Elliot J. Chambers
Vice President - Finance and Assistant Treasurer

June 17, 2011

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Gary K. Van Meter
Acting Director
Office of Regulatory Policy
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102

Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street SW, Mail Stop 2-3
Washington, DC 20219

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Attention: Comments/RIN 2590-AA45
1700 G Street NW, Fourth Floor
Washington, DC 20552

Re: Comments Regarding Proposed Margin and Capital Requirements for Covered Swap Entities

Dear Sirs and Madam:

Chesapeake Energy Corporation, the nation's most active driller and the second-largest producer of American natural gas, appreciates the opportunity to comment on the proposed rules by prudential regulators for margin and capital requirements. These rules in particular stand to directly and significantly impact our company's risk-mitigation efforts, and we thank you for your consideration of the following comments.

Our Core Business and Important Risk Management Program

First, we must emphasize that our industry-leading efforts to develop and deliver abundant U.S. natural gas at affordable prices to American consumers to help lead our nation towards greater energy independence are not possible without significant costs. Whether we invest in new leasehold acreage or develop existing reserves, our line of business requires us to invest significant amounts of capital. In fact, we and other independent exploration and production companies routinely reinvest more than 100 percent of our operating cash flow directly into finding and producing natural gas and oil here in the U.S.

Chesapeake Energy Corporation
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Our risk management program plays an integral role in the development and execution of our business plan. Because we are highly exposed to natural gas and oil prices that are often times volatile, we utilize over-the-counter ("OTC") derivative contracts to sell our future production at prices above the cost to produce our reserves, thus locking in a satisfactory operating margin. This fixed margin from oil and gas sales provides us with valuable predictability and stability of our future cash flows and helps us plan more accurately to meet our forecasted cash requirements. These cash requirements are significant and highly correlated to our capital-intensive, job-creating business plan initiatives, which range from finding and developing new and existing reserves to investing in advanced technologies. Relative to job creation, in December 2007, Chesapeake Energy employed approximately 6,000 people. Currently, our company directly employs nearly 11,000 people, the difference having been added during the worst economic crisis in modern history. Additionally, we help employ many times that number of people indirectly. Our risk-mitigating hedging efforts have been a key part of Chesapeake's success in growing our business and continuing to create and sustain jobs through this difficult economic time.

Chesapeake's efforts to protect against volatile natural gas and oil prices using OTC contracts also directly benefits American consumers and the U.S. economy as a whole. If we were not able to responsibly mitigate price risks using OTC contracts in the manner we do today, we would be forced to curtail our drilling program. The result would be a reduction in our future natural gas and oil production, thus creating higher prices for U.S. energy consumers because of a drop in supply of the underlying commodity.

Given the importance of accurately estimating our future cash flows and the critical link to our capital-intensive, growth-oriented business plan, Chesapeake spends significant time analyzing and implementing our commodity risk management program, a function that falls directly under my responsibility. To provide sufficient capacity for executing the program, we utilize a multi-counterparty hedging facility with 12 large, well-capitalized institutions. This hedging facility provides rigorous checks on our utilization of commodity derivatives, the most important of which are provisions regarding the collateralization of our derivative contracts and limitations related to the production volumes we can hedge in any given period of time. With respect to the latter, we are strictly prohibited from hedging more than our estimated underlying production for any given future month, meaning *we cannot and do not speculate*.

We are significantly exposed to energy commodity prices because of the reserves we physically own. We do not look to create synthetic exposure via the OTC market. To do so would be imprudent; thus, our company's risk management policy and multi-counterparty hedging facility prohibit such speculative activities. Additionally, we collateralize our OTC derivative positions with first-lien mortgages on the underlying natural gas and oil properties from which our production is derived – rather than with cash margin. Further details on how this works and our concerns with the proposed margin rules are detailed below.

Throughout the life of the Dodd-Frank Act, Chesapeake has been very concerned that our risk management efforts were being grouped with strategies that were inherently less geared towards risk reduction. Our trades do not create additional exposure to us or the financial system like the poorly priced, inappropriately managed credit default swaps of AIG and similar companies. In fact, commodity derivatives of the kind Chesapeake uses were not remotely to blame for the events that unfolded in 2008. For this reason and those stated above, Chesapeake Energy has been very engaged in discussions surrounding the legislative and regulatory process in regard to OTC derivatives and the impact to our risk management program.

Margin and Capital Requirements – Chesapeake's Concerns
Dodd-Frank Statutory Requirements fn.10 p. **27566** *"the margin requirements imposed by the Agencies must permit the use of noncash collateral, as the Agencies determine to be consistent with (i) preserving the financial integrity of the markets trading swaps and security-based swaps and (ii) preserving the stability of the U.S. financial system. See 7 U.S.C. 6s(e)(3)(C); 15 U.S.C. 78o–8(e)(3)(C)."*

One of Chesapeake's greatest concerns about new OTC derivatives market regulations is the potential for the new margin rules to siphon cash away from our efforts to maintain and grow our business. Under the terms of Chesapeake's hedging facility referenced above, we collateralize our OTC derivative positions with first-lien mortgages on natural gas and oil properties, rather than with cash margin. "The proposed rule does not allow for the use of non-cash collateral, other than the limited types of highly-liquid, high-quality debt securities." (p. 27578)

We understand that the reason for this provision of the proposed rule is the regulators' concerns that "during a period of financial stress, the value of non-cash collateral pledged as margin may also come under stress just as counterparties default and the non-cash collateral is required to offset the cost of replacing defaulted swap positions." While not cash, the security we provide is very significant, and it is posted in higher amounts than if we were posting cash. It should be further noted that the collateral our company provides to our hedge counterparties provides right-way risk coverage, meaning that as commodity prices increase and the value of our hedges moves against us, the underlying reserves collateralizing those trades increase in value as well. This provides a more stable coverage ratio than other forms of non-cash collateral. Another feature of our hedging facility is that it is a pledge-to-hedge arrangement, meaning that we must post reserve-based collateral in order to have the capacity to execute OTC contracts. This means that in times of economic downturns, when prices are low and credits are strained in our sector, we could very well be owed money on our OTC contracts and still have billions of dollars in oil and gas collateral posted to our hedge counterparties.

As an example of how significant the relationship of collateral and market prices can be, at the end of June 2008, when the mark-to-market value that Chesapeake Energy owed to our OTC derivative counterparties was approximately $6 billion, we had posted to our counterparties oil and gas collateral valued at more than $11 billion.

Chesapeake Energy agrees that it is "extremely difficult to establish accurate haircuts by regulation" ... "given the infinite variety of potential types of noncash collateral." (p27578) Indeed, it is also unnecessary since our counterparties have accurate and effective internal formulas to appropriately haircut our collateral. The collateral coverage we provide is greater than 1-to-1 due to our credit rating and the fact that non-cash collateral is less liquid than cash. If the mark-to-market on the OTC contracts covered under the terms of our multi-counterparty hedging facility equaled the maximum amount of $15 billion allowed by the facility, Chesapeake would be required to post nearly $25 billion worth of oil and gas collateral to secure its mark-to-market position.

If we were required to post cash margin to cover such a large mark-to-market position, we would need to make a strategic decision to *either* invest in exploring for and developing oil and gas reserves *or* post cash for collateralizing OTC contracts. Considering our line of business, it is clear we would decide on the former instead of the latter. At the same time, unfortunately, we would not execute nearly as many risk-reducing OTC contracts. Ultimately, we will be much more exposed to commodity price swings, which could prove disastrous to our business plan in a low natural gas price environment. For reference, from January 2009 to the present, our risk management program has generated more than $5 billion of cash, which we have deployed to drill more wells in the U.S. than any of our peers, boosting American production and lowering costs to American energy consumers. In our case, if we were not able to use OTC derivatives to provide certainty and predictability of our cash flows, we would not feel comfortable investing as much cash today to bring new energy resources and projects to market. As stated earlier, less exploration and production activity would threaten the supply of commodities vital to the U.S. economy.

Please note that our concerns around cash margining are not limited to the energy industry. If we have to curtail our risk management efforts to avoid cash margin calls, other capital-intensive companies in many different industries would need to do the same. I cannot speak to the negative effects all industries would face if there was a wholesale reduction in the use of OTC derivatives as risk management tools; however, I am certain that any commodity-based industry would be adversely impacted.

The regulators have proposed that end users that "wish to rely on other non-cash assets to meet margin requirements could pledge those assets with a bank or group of banks in a separate arrangement, such as a secured financing facility, and could draw cash from that arrangement to meet margin requirements." (p. 27578) This argument is misguided and could negatively impact an end user's ability to access short-term capital necessary to fund its business.

Institutions that already lend to us for our working capital needs have made internal credit decisions determining the amount of funded credit they are willing to extend (our hedging facility is considered an unfunded commitment by our counterparties). Chesapeake has a $4 billion revolving credit facility with 29 lenders, one of the largest in the industry, which we use to fund our short-term business activities. To suggest those lenders would be willing to increase their lending commitments in the aggregate from $4 billion to $19 billion – the sum of our credit facility and maximum permitted hedging facility mark-to-market capacity – is not a reasonable

expectation. Further, it is unreasonable to assume we could find lenders on top of the 29 that already lend to us, especially since the total additional funded credit needed would be multiples of the $4 billion already in place.

Essentially, our company would not be able to obtain enough funded credit to sustain the current size of our risk management program, which would directly impact our ability to protect and fund our business. Additionally, we do not understand how borrowing to fund cash margin alleviates interconnectedness in the financial system, something the Dodd-Frank law was specifically meant to reduce. Most of our hedge counterparties are banks that make markets for commercial end users. It is incorrect to assume that banks would be better protected from a systemic risk perspective if we posted cash collateral for our OTC contracts, which was funded by drawing on a credit facility that included those same banks. Essentially, we would be borrowing cash from one hand to pay to the other, something that does not alleviate systemic risk.

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

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

We are also very concerned about the implications of a reduction in market liquidity. Much like end users curtailing their risk management efforts if forced to post cash margin, our counterparties may reconsider making a market in OTC derivatives if capital charges are set too high. The larger institutions, which are much more systemically risky to begin with, will continue to make a market in OTC derivatives but possibly to a smaller degree. For mid-level and smaller institutions, the increased costs could be game-changers and could lead them to close down their market making efforts. Just like any market, having fewer participants causes the risk to the entire market to be much more pronounced.

End users want a diversity of market makers in order to manage our own counterparty risks efficiently and effectively. Ultimately, we feel that if capital charges are too strict the OTC market would shrink, which would likely increase the bid-ask spread and transaction costs. This is especially relevant for longer-dated risk management contracts where market liquidity has traditionally been very thin.

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

Best regards,

Elliot J. Chambers