shares.

(iv) Upon a Change of Control, holders of Preferred Stock shall, if the Market Value at such time is less than the Conversion Price, have a one-time option to convert all of their outstanding shares of Preferred Stock into Common Stock pursuant to Section 4.

(v) Upon determination that holders of Preferred Stock are or will be entitled to convert their Preferred Stock into Common Stock in accordance with any of the provisions of this Section 7(b), the Company will issue a press release and publish such information on its website on the World Wide Web.

(c) If the last day for the exercise of the conversion right shall not be a Business Day, then such conversion right may be exercised on the next preceding Business Day.

(d) The Conversion Price shall be subject to adjustment as follows:

(i) In case the Company shall at any time or from time to time (A) pay a dividend (or other distribution) payable in shares of Common Stock on any class of capital stock (which, for purposes of this Section 7(d) shall include, without limitation, any dividends or distributions in the form of options, warrants or other rights to acquire capital stock) of the Company (other than the issuance of shares of Common Stock in connection with the conversion of preferred stock); (B) subdivide the outstanding shares of Common Stock into a larger number of shares; (C) combine the outstanding shares of Common Stock into a smaller number of shares; (D) issue any shares of its capital stock in a reclassification of the Common Stock; or (E) pay a dividend or make a distribution to all holders of shares of Common Stock (other than a dividend or distribution subject to Section 7(d)(ii)) pursuant to a stockholder rights plan, "poison pill" or similar arrangement and excluding dividends payable on the Preferred Stock then, and in each such case, the Conversion Price in effect immediately prior to such event shall be adjusted (and any other appropriate actions shall be taken by the Company) so that the holder of any share of Preferred Stock thereafter surrendered for conversion shall be entitled to receive the number of shares of Common Stock that such holder would have owned or would have been entitled to receive upon or by reason of any of the events described above, had such share of Preferred Stock been converted into shares of Common Stock immediately prior to the occurrence of such event. An adjustment made pursuant to this Section 7(d)(i) shall become effective retroactively (x) in the case of any such dividend or distribution, to the day immediately following the close of business on the record date for the determination of holders of Common Stock entitled to receive such dividend or distribution or (y) in the case of any such subdivision, combination or reclassification, to the close of business on the day upon which such corporate action becomes effective.

(ii) In case the Company shall at any time or from time to time issue to all holders of its Common Stock rights, options or warrants entitling the holders thereof to subscribe for or purchase shares of Common Stock (or securities convertible into or exchangeable for shares of Common Stock) at a price per share less than the Market Value for the period ending on the date of issuance (treating the price per share of any security convertible or exchangeable or exercisable into Common Stock as equal to (A) the sum of the price paid to acquire such security convertible, exchangeable or exercisable into Common Stock plus any additional consideration payable (without regard to any anti-dilution adjustments) upon the conversion, exchange or exercise of such security into Common Stock divided by (B) the number of shares of Common Stock into which such convertible, exchangeable or exercisable security is initially convertible, exchangeable or exercisable), other than (i) issuances of such rights, options or warrants if the holder of Preferred Stock would be entitled to receive such rights, options or warrants upon conversion at any time of shares of Preferred Stock into Common Stock and (ii) issuances that are subject to certain triggering events (until such time as such triggering events occur), then, and in each such case, the Conversion Price then in effect shall be adjusted by dividing the Conversion Price in effect on the day immediately prior to the record date of such issuance by a fraction (y) the numerator of which shall be the sum of the number of shares of Common Stock outstanding on such record date plus the number of additional shares of Common Stock issued or to be issued upon or as a result of the issuance of such rights, options or warrants (or the maximum number into or for which such convertible or exchangeable securities initially may convert or exchange or for which such options, warrants or other rights initially may be exercised) and (z) the denominator of which shall be the sum of the number of shares of Common Stock outstanding on such record date plus the number of shares of Common Stock which the aggregate consideration for the total number of such additional shares of Common Stock so issued (or into or for which such convertible or exchangeable securities may convert or exchange or for which such options, warrants or other rights may be exercised plus the aggregate amount of any additional consideration initially payable upon the conversion, exchange or exercise of such security) would purchase at the Market Value for the period ending on the date of conversion; provided, that if the Company distributes rights or warrants (other than those referred to above in this subparagraph (d)(ii)) pro rata to the holders of Common Stock, so long as such rights or warrants have not expired or been redeemed by the Company, (y) the holder of any Preferred Stock surrendered for conversion shall be entitled to receive upon such conversion, in addition to the shares of Common Stock then issuable upon such conversion (the "Conversion Shares"), a number of rights or warrants to be determined as follows: (i) if such conversion occurs on or prior to the date for the distribution to the holders of rights or warrants of separate certificates evidencing such rights or warrants (the "Distribution Date"), the same number of rights or warrants to which a holder of a number of shares of Common Stock equal to the number of Conversion Shares is entitled at the time of such conversion in accordance with the terms and provisions applicable to the rights or warrants and (ii) if such conversion occurs after the Distribution Date, the same number of rights or warrants to which a holder of the number of shares of Common Stock into which such Preferred Stock was convertible immediately prior to such Distribution Date would have been entitled on such Distribution Date had such Preferred Stock been converted immediately prior to such Distribution Date in accordance with the terms and provisions applicable to the rights and warrants and (z) the Conversion Price shall not be subject to adjustment on account of any declaration, distribution or exercise of such rights or warrants.

(iii) If the Company shall at any time make a distribution, by dividend or otherwise, to all holders of shares of its Common Stock consisting exclusively of cash (excluding any cash portion of distributions referred to in clause (E) of paragraph (d)(i) above and cash distributed upon a merger or consolidation to which paragraph (h) below applies) in an amount per share of Common Stock that, when combined with the per share amounts of all other all-cash distributions to all holders of shares of its Common Stock made within the 90-day period ending on the record date for the distribution giving rise to an adjustment pursuant to this Section 7(d)(iii), exceeds \$0.055 per share of Common Stock (the "Distribution Threshold Amount"), then the Conversion Price will be adjusted by multiplying:

(1) the Conversion Price in effect immediately prior to the close of business on the record date fixed for the determination of holders of Common Stock entitled to receive such distribution by

(2) a fraction, the numerator of which will be the Market Value on the fourth trading day on the NYSE prior to such record date minus the amount of cash per share of Common Stock so distributed in excess of the Dividend Threshold Amount for which an adjustment has not otherwise been made pursuant to this Section 7(d)(iii) and the denominator of which will be the Market Value on the fourth trading day on the NYSE prior to such record date.

Subject to Section 7(e), such adjustment shall become effective immediately after the record date for the determination of holders of Common Stock entitled to receive the distribution giving rise to an adjustment pursuant to this Section 7(d)(iii). The Dividend Threshold Amount is subject to adjustment under the same circumstances under which the Conversion Price is subject to adjustment pursuant to Section 7(d)(i) or Section 7(d)(ii).

(iv) In the case the Company at any time or from time to time shall take any action affecting its Common Stock (it being understood that the issuance or sale of shares of Common Stock (or securities convertible into or exchangeable for shares of Common Stock, or any options, warrants or other rights to acquire shares of Common Stock) to any Person at a price per share less than the Conversion Price then in effect shall not be deemed such an action), other than an action described in any of Section 7(d)(i) through Section 7(d)(iii), inclusive, or Section 7(h), then the Conversion Price shall be adjusted in such manner and at such time as the Board of Directors of the Company in good faith determines to be equitable in the circumstances (such determination to be evidenced in a resolution, a certified copy of which shall be mailed to the holders of the Preferred Stock).

(v) Notwithstanding anything herein to the contrary, no adjustment under this Section 7(d) need be made to the Conversion Price unless such adjustment would require an increase or decrease of at least 1% of the Conversion Price then in effect. Any lesser adjustment shall be carried forward and shall be made at the time of and together with the next subsequent adjustment, if any, which, together with any adjustment or adjustments so carried forward, shall amount to an increase or decrease of at least 1% of such Conversion; provided, however, that with respect to adjustments to be made to the Conversion Price in connection with cash dividends paid by the Company, the Company shall make such adjustments, regardless of whether such aggregate adjustments amount to 1% or more of the Conversion Price, no later than March 15 of each calendar year.

(vi) The Company reserves the right to make such reductions in the Conversion Price in addition to those required in the foregoing provisions as it considers advisable in order that any event treated for Federal income tax purposes as a dividend of stock or stock rights will not be taxable to the recipients. In the event the Company elects to make such a reduction in the Conversion Price, the Company will comply with the requirements of Rule 14e-1 under the Exchange Act, and any other securities laws and regulations thereunder if and to the extent that such laws and regulations are applicable in connection with the reduction of the Conversion Price.

(e) If the Company shall take a record of the holders of its Common Stock for the purpose of entitling them to receive a dividend or other distribution, and shall thereafter (and before the dividend or distribution has been paid or delivered to stockholders) legally abandon its plan to pay or deliver such dividend or distribution, then thereafter no adjustment in the Conversion Price then in effect shall be required by reason of the taking of such record.

(f) Upon any increase or decrease in the Conversion Price, then, and in each such case, the Company promptly shall deliver to each holder of Preferred Stock a certificate signed by an authorized officer of the Company, setting forth in reasonable detail the event requiring the adjustment and the method by which such adjustment was calculated and specifying the increased or decreased Conversion Price then in effect following such adjustment.

(g) No fractional shares or securities representing fractional shares of Common Stock shall be issued upon the conversion of any shares of Preferred Stock, whether voluntary or mandatory. If more than one share of Preferred Stock shall be surrendered for conversion at one time by the same holder, the number of full shares of Common Stock issuable upon conversion thereof shall be computed on the basis of the aggregate Liquidation Preference of the shares of Preferred Stock so

surrendered. If the conversion of any share or shares of Preferred Stock results in a fraction, an amount equal to such fraction multiplied by the last reported sale price of the Common Stock on the NYSE (or on such other national securities exchange or automated quotation system on which the Common Stock is then listed for trading or authorized for quotation or, if the Common Stock is not then so listed or authorized for quotation, an amount determined in good faith by the Board of Directors to be the fair value of the Common Stock) at the close of business on the trading day next preceding the day of conversion shall be paid to such holder in cash by the Company.

(h) In the event of any reclassification of outstanding shares of Common Stock (other than a change in par value, or from par value to no par value, or from no par value to par value), or in the event of any consolidation or merger of the Company with or into another Person or any merger of another Person with or into the Company (other than a consolidation or merger in which the Company is the resulting or surviving Person and which does not result in any reclassification or change of outstanding Common Stock), or in the event of any sale or other disposition to another Person of all or substantially all of the assets of the Company (computed on a consolidated basis) (any of the foregoing, a "Transaction"), each share of Preferred Stock then outstanding shall, without the consent of any holder of Preferred Stock, become convertible at any time, at the option of the holder thereof, only into the kind and amount of securities (of the Company or another issuer), cash and other property receivable upon such Transaction by a holder of the number of shares of Common Stock into which such share of Preferred Stock could have been converted immediately prior to such Transaction, after giving effect to any adjustment event. The provisions of this Section 7(h) and any equivalent thereof in any such securities similarly shall apply to successive Transactions. The provisions of this Section 7(h) shall be the sole right of holders of Preferred Stock in connection with any Transaction and such holders shall have no separate vote thereon.

(i) The Company shall at all times reserve and keep available for issuance upon the conversion of the Preferred Stock such number of its authorized but unissued shares of Common Stock as will from time to time be sufficient to permit the conversion of all outstanding shares of Preferred Stock, and shall take all action required to increase the authorized number of shares of Common Stock if at any time there shall be insufficient unissued shares of Common Stock to permit such reservation or to permit the conversion of all outstanding shares of Preferred Stock.

(j) The issuance or delivery of certificates for Common Stock upon the conversion of shares of Preferred Stock shall be made without charge to the converting holder of shares of Preferred Stock for such certificates or for any tax in respect of the issuance or delivery of such certificates or the securities represented thereby, and such certificates shall be issued or delivered in the respective names of, or in such names as may be directed by, the holders of the shares of Preferred Stock converted; provided, however, that the Company shall not be required to pay any tax which may be payable in respect of any transfer involved in the issuance and delivery of any such certificate in a name other than that of the holder of the shares of Preferred Stock converted, and the Company shall not be required to issue or deliver such certificate unless or until the Person or Persons requesting the issuance or delivery thereof shall have paid to the Company the amount of such tax or shall have established to the reasonable satisfaction of the Company that such tax has been paid.

#### 8. Mandatory Conversion.

(a) At any time on or after March 15, 2009, the Company shall have the right, at its option, to cause the Preferred Stock, in whole but not in part, to be automatically converted into that number of whole shares of Common Stock for each share of Preferred Stock equal to the quotient of (i) the Liquidation Preference divided by (ii) the Conversion Price then in effect, with any resulting fractional shares of Common Stock to be settled in accordance with Section 7(g). The Company may exercise its right to cause a mandatory conversion pursuant to this Section 8(a) only if the closing price of the Common Stock equals or exceeds 130% of the Conversion Price then in effect for at least 20 trading days in any consecutive 30-day trading period on the NYSE (or such other national securities exchange or automated quotation system on which the Common Stock is then listed or authorized for quotation), including the last trading day of such 30-day period, ending on the trading day prior to the Company's issuance of a press release announcing the mandatory conversion as described in Section 8(b).

(b) To exercise the mandatory conversion right described in Section 8(a), the Company must issue a press release for publication on the Dow Jones News Service prior to the opening of business on the first trading day following any date on which the conditions described in Section 8(a) are met, announcing such a mandatory conversion. The Company shall also give notice by mail or by publication (with subsequent prompt notice by mail) to the holders of Preferred Stock (not more than four Business Days after the date of the press release) of the mandatory conversion announcing the Company's intention to convert the Preferred Stock. The conversion date will be a date selected by the Company (the "Mandatory Conversion Date") and will be no more than five days after the date on which the Company issues the press release described in this Section 8(b).

(c) In addition to any information required by applicable law or regulation, the press release and notice of a mandatory conversion described in Section 8(b) shall state, as appropriate: (i) the Mandatory Conversion Date; (ii) the number of shares

of Common Stock to be issued upon conversion of each share of Preferred Stock; (iii) the number of shares of Preferred Stock to be converted; and (iv) that dividends on the Preferred Stock to be converted will cease to accrue on the Mandatory Conversion Date.

(d) On and after the Mandatory Conversion Date, dividends will cease to accrue on the Preferred Stock called for a mandatory conversion pursuant to Section 8(a) and all rights of holders of such Preferred Stock will terminate except for the right to receive the whole shares of Common Stock issuable upon conversion thereof and cash, in lieu of any fractional shares of Common Stock in accordance with Section 7(g). The dividend payment with respect to the Preferred Stock called for a mandatory conversion pursuant to Section 8(a) on a date during the period between the close of business on any Dividend Record Date to the close of business on the corresponding Dividend Payment Date will be payable on such Dividend Payment Date to the record holder of such share on such Dividend Record Date if such share has been converted after such Dividend Record Date and prior to such Dividend Payment Date. Except as provided in the immediately preceding sentence with respect to a mandatory conversion pursuant to Section 8(a), no payment or adjustment will be made upon conversion of Preferred Stock for Accrued Dividends or for dividends with respect to the Common Stock issued upon such conversion.

(e) The Company may not authorize, issue a press release or give notice of any mandatory conversion pursuant to Section 8(a) unless, prior to giving the conversion notice, all Accumulated Dividends on the Preferred Stock for periods ended prior to the date of such conversion notice shall have been paid in cash.

(f) In addition to the mandatory conversion right described in Section 8(a), if there are less than 25,000 shares of Preferred Stock outstanding, the Company shall have the right, at any time on or after March 15, 2009, at its option, to cause the Preferred Stock to be automatically converted into that number of whole shares of Common Stock equal to the quotient of (i) the Liquidation Preference divided by (ii) the lesser of (A) the Conversion Price then in effect and (B) the Market Value for the period ending on the second trading day immediately prior to the Mandatory Conversion Date, with any resulting fractional shares of Common Stock to be settled in cash in accordance with Section 7(g). The provisions of clauses (b), (c), (d) and (e) of this Section 8 shall apply to any mandatory conversion pursuant to this clause (f); provided that (i) the Mandatory Conversion Date described in Section 8(b) shall not be less than 15 days nor more than 30 days after the date on which the Company issues a press release pursuant to Section 8(b) announcing such mandatory conversion and (ii) the press release and notice of mandatory conversion described in Section 8(c) will not state the number of shares of Common Stock to be issued upon conversion of each share of Preferred Stock.

#### 9. Consolidation, Merger and Sale of Assets.

(a) The Company, without the consent of the holders of any of the outstanding Preferred Stock, may consolidate with or merge into any other Person or convey, transfer or lease all or substantially all its assets to any Person or may permit any Person to consolidate with or merge into, or transfer or lease all or substantially all its properties to, the Company; provided, however, that (a) the successor, transferee or lessee is organized under the laws of the United States or any political subdivision thereof; (b) the shares of Preferred Stock will become shares of such successor, transferee or lessee, having in respect of such successor, transferee or lessee the same powers, preferences and relative participating, optional or other special rights and the qualification, limitations or restrictions thereon, the Preferred Stock had immediately prior to such transaction; and (c) the Company delivers to the Transfer Agent an Officers' Certificate and an Opinion of Counsel stating that such transaction complies with this Certificate of Designation.

(b) Upon any consolidation by the Company with, or merger by the Company into, any other person or any conveyance, transfer or lease of all or substantially all the assets of the Company as described in Section 9(a), the successor resulting from such consolidation or into which the Company is merged or the transferee or lessee to which such conveyance, transfer or lease is made, will succeed to, and be substituted for, and may exercise every right and power of, the Company under the shares of Preferred Stock, and thereafter, except in the case of a lease, the predecessor (if still in existence) will be released from its obligations and covenants with respect to the Preferred Stock.

#### 10. SEC Reports.

Whether or not the Company is required to file reports with the Commission, if any shares of Preferred Stock are outstanding, the Company shall file with the Commission all such reports and other information as it would be required to file with the Commission by Section 13(a) or 15(d) under the Exchange Act. The Company shall supply each holder of Preferred Stock, upon request, without cost to such holder, copies of such reports or other information.

#### 11. Certificates.

(a) *Form and Dating.* The Preferred Stock and the Transfer Agent's certificate of authentication shall be substantially in the form set forth in Exhibit A, which is hereby incorporated in and expressly made a part of this Certificate of

Designation. The Preferred Stock certificate may have notations, legends or endorsements required by law, stock exchange rule, agreements to which the Company is subject, if any, or usage (provided that any such notation, legend or endorsement is in a form acceptable to the Company). Each Preferred Stock certificate shall be dated the date of its authentication. The terms of the Preferred Stock certificate set forth in Exhibit A are part of the terms of this Certificate of Designation.

(i) **Global Preferred Stock.** The Preferred Stock shall be issued initially in the form of one or more fully registered global certificates with the global securities legend and restricted securities legend set forth in Exhibit A hereto (the “Global Preferred Stock”), which shall be deposited on behalf of the purchasers represented thereby with the Transfer Agent, as custodian for DTC (or with such other custodian as DTC may direct), and registered in the name of DTC or a nominee of DTC, duly executed by the Company and authenticated by the Transfer Agent as hereinafter provided. The number of shares of Preferred Stock represented by Global Preferred Stock may from time to time be increased or decreased by adjustments made on the records of the Transfer Agent and DTC or its nominee as hereinafter provided. With respect to shares of Preferred Stock that are not “restricted securities” as defined in Rule 144 on a conversion date, all shares of Common Stock distributed on such conversion date will be freely transferable without restriction under the Securities Act (other than by affiliates), and such shares will be eligible for receipt in global form through the facilities of DTC.

(ii) **Book-Entry Provisions.** In the event Global Preferred Stock is deposited with or on behalf of DTC, the Company shall execute and the Transfer Agent shall authenticate and deliver initially one or more Global Preferred Stock certificates that (a) shall be registered in the name of DTC as depository for such Global Preferred Stock or the nominee of DTC and (b) shall be delivered by the Transfer Agent to DTC or pursuant to DTC’s instructions or held by the Transfer Agent as custodian for DTC.

Members of, or participants in, DTC (“Agent Members”) shall have no rights under this Certificate of Designation with respect to any Global Preferred Stock held on their behalf by DTC or by the Transfer Agent as the custodian of DTC or under such Global Preferred Stock, and DTC may be treated by the Company, the Transfer Agent and any agent of the Company or the Transfer Agent as the absolute owner of such Global Preferred Stock for all purposes whatsoever. Notwithstanding the foregoing, nothing herein shall prevent the Company, the Transfer Agent or any agent of the Company or the Transfer Agent from giving effect to any written certification, proxy or other authorization furnished by DTC or impair, as between DTC and its Agent Members, the operation of customary practices of DTC governing the exercise of the rights of a holder of a beneficial interest in any Global Preferred Stock.

(iii) **Certificated Preferred Stock; Certificated Common Stock.** Except as provided in this paragraph 11(a) or in paragraph 11(c), owners of beneficial interests in Global Preferred Stock will not be entitled to receive physical delivery of Preferred Stock in fully registered certificated form (“Certificated Preferred Stock”). With respect to shares of Preferred Stock that are “restricted securities” as defined in Rule 144 on a conversion date, all shares of Common Stock issuable on conversion of such shares on such conversion date will be issued in fully registered certificated form (“Certificated Common Stock”). Certificates of Certificated Common Stock will be mailed or made available at the office of the Transfer Agent for the Preferred Stock on or as soon as reasonably practicable after the relevant conversion date to the converting holder.

After a transfer of any Preferred Stock or Certificated Common Stock during the period of the effectiveness of a Shelf Registration Statement with respect to such Preferred Stock or such Certificated Common Stock, all requirements pertaining to legends on such Preferred Stock (including Global Preferred Stock) or Certificated Common Stock will cease to apply, the requirements requiring that any such Certificated Common Stock issued to Holders be issued in certificated form, as the case may, will cease to apply, and Preferred Stock or Common Stock, as the case may be, in global or fully registered certificated form, in either case without legends, will be available to the transferee of the Holder of such Preferred Stock or Certificated Common Stock upon exchange of such transferring Holder’s Preferred Stock or Common Stock or directions to transfer such Holder’s interest in the Global Preferred Stock, as applicable.

(b) *Execution and Authentication.* Two Officers shall sign the Preferred Stock certificate for the Company by manual or facsimile signature.

If an Officer whose signature is on a Preferred Stock certificate no longer holds that office at the time the Transfer Agent authenticates the Preferred Stock certificate, the Preferred Stock certificate shall be valid nevertheless.

A Preferred Stock certificate shall not be valid until an authorized signatory of the Transfer Agent manually signs the certificate of authentication on the Preferred Stock certificate. The signature shall be conclusive evidence that the Preferred Stock certificate has been authenticated under this Certificate of Designation.

The Transfer Agent shall authenticate and deliver certificates for up to 313,250 shares of Preferred Stock for original issue upon a written order of the Company signed by two Officers or by an Officer and an Assistant Treasurer of the



Company. Such order shall specify the number of shares of Preferred Stock to be authenticated and the date on which the original issue of Preferred Stock is to be authenticated.

The Transfer Agent may appoint an authenticating agent reasonably acceptable to the Company to authenticate the certificates for Preferred Stock. Unless limited by the terms of such appointment, an authenticating agent may authenticate certificates for Preferred Stock whenever the Transfer Agent may do so. Each reference in this Certificate of Designation to authentication by the Transfer Agent includes authentication by such agent. An authenticating agent has the same rights as the Transfer Agent or agent for service of notices and demands.

(c) *Transfer and Exchange.* (i) *Transfer and Exchange of Certificated Preferred Stock.* When Certificated Preferred Stock is presented to the Transfer Agent with a request to register the transfer of such Certificated Preferred Stock or to exchange such Certificated Preferred Stock for an equal number of shares of Certificated Preferred Stock, the Transfer Agent shall register the transfer or make the exchange as requested if its reasonable requirements for such transaction are met; provided, however, that the Certificated Preferred Stock surrendered for transfer or exchange:

(1) shall be duly endorsed or accompanied by a written instrument of transfer in form reasonably satisfactory to the Company and the Transfer Agent, duly executed by the Holder thereof or its attorney duly authorized in writing; and

(2) is being transferred or exchanged pursuant to an effective registration statement under the Securities Act or pursuant to clause (i) or (ii) below, and is accompanied by the following additional information and documents, as applicable:

(I) if such Certificated Preferred Stock is being delivered to the Transfer Agent by a Holder for registration in the name of such Holder, without transfer, a certification from such Holder to that effect in substantially the form of Exhibit C hereto; or

(II) if such Certificated Preferred Stock is being transferred to the Company or to a “qualified institutional buyer (“QIB”) in accordance with Rule 144A under the Securities Act or pursuant to another exemption from registration under the Securities Act, (i) a certification to that effect (in substantially the form of Exhibit C hereto) and (ii) if the Company so requests, an Opinion of Counsel or other evidence reasonably satisfactory to it as to the compliance with the restrictions set forth in the legend set forth in paragraph 11(c) (vii).

(ii) *Restrictions on Transfer of Certificated Preferred Stock for a Beneficial Interest in Global Preferred Stock.* Certificated Preferred Stock may not be exchanged for a beneficial interest in Global Preferred Stock except upon satisfaction of the requirements set forth below. Upon receipt by the Transfer Agent of Certificated Preferred Stock, duly endorsed or accompanied by appropriate instruments of transfer, in form reasonably satisfactory to the Company and the Transfer Agent, together with written instructions directing the Transfer Agent to make, or to direct DTC to make, an adjustment on its books and records with respect to such Global Preferred Stock to reflect an increase in the number of shares of Preferred Stock represented by the Global Preferred Stock, then the Transfer Agent shall cancel such Certificated Preferred Stock and cause, or direct DTC to cause, in accordance with the standing instructions and procedures existing between DTC and the Transfer Agent, the number of shares of Preferred Stock represented by the Global Preferred Stock to be increased accordingly. If no Global Preferred Stock is then outstanding, the Company shall issue and the Transfer Agent shall authenticate, upon written order of the Company in the form of an Officers’ Certificate, a new Global Preferred Stock representing the appropriate number of shares.

(iii) *Transfer and Exchange of Global Preferred Stock.* The transfer and exchange of Global Preferred Stock or beneficial interests therein shall be effected through DTC, in accordance with this Certificate of Designation (including applicable restrictions on transfer set forth herein, if any) and the procedures of DTC therefor.

(iv) *Transfer of a Beneficial Interest in Global Preferred Stock for a Certificated Preferred Stock.*

(1) Any Person having a beneficial interest in Preferred Stock that is being transferred or exchanged pursuant to an effective registration statement under the Securities Act or pursuant to another exemption from registration thereunder may upon request, but only with the consent of the Company, and if accompanied by a certification from such Person to that effect (in substantially the form of Exhibit C hereto), exchange such beneficial interest for Certificated Preferred Stock representing the same number of shares of Preferred Stock. Upon receipt by the Transfer Agent of written instructions or such other form of instructions as is customary for DTC from DTC or its nominee on behalf of any Person having a beneficial interest in Global Preferred Stock and upon receipt by the Transfer Agent of a written order or such other form of instructions as is customary for DTC or the Person designated by DTC as having such a beneficial interest in a Transfer Restricted Security only, then, the Transfer Agent or DTC, at the direction of the

Transfer Agent, will cause, in accordance with the standing instructions and procedures existing between DTC and the Transfer Agent, the number of shares of Preferred Stock represented by Global Preferred Stock to be reduced on its books and records and, following such reduction, the Company will execute and the Transfer Agent will authenticate and deliver to the transferee Certificated Preferred Stock.

(2) Certificated Preferred Stock issued in exchange for a beneficial interest in a Global Preferred Stock pursuant to this paragraph 11(c)(iv) shall be registered in such names and in such authorized denominations as DTC, pursuant to instructions from its direct or indirect participants or otherwise, shall instruct the Transfer Agent. The Transfer Agent shall deliver such Certificated Preferred Stock to the Persons in whose names such Preferred Stock are so registered in accordance with the instructions of DTC.

(v) Restrictions on Transfer and Exchange of Global Preferred Stock.

(1) Notwithstanding any other provisions of this Certificate of Designation (other than the provisions set forth in paragraph 11(c)(vi)), Global Preferred Stock may not be transferred as a whole except by DTC to a nominee of DTC or by a nominee of DTC to DTC or another nominee of DTC or by DTC or any such nominee to a successor depository or a nominee of such successor depository.

(2) In the event that the Global Preferred Stock is exchanged for Preferred Stock in definitive registered form pursuant to paragraph 11(c)(vi) prior to the effectiveness of a Shelf Registration Statement with respect to such securities, such Preferred Stock may be exchanged only in accordance with such procedures as are substantially consistent with the provisions of this paragraph 11(c) (including the certification requirements set forth in the Exhibits to this Certificate of Designation intended to ensure that such transfers comply with Rule 144A or such other applicable exemption from registration under the Securities Act, as the case may be) and such other procedures as may from time to time be adopted by the Company.

(vi) Authentication of Certificated Preferred Stock. If at any time:

(1) DTC notifies the Company that DTC is unwilling or unable to continue as depository for the Global Preferred Stock and a successor depository for the Global Preferred Stock is not appointed by the Company within 90 days after delivery of such notice;

(2) DTC ceases to be a clearing agency registered under the Exchange Act and a successor depository for the Global Preferred Stock is not appointed by the Company within 90 days; or

(3) the Company, in its sole discretion, notifies the Transfer Agent in writing that it elects to cause the issuance of Certificated Preferred Stock under this Certificate of Designation,

then the Company will execute, and the Transfer Agent, upon receipt of a written order of the Company signed by two Officers or by an Officer and an Assistant Treasurer of the Company requesting the authentication and delivery of Certificated Preferred Stock to the Persons designated by the Company, will authenticate and deliver Certificated Preferred Stock equal to the number of shares of Preferred Stock represented by the Global Preferred Stock, in exchange for such Global Preferred Stock.

(vii) Legend.

(1) Except as permitted by the following paragraph (2) and in paragraph 11(a)(iii), each certificate evidencing the Global Preferred Stock, the Certificated Preferred Stock and Certificated Common Stock shall bear a legend in substantially the following form:

“THE SECURITY EVIDENCED HEREBY (OR ITS PREDECESSOR) WAS ORIGINALLY ISSUED IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE “SECURITIES ACT”), AND THIS SECURITY (AND THE COMMON STOCK INTO WHICH THIS SECURITY IS CONVERTIBLE) MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED IN THE ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. EACH PURCHASER OF THE SECURITY EVIDENCED HEREBY IS HEREBY NOTIFIED THAT THE SELLER MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER. THE HOLDER OF THE SECURITY EVIDENCED HEREBY AGREES FOR THE BENEFIT OF THE COMPANY THAT (A) SUCH SECURITY (AND THE COMMON STOCK INTO WHICH THIS SECURITY IS CONVERTIBLE) MAY BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED, ONLY (1) IN THE UNITED STATES TO

A PERSON WHO THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (2) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), (3) TO THE COMPANY OR (4) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH OF CASES (1) THROUGH (4) IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER OF THIS SECURITY FROM IT OF THE RESALE RESTRICTIONS REFERRED TO IN (A) ABOVE. IN ANY CASE, THE HOLDER OF THIS SECURITY WILL NOT, DIRECTLY OR INDIRECTLY, ENGAGE IN ANY HEDGING TRANSACTION WITH REGARD TO THE SECURITY EXCEPT AS PERMITTED UNDER THE SECURITIES ACT.”<sup>1</sup>

(2) Upon any sale or transfer of a Transfer Restricted Security (including any Transfer Restricted Security represented by Global Preferred Stock) pursuant to Rule 144 under the Securities Act or another exemption from registration under the Securities Act or an effective registration statement under the Securities Act:

(I) in the case of any Transfer Restricted Security that is a Certificated Preferred Stock, the Transfer Agent shall permit the Holder thereof to exchange such Transfer Restricted Security for Certificated Preferred Stock that does not bear a restrictive legend and rescind any restriction on the transfer of such Transfer Restricted Security; and

<sup>1</sup> Subject to removal upon registration under the Securities Act of 1933 or otherwise when the security shall no longer be a Transfer Restricted Security.

(II) in the case of any Transfer Restricted Security that is represented by a Global Preferred Stock, with the consent of the Company, the Transfer Agent shall permit the Holder thereof to exchange such Transfer Restricted Security for Certificated Preferred Stock that does not bear the legend set forth above and rescind any restriction on the transfer of such Transfer Restricted Security, if the Holder's request for such exchange was made in reliance on Rule 144 or another exemption from registration under the Securities Act and the Holder certifies to that effect in writing to the Transfer Agent (such certification to be in the form set forth in Exhibit C hereto).

(viii) Cancellation or Adjustment of Global Preferred Stock. At such time as all beneficial interests in Global Preferred Stock have either been exchanged for Certificated Preferred Stock, converted or canceled, such Global Preferred Stock shall be returned to DTC for cancellation or retained and canceled by the Transfer Agent. At any time prior to such cancellation, if any beneficial interest in Global Preferred Stock is exchanged for Certificated Preferred Stock, converted or canceled, the number of shares of Preferred Stock represented by such Global Preferred Stock shall be reduced and an adjustment shall be made on the books and records of the Transfer Agent with respect to such Global Preferred Stock, by the Transfer Agent or DTC, to reflect such reduction.

(ix) Obligations with Respect to Transfers and Exchanges of Preferred Stock.

(1) To permit registrations of transfers and exchanges, the Company shall execute and the Transfer Agent shall authenticate Certificated Preferred Stock and Global Preferred Stock as required pursuant to the provisions of this paragraph 11(c).

(2) All Certificated Preferred Stock and Global Preferred Stock issued upon any registration of transfer or exchange of Certificated Preferred Stock or Global Preferred Stock shall be the valid obligations of the Company, entitled to the same benefits under this Certificate of Designation as the Certificated Preferred Stock or Global Preferred Stock surrendered upon such registration of transfer or exchange.

(3) Prior to due presentment for registration of transfer of any shares of Preferred Stock, the Transfer Agent and the Company may deem and treat the Person in whose name such shares of Preferred Stock are registered as the absolute owner of such Preferred Stock and neither the Transfer Agent nor the Company shall be affected by notice to the contrary.

(4) No service charge shall be made to a Holder for any registration of transfer or exchange upon surrender of any Preferred Stock certificate or Common Stock certificate at the office of the Transfer Agent maintained for that

purpose. However, the Company may require payment of a sum sufficient to cover any tax or other governmental charge that may be imposed in connection with any registration of transfer or exchange of Preferred Stock certificates or Common Stock certificates.

(5) Upon any sale or transfer of shares of Preferred Stock (including any Preferred Stock represented by a Global Preferred Stock Certificate) or of Certificated Common Stock pursuant to an effective registration statement under the Securities Act or pursuant to Rule 144 or another exemption from registration under the Securities Act (and based upon an Opinion of Counsel reasonably satisfactory to the Company if it so requests):

(A) in the case of any Certificated Preferred Stock or Certificated Common Stock, the Company and the Transfer Agent shall permit the holder thereof to exchange such Preferred Stock or Certificated Common Stock for Certificated Preferred Stock or Certificated Common Stock, as the case may be, that does not bear a restrictive legend and rescind any restriction on the transfer of such Preferred Stock or Common Stock issuable in respect of the conversion of the Preferred Stock; and

(B) in the case of any Global Preferred Stock, such Preferred Stock shall not be required to bear the legend set forth in paragraph (c)(vii) above but shall continue to be subject to the provisions of paragraph (c)(iv) hereof; provided, however, that with respect to any request for an exchange of Preferred Stock that is represented by Global Preferred Stock for Certificated Preferred Stock that does not bear the legend set forth in paragraph (c)(vii) above in connection with a sale or transfer thereof pursuant to Rule 144 or another exemption from registration under the Securities Act (and based upon an Opinion of Counsel if the Company so requests), the Holder thereof shall certify in writing to the Transfer Agent that such request is being made pursuant to such exemption (such certification to be substantially in the form of Exhibit C hereto).

(x) No Obligation of the Transfer Agent.

(1) The Transfer Agent shall have no responsibility or obligation to any beneficial owner of Global Preferred Stock, a member of, or a participant in DTC or any other Person with respect to the accuracy of the records of DTC or its nominee or of any participant or member thereof, with respect to any ownership interest in the Preferred Stock or with respect to the delivery to any participant, member, beneficial owner or other Person (other than DTC) of any notice or the payment of any amount, under or with respect to such Global Preferred Stock. All notices and communications to be given to the Holders and all payments to be made to Holders under the Preferred Stock shall be given or made only to the Holders (which shall be DTC or its nominee in the case of the Global Preferred Stock). The rights of beneficial owners in any Global Preferred Stock shall be exercised only through DTC subject to the applicable rules and procedures of DTC. The Transfer Agent may rely and shall be fully protected in relying upon information furnished by DTC with respect to its members, participants and any beneficial owners.

(2) The Transfer Agent shall have no obligation or duty to monitor, determine or inquire as to compliance with any restrictions on transfer imposed under this Certificate of Designation or under applicable law with respect to any transfer of any interest in any Preferred Stock (including any transfers between or among DTC participants, members or beneficial owners in any Global Preferred Stock) other than to require delivery of such certificates and other documentation or evidence as are expressly required by, and to do so if and when expressly required by, the terms of this Certificate of Designation, and to examine the same to determine substantial compliance as to form with the express requirements hereof.

(d) *Replacement Certificates.* If a mutilated Preferred Stock certificate is surrendered to the Transfer Agent or if the Holder of a Preferred Stock certificate claims that the Preferred Stock certificate has been lost, destroyed or wrongfully taken, the Company shall issue and the Transfer Agent shall countersign a replacement Preferred Stock certificate if the reasonable requirements of the Transfer Agent and of Section 8–405 of the Uniform Commercial Code as in effect in the State of Oklahoma are met. If required by the Transfer Agent or the Company, such Holder shall furnish an indemnity bond sufficient in the judgment of the Company and the Transfer Agent to protect the Company and the Transfer Agent from any loss which either of them may suffer if a Preferred Stock certificate is replaced. The Company and the Transfer Agent may charge the Holder for their expenses in replacing a Preferred Stock certificate.

(e) *Temporary Certificates.* Until definitive Preferred Stock certificates are ready for delivery, the Company may prepare and the Transfer Agent shall countersign temporary Preferred Stock certificates. Temporary Preferred Stock certificates shall be substantially in the form of definitive Preferred Stock certificates but may have variations that the Company considers appropriate for temporary Preferred Stock certificates. Without unreasonable delay, the Company shall prepare and the Transfer Agent shall countersign definitive Preferred Stock certificates and deliver them in exchange for temporary Preferred Stock certificates.



## FORM OF PREFERRED STOCK

## FACE OF SECURITY

[THE SECURITY EVIDENCED HEREBY (OR ITS PREDECESSOR) WAS ORIGINALLY ISSUED IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE UNITED STATES SECURITIES ACT OF 1933 (THE "SECURITIES ACT"), AND THIS SECURITY (AND THE COMMON STOCK INTO WHICH THIS SECURITY IS CONVERTIBLE) MAY NOT BE OFFERED, SOLD OR OTHERWISE TRANSFERRED IN ABSENCE OF SUCH REGISTRATION OR AN APPLICABLE EXEMPTION THEREFROM. EACH PURCHASER OF THE SECURITY EVIDENCED HEREBY IS HEREBY NOTIFIED THAT THE SELLER MAY BE RELYING ON THE EXEMPTION FROM THE PROVISIONS OF SECTION 5 OF THE SECURITIES ACT PROVIDED BY RULE 144A THEREUNDER. THE HOLDER OF THE SECURITY EVIDENCED HEREBY AGREES FOR THE BENEFIT OF THE COMPANY THAT (A) SUCH SECURITY (AND THE COMMON STOCK INTO WHICH THIS SECURITY IS CONVERTIBLE) MAY BE OFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED, ONLY (1) IN THE UNITED STATES TO A PERSON WHO THE SELLER REASONABLY BELIEVES IS A QUALIFIED INSTITUTIONAL BUYER (AS DEFINED IN RULE 144A UNDER THE SECURITIES ACT) PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (2) PURSUANT TO AN EXEMPTION FROM REGISTRATION UNDER THE SECURITIES ACT PROVIDED BY RULE 144 THEREUNDER (IF AVAILABLE), (3) TO THE COMPANY OR (4) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT, IN EACH OF CASES (1) THROUGH (4) IN ACCORDANCE WITH ALL APPLICABLE SECURITIES LAWS OF THE STATES OF THE UNITED STATES AND (B) THE HOLDER WILL, AND EACH SUBSEQUENT HOLDER IS REQUIRED TO, NOTIFY ANY PURCHASER OF THIS SECURITY FROM IT OF THE RESALE RESTRICTIONS REFERRED TO IN (A) ABOVE. IN ANY CASE, THE HOLDER OF THIS SECURITY WILL NOT, DIRECTLY OR INDIRECTLY, ENGAGE IN ANY HEDGING TRANSACTION WITH REGARD TO THE SECURITY EXCEPT AS PERMITTED UNDER THE SECURITIES ACT.]<sup>[1]</sup>

[UNLESS THIS CERTIFICATE IS PRESENTED BY AN AUTHORIZED REPRESENTATIVE OF THE DEPOSITORY TRUST COMPANY, A NEW YORK CORPORATION ("DTC"), NEW YORK, NEW YORK, TO THE COMPANY OR ITS AGENT FOR REGISTRATION OF TRANSFER, EXCHANGE OR PAYMENT, AND ANY CERTIFICATE ISSUED IS REGISTERED IN THE NAME OF CEDE & CO. OR SUCH OTHER NAME AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC (AND ANY PAYMENT IS MADE TO CEDE & CO., OR TO SUCH OTHER ENTITY AS IS REQUESTED BY AN AUTHORIZED REPRESENTATIVE OF DTC) ANY TRANSFER, PLEDGE OR OTHER USE HEREOF FOR VALUE OR OTHERWISE BY OR TO ANY PERSON IS WRONGFUL INASMUCH AS THE REGISTERED OWNER HEREOF, CEDE & CO. HAS AN INTEREST HEREIN.]<sup>[2]</sup>

[TRANSFERS OF THIS GLOBAL SECURITY SHALL BE LIMITED TO TRANSFERS IN WHOLE, BUT NOT IN PART, TO NOMINEES OF DTC OR TO A SUCCESSOR THEREOF OR SUCH SUCCESSOR'S NOMINEE AND TRANSFERS OF PORTIONS OF THIS GLOBAL SECURITY SHALL BE LIMITED TO TRANSFERS<sup>2</sup> MADE IN ACCORDANCE WITH THE RESTRICTIONS SET FORTH IN THE CERTIFICATE OF DESIGNATION REFERRED TO BELOW.]

IN CONNECTION WITH ANY TRANSFER, THE HOLDER WILL DELIVER TO THE TRANSFER AGENT SUCH CERTIFICATES AND OTHER INFORMATION AS SUCH TRANSFER AGENT MAY REASONABLY REQUIRE TO CONFIRM THAT THE TRANSFER COMPLIES WITH THE FOREGOING RESTRICTIONS.

<sup>1</sup> Subject to removal upon registration under the Securities Act of 1933 or otherwise when the security shall no longer be a Transfer Restricted Security.

<sup>2</sup> Subject to removal if not a global security.

Certificate Number  
[       ]

Number of Shares of Convertible Preferred Stock  
[       ]

CUSIP NO.: 165167883

4.125% Cumulative Convertible Preferred Stock (par value \$0.01)  
(liquidation preference \$1000 per share of Convertible Preferred Stock)

of

Chesapeake Energy Corporation

Chesapeake Energy Corporation, an Oklahoma corporation (the "Company"), hereby certifies that [ \_\_\_\_\_ ] (the "Holder") is the registered owner of [ \_\_\_\_\_ ] fully paid and non-assessable preferred securities of the Company designated the 4.125% Cumulative Convertible Preferred Stock (par value \$0.01) (liquidation preference \$1000 per share of Preferred Stock) (the "Preferred Stock"). The shares of Preferred Stock are transferable on the books and records of the Transfer Agent, in person or by a duly authorized attorney, upon surrender of this certificate duly endorsed and in proper form for transfer. The designations, rights, privileges, restrictions, preferences and other terms and provisions of the Preferred Stock represented hereby are issued and shall in all respects be subject to the provisions of the Certificate of Designation dated March 29, 2004, as the same may be amended from time to time (the "Certificate of Designation"). Capitalized terms used herein but not defined shall have the meaning given them in the Certificate of Designation. The Company will provide a copy of the Certificate of Designation to a Holder without charge upon written request to the Company at its principal place of business.

Reference is hereby made to select provisions of the Preferred Stock set forth on the reverse hereof, and to the Certificate of Designation, which select provisions and the Certificate of Designation shall for all purposes have the same effect as if set forth at this place.

Upon receipt of this certificate, the Holder is bound by the Certificate of Designation and is entitled to the benefits thereunder.

Unless the Transfer Agent's Certificate of Authentication hereon has been properly executed, these shares of Preferred Stock shall not be entitled to any benefit under the Certificate of Designation or be valid or obligatory for any purpose.

IN WITNESS WHEREOF, the Company has executed this certificate this [       ] day of [       ], 2004.

CHESAPEAKE ENERGY CORPORATION

By: \_\_\_\_\_  
Name:  
Title:

By: \_\_\_\_\_  
Name:  
Title:

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TRANSFER AGENT'S CERTIFICATE OF AUTHENTICATION

These are shares of the Preferred Stock referred to in the within-mentioned Certificate of Designation.

Dated: \_\_\_\_\_, 2004

UMB BANK, N.A., as Transfer Agent,

By: \_\_\_\_\_  
Authorized Signatory



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REVERSE OF SECURITY

Cash dividends on each share of Preferred Stock shall be payable at a rate per annum set forth in the face hereof or as provided in the Certificate of Designation.

The shares of Preferred Stock shall be convertible into the Company's Common Stock in the manner and according to the terms set forth in the Certificate of Designation.

The Company will furnish without charge to each holder who so requests the powers, designations, preferences and relative, participating, optional or other special rights of each class of stock and the qualifications, limitations or restrictions of such preferences and/or rights.

ASSIGNMENT

FOR VALUE RECEIVED, the undersigned assigns and transfers the shares of Preferred Stock evidenced hereby to:

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(Insert assignee's social security or tax identification number)

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(Insert address and zip code of assignee)

and irrevocably appoints: \_\_\_\_\_

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agent to transfer the shares of Preferred Stock evidenced hereby on the books of the Transfer Agent. The agent may substitute another to act for him or her.

Date: \_\_\_\_\_

Signature: \_\_\_\_\_

(Sign exactly as your name appears on the other side of this Preferred Stock Certificate)

Signature Guarantee:<sup>3</sup> \_\_\_\_\_

<sup>1</sup> (Signature must be guaranteed by an "eligible guarantor institution" that is a bank, stockbroker, savings and loan association or credit union meeting the requirements of the Transfer Agent, which requirements include membership or participation in the Securities Transfer Agents Medallion Program ("STAMP") or such other "signature guarantee program" as may be determined by the Transfer Agent in addition to, or in substitution for, STAMP, all in accordance with the Securities Exchange Act of 1934, as amended.)

## NOTICE OF CONVERSION

(To be Executed by the Holder  
in order to Convert the Preferred Stock)

The undersigned hereby irrevocably elects to convert (the "Conversion") shares of 4.125% Cumulative Convertible Preferred Stock (the "Preferred Stock"), represented by stock certificate No(s). (the "Preferred Stock Certificates") into shares of common stock ("Common Stock") of Chesapeake Energy Corporation (the "Company") according to the conditions of the Certificate of Designation of the Preferred Stock (the "Certificate of Designation"), as of the date written below. If shares are to be issued in the name of a person other than the undersigned, the undersigned will pay all transfer taxes payable with respect thereto and is delivering herewith the Preferred Stock Certificates. No fee will be charged to the holder for any conversion, except for transfer taxes, if any. A copy of each Preferred Stock Certificate is attached hereto (or evidence of loss, theft or destruction thereof).

The undersigned represents and warrants that all offers and sales by the undersigned of the shares of Common Stock issuable to the undersigned upon conversion of the Preferred Stock shall be made pursuant to registration of the Common Stock under the Securities Act of 1933 (the "Act"), or pursuant to any exemption from registration under the Act.

Any holder, upon the exercise of its conversion rights in accordance with the terms of the Certificate of Designation and the Preferred Stock, agrees to be bound by the terms of the Registration Rights Agreement.

Capitalized terms used but not defined herein shall have the meanings ascribed thereto in or pursuant to the Certificate of Designation.

Date of Conversion: \_\_\_\_\_

Applicable Conversion Price: \_\_\_\_\_

Number of shares of Preferred Stock to be Converted: \_\_\_\_\_

Number of shares of Common Stock to be Issued: \* \_\_\_\_\_

Signature: \_\_\_\_\_

Name: \_\_\_\_\_

Address:\*\* \_\_\_\_\_

Fax No.: \_\_\_\_\_

\* The Company is not required to issue shares of Common Stock until the original Preferred Stock Certificate(s) (or evidence of loss, theft or destruction thereof) to be converted are received by the Company or its Transfer Agent. The Company shall issue and deliver shares of Common Stock to an overnight courier not later than three business days following receipt of the original Preferred Stock Certificate(s) to be converted.

\*\* Address where shares of Common Stock and any other payments or certificates shall be sent by the Company.

CERTIFICATE TO BE DELIVERED UPON EXCHANGE OR  
REGISTRATION OF TRANSFER OF PREFERRED STOCK

Re: 4.125% Cumulative Convertible Preferred Stock (the "Preferred Stock") of Chesapeake Energy Corporation (the "Company")

This Certificate relates to \_\_\_\_\_ shares of Preferred Stock held in \*/ book-entry or \*/ definitive form \_\_\_\_\_ by (the "Transferor").

The Transferor\*:

- has requested the Transfer Agent by written order to deliver in exchange for its beneficial interest in the Preferred Stock held by the Depository shares of Preferred Stock in definitive, registered form equal to its beneficial interest in such Preferred Stock (or the portion thereof indicated above); or
- has requested the Transfer Agent by written order to exchange or register the transfer of Preferred Stock.

In connection with such request and in respect of such Preferred Stock, the Transferor does hereby certify that the Transferor is familiar with the Certificate of Designation relating to the above-captioned Preferred Stock and that the transfer of this Preferred Stock does not require registration under the Securities Act of 1933 (the "Securities Act") because \*/:

- Such Preferred Stock is being acquired for the Transferor's own account without transfer.
- Such Preferred Stock is being transferred to the Company.
- Such Preferred Stock is being transferred to a qualified institutional buyer (as defined in Rule 144A under the Securities Act), in reliance on Rule 144A.
- Such Preferred Stock is being transferred in reliance on and in compliance with another exemption from the registration requirements of the Securities Act (and based on an Opinion of Counsel if the Company so requests).

\_\_\_\_\_  
[INSERT NAME OF TRANSFEROR]

by: \_\_\_\_\_

Date: \_\_\_\_\_

\*/ Please check applicable box.





**CERTIFICATE OF ELIMINATION**

Chesapeake Energy Corporation (the “Corporation”), a corporation organized and existing under the Oklahoma General Corporation Act,

DOES HEREBY CERTIFY:

**FIRST:** That the Corporation has acquired 41,765 shares of its 4.125% Cumulative Convertible Preferred Stock, par value \$.01 per share (the “Acquired Shares”).

**SECOND:** That the Board of Directors of the Corporation has adopted resolutions retiring the Acquired Shares.

**THIRD:** That the Certificate of Designation for the 4.125% Cumulative Convertible Preferred Stock (the “Certificate of Designation”) prohibits the reissuance of shares when so retired and, pursuant to the provisions of Section 1078 of the Oklahoma General Corporation Act, upon the date of the filing of this Certificate of Elimination, the Certificate of Designation shall be amended so as to reduce the number of authorized shares of the 4.125% Cumulative Convertible Preferred Stock by 41,765 shares, being the total number of the Acquired Shares retired by the Board of Directors. Accordingly, the number of authorized but undesignated shares of preferred stock of the Company shall be increased by 41,765 shares. The retired Acquired Shares have a par value of \$.01 per share and an aggregate par value of \$417.65.

**IN WITNESS WHEREOF**, the Corporation has caused this Certificate to be executed by its Treasurer and Senior Vice President–Human Resources, and attested to by its Secretary, this 15<sup>th</sup> day of August, 2005.

**CHESAPEAKE ENERGY CORPORATION**

By:                     /s/ MARTHA A. BURGER                      
Martha A. Burger  
Treasurer & Senior Vice President–  
Human Resources

**ATTEST:**

                    /s/ JENNIFER M. GRIGSBY                      
Jennifer M. Grigsby, Secretary

**CERTIFICATE OF ELIMINATION**

Chesapeake Energy Corporation (the "Corporation"), a corporation organized and existing under the Oklahoma General Corporation Act,

DOES HEREBY CERTIFY:

**FIRST:** That the Corporation has acquired 11,265 shares of its 4.125% Cumulative Convertible Preferred Stock, par value \$.01 per share (the "Acquired Shares").

**SECOND:** That the Board of Directors of the Corporation has adopted resolutions retiring the Acquired Shares.

**THIRD:** That the Certificate of Designation for the 4.125% Cumulative Convertible Preferred Stock (the "Certificate of Designation") prohibits the reissuance of shares when so retired and, pursuant to the provisions of Section 1078 of the Oklahoma General Corporation Act, upon the date of the filing of this Certificate of Elimination, the Certificate of Designation shall be amended so as to reduce the number of authorized shares of the 4.125% Cumulative Convertible Preferred Stock by 11,265 shares, being the total number of the Acquired Shares retired by the Board of Directors. Accordingly, the number of authorized but undesignated shares of preferred stock of the Company shall be increased by 11,265 shares. The retired Acquired Shares have a par value of \$.01 per share and an aggregate par value of \$112.65.

**IN WITNESS WHEREOF,** the Corporation has caused this Certificate to be executed by its Treasurer and Senior Vice President–Human Resources, and attested to by its Secretary, this 16<sup>th</sup> day of August, 2005.

**CHESAPEAKE ENERGY CORPORATION**

By: \_\_\_\_\_ /s/ MARTHA A. BURGER  
Martha A. Burger  
Treasurer & Senior Vice President–  
Human Resources

**ATTEST:**

\_\_\_\_\_/s/ JENNIFER M. GRIGSBY  
Jennifer M. Grigsby, Secretary





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**CERTIFICATE OF ELIMINATION**

Chesapeake Energy Corporation (the “Corporation”), a corporation organized and existing under the Oklahoma General Corporation Act,

DOES HEREBY CERTIFY:

**FIRST:** That the Corporation has acquired 13,540 shares of its 4.125% Cumulative Convertible Preferred Stock, par value \$.01 per share (the “Acquired Shares”).

**SECOND:** That the Board of Directors of the Corporation has adopted resolutions retiring the Acquired Shares.

**THIRD:** That the Certificate of Designation for the 4.125% Cumulative Convertible Preferred Stock (the “Certificate of Designation”) prohibits the reissuance of shares when so retired and, pursuant to the provisions of Section 1078 of the Oklahoma General Corporation Act, upon the date of the filing of this Certificate of Elimination, the Certificate of Designation shall be amended so as to reduce the number of authorized shares of the 4.125% Cumulative Convertible Preferred Stock by 13,540 shares, being the total number of the Acquired Shares retired by the Board of Directors. Accordingly, the number of authorized but undesignated shares of preferred stock of the Company shall be increased by 13,540 shares. The retired Acquired Shares have a par value of \$.01 per share and an aggregate par value of \$135.40.

**IN WITNESS WHEREOF**, the Corporation has caused this Certificate to be executed by its Treasurer and Senior Vice President–Human Resources, and attested to by its Secretary, this 23<sup>rd</sup> day of August, 2005.

**CHESAPEAKE ENERGY CORPORATION**

By:                                 /s/ MARTHA A. BURGER                                  
Martha A. Burger  
Treasurer & Senior Vice President–  
Human Resources

**ATTEST:**

                                /s/ JENNIFER M. GRIGSBY                                  
Jennifer M. Grigsby, Secretary



**CERTIFICATE OF ELIMINATION**

Chesapeake Energy Corporation (the "Corporation"), a corporation organized and existing under the Oklahoma General Corporation Act,

DOES HEREBY CERTIFY:

**FIRST:** That the Corporation has acquired 4,035 shares of its 4.125% Cumulative Convertible Preferred Stock, par value \$.01 per share (the "Acquired Shares").

**SECOND:** That the Board of Directors of the Corporation has adopted resolutions retiring the Acquired Shares.

**THIRD:** That the Certificate of Designation for the 4.125% Cumulative Convertible Preferred Stock (the "Certificate of Designation") prohibits the reissuance of shares when so retired and, pursuant to the provisions of Section 1078 of the Oklahoma General Corporation Act, upon the date of the filing of this Certificate of Elimination, the Certificate of Designation shall be amended so as to reduce the number of authorized shares of the 4.125% Cumulative Convertible Preferred Stock by 4,035 shares, being the total number of the Acquired Shares retired by the Board of Directors. Accordingly, the number of authorized but undesignated shares of preferred stock of the Company shall be increased by 4,035 shares. The retired Acquired Shares have a par value of \$.01 per share and an aggregate par value of \$40.35.

**IN WITNESS WHEREOF,** the Corporation has caused this Certificate to be executed by its Treasurer and Senior Vice President–Human Resources, and attested to by its Secretary, this 30<sup>th</sup> day of September, 2005.

**CHESAPEAKE ENERGY CORPORATION**

By: \_\_\_\_\_ /s/ **M<sup>A</sup>RTHA A. B<sup>U</sup>RGER**  
**Martha A. Burger**  
**Treasurer & Senior Vice President–**  
**Human Resources**

**ATTEST:**

\_\_\_\_\_ /s/ **J<sup>E</sup>NNIFER M. G<sup>R</sup>IGSBY**  
**Jennifer M. Grigsby, Secretary**

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**CERTIFICATE OF ELIMINATION**

Chesapeake Energy Corporation (the "Corporation"), a corporation organized and existing under the Oklahoma General Corporation Act,

DOES HEREBY CERTIFY:

**FIRST:** That the Corporation has acquired 4,530 shares of its 4.125% Cumulative Convertible Preferred Stock, par value \$.01 per share (the "Acquired Shares").

**SECOND:** That the Board of Directors of the Corporation has adopted resolutions retiring the Acquired Shares.

**THIRD:** That the Certificate of Designation for the 4.125% Cumulative Convertible Preferred Stock (the "Certificate of Designation") prohibits the reissuance of shares when so retired and, pursuant to the provisions of Section 1078 of the Oklahoma General Corporation Act, upon the date of the filing of this Certificate of Elimination, the Certificate of Designation shall be amended so as to reduce the number of authorized shares of the 4.125% Cumulative Convertible Preferred Stock by 4,530 shares, being the total number of the Acquired Shares retired by the Board of Directors. Accordingly, the number of authorized but undesignated shares of preferred stock of the Company shall be increased by 4,530 shares. The retired Acquired Shares have a par value of \$.01 per share and an aggregate par value of \$45.30.

**IN WITNESS WHEREOF,** the Corporation has caused this Certificate to be executed by its Treasurer and Senior Vice President–Human Resources, and attested to by its Secretary, this 6<sup>th</sup> day of October, 2005.

**CHESAPEAKE ENERGY CORPORATION**

By: \_\_\_\_\_ /s/ MARTHA A. BURGER  
Martha A. Burger  
Treasurer & Senior Vice President–  
Human Resources

**ATTEST:**

\_\_\_\_\_/s/ JENNIFER M. GRIGSBY  
Jennifer M. Grigsby, Secretary

**CERTIFICATE OF ELIMINATION**

Chesapeake Energy Corporation (the "Corporation"), a corporation organized and existing under the Oklahoma General Corporation Act,

DOES HEREBY CERTIFY:

**FIRST:** That the Corporation has acquired 3,950 shares of its 4.125% Cumulative Convertible Preferred Stock, par value \$.01 per share (the "Acquired Shares").

**SECOND:** That the Board of Directors of the Corporation has adopted resolutions retiring the Acquired Shares.

**THIRD:** That the Certificate of Designation for the 4.125% Cumulative Convertible Preferred Stock (the "Certificate of Designation") prohibits the reissuance of shares when so retired and, pursuant to the provisions of Section 1078 of the Oklahoma General Corporation Act, upon the date of the filing of this Certificate of Elimination, the Certificate of Designation shall be amended so as to reduce the number of authorized shares of the 4.125% Cumulative Convertible Preferred Stock by 3,950 shares, being the total number of the Acquired Shares retired by the Board of Directors. Accordingly, the number of authorized but undesignated shares of preferred stock of the Company shall be increased by 3,950 shares. The retired Acquired Shares have a par value of \$.01 per share and an aggregate par value of \$39.50.

**IN WITNESS WHEREOF,** the Corporation has caused this Certificate to be executed by its Treasurer and Senior Vice President–Human Resources, and attested to by its Secretary, this 21<sup>st</sup> day of October, 2005.

**CHESAPEAKE ENERGY CORPORATION**

By: \_\_\_\_\_ /s/ MAR<sup>A</sup>THA A. BURGER  
Martha A. Burger  
Treasurer & Senior Vice President–  
Human Resources

**ATTEST:**

\_\_\_\_\_/s/ JENNIFER M. GRIGSBY  
Jennifer M. Grigsby, Secretary

**CHESAPEAKE ENERGY CORPORATION**  
**RATIOS OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS**  
(dollars in 000's)

	Year Ended December 31, 2000	Year Ended December 31, 2001	Year Ended December 31, 2002	Year Ended December 31, 2003	Year Ended December 31, 2004	Nine Months Ended September 30, 2005
<b>EARNINGS:</b>						
Income before income taxes and cumulative effect of accounting change <sup>(a)</sup>	\$ 196,162	\$ 361,698	\$ 67,140	\$ 500,952	\$ 804,926	\$ 780,754
Interest expense	86,256	98,321	111,280	147,817	161,990	157,570
(Gain)/loss on investment in equity investees in excess of distributed earnings	—	—	—	409	(606)	(594)
Amortization of capitalized interest <sup>(b)</sup>	1,226	1,784	1,804	2,519	4,620	6,615
Bond discount amortization	—	—	—	—	—	—
Loan cost amortization	3,669	4,022	4,962	4,254	5,728	6,368
<b>Earnings</b>	<b>\$ 287,313</b>	<b>\$ 465,825</b>	<b>\$ 185,186</b>	<b>\$ 655,951</b>	<b>\$ 976,658</b>	<b>\$ 950,713</b>
<b>FIXED CHARGES:</b>						
Interest expense	\$ 86,256	\$ 98,321	\$ 111,280	\$ 147,817	\$ 161,990	\$ 157,570
Capitalized interest <sup>(b)</sup>	2,452	4,719	4,976	13,041	36,240	54,758
Bond discount amortization	—	—	—	—	—	—
Loan cost amortization	3,669	4,022	4,962	4,254	5,728	6,368
<b>Fixed Charges</b>	<b>\$ 92,377</b>	<b>\$ 107,062</b>	<b>\$ 121,218</b>	<b>\$ 165,112</b>	<b>\$ 203,958</b>	<b>\$ 218,696</b>
<b>Preferred Stock Dividends</b>						
Preferred Dividend Requirements <sup>(c)</sup>	\$ 8,484	\$ 2,050	\$ 10,117	\$ 22,469	\$ 39,506	\$ 25,526
Ratio of income before provision for taxes to net income	N/A	1.66	1.67	1.61	1.56	1.57
<b>Subtotal – Preferred Dividends</b>	<b>\$ 8,484</b>	<b>\$ 3,411</b>	<b>\$ 16,861</b>	<b>\$ 36,240</b>	<b>\$ 61,629</b>	<b>\$ 40,076</b>
<b>Combined Fixed Charges and Preferred Dividends</b>	<b>\$ 100,861</b>	<b>\$ 110,473</b>	<b>\$ 138,079</b>	<b>\$ 201,352</b>	<b>\$ 265,587</b>	<b>\$ 258,772</b>
<b>Ratio of Earnings to Fixed Charges</b>	<b>3.1</b>	<b>4.4</b>	<b>1.5</b>	<b>4.0</b>	<b>4.8</b>	<b>4.3</b>
<b>Insufficient coverage</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>
<b>Ratio of Earnings to Combined Fixed Charges and Preferred Dividends</b>	<b>2.8</b>	<b>4.2</b>	<b>1.3</b>	<b>3.3</b>	<b>3.7</b>	<b>3.7</b>
<b>Insufficient coverage</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>

(a) Excludes the effect on unrealized gains or losses on interest rate derivatives.

(b) Amortization of bond discount is excluded since it is included in interest expense.

(c) Amounts of income before provision for taxes and of net income exclude the cumulative effect of accounting change.

**Exhibit 31.1**  
**CERTIFICATION**

I, Aubrey K. McClendon, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Chesapeake Energy Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 1, 2005

/s/ AUBREY K. MCCLENDON  
**Aubrey K. McClendon**  
Chairman of the Board and Chief Executive Officer



Exhibit 31.2

CERTIFICATION

I, Marcus C. Rowland, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Chesapeake Energy Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 1, 2005

/s/ MARCUS C. ROWLAND

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Marcus C. Rowland  
Executive Vice President and Chief Financial Officer

**Exhibit 32.1**

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES–OXLEY ACT OF 2002**

In connection with the Quarterly Report of Chesapeake Energy Corporation (the “Company”) on Form 10–Q for the period ended September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Aubrey K. McClendon, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C § 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ AUBREY K. MCCLENDON

**Aubrey K. McClendon**  
**Chairman of the Board and Chief Executive Officer**

Date: November 1, 2005

**Exhibit 32.2**

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO SECTION 906  
OF THE SARBANES–OXLEY ACT OF 2002**

In connection with the Quarterly Report of Chesapeake Energy Corporation (the “Company”) on Form 10–Q for the period ended September 30, 2005 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Marcus C. Rowland, Executive Vice President and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C § 1350, as adopted pursuant to Section 906 of the Sarbanes–Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ **MARCUS C. ROWLAND**

**Marcus C. Rowland**

**Executive Vice President and Chief Financial Officer**

Date: November 1, 2005

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